President Sebastián Piñera (second from the left) headed the launch of the program "Chile a developed nation."

PHOTO: COURTESY GOVERNMENT OF CHILE/ JOSÉ MANUEL DE LA MAZA

EDGING TOWARDS DEVELOPED STATUS

Will the country make the grade by 2020, as President Piñera hopes, or will it become stuck in the dreaded middle-income trap?

BY GIDEON LONG

Sebastián Piñera, the Chilean president, made a lot of bold promises during his election campaign in 2009, but perhaps the most eye-catching was his pledge to set Chile on course to becoming a developed country by the end of this decade. It sparked a debate about what exactly that means, and what Chile needs to do to join the club. Will the country make the grade by 2020, as Piñera hopes, or will it become stuck in what some economists refer to as the dreaded "middle-income trap"?

It is a debate that is key to understanding the country's business climate at the moment. Chile is in transition. In many ways, it is no longer a developing country: it is the only South American member of the OECD and its per capita income, adjusted for purchasing power parity, is around $19,000, in line with those of Croatia, Russia and Poland. Along with Uruguay, it is the least corrupt nation in Latin America and beat France, Austria and Ireland in Transparency International's most recent corruption perceptions index. It is one of the easiest countries in Latin America in which to do business.

And yet, when it comes to education, vocational training and research and development, Chile still lags behind its OECD peers. It spends only 0.7 percent of its product on research and develeopment compared to an OECD average of around 2.5 percent. It has the highest level of income inequality in the organization, with a Gini coefficient of more than 50 percent, and although poverty has fallen sharply since the return to democracy in 1990, around 15 percent of the population still lives below the poverty line.

To compound these shortfalls, Chile is the only major country in Latin America without significant fossil fuel reserves, and the prospect of an energy crisis hangs over economic growth prospects like a Sword of Damocles.

As the country evolves, so do its citizens. Chileans demand far more from their politicians and business leaders these days, and are more willing to take to the streets to voice their discontent. In the past, a reasonable degree of stability and prosperity were enough to keep people happy, but not now. Chileans want

social justice, political reform, better health care and fairer education. They are increasingly concerned about the environment and sustainable development. In short, Chile is starting to face rich nations' problems.

Piñera is all too aware of this. The student-led protests of the past two years have helped keep his approval ratings mired below 35 percent. He acknowledges that transforming Chile into a developed nation will not be easy. "Do you know how many countries have managed to pass from underdevelopment to development in the past 50 years?" he asked a recent meeting of foreign correspondents in Santiago. "You can count them on the fingers of one hand. There are very few that have achieved it – South Korea, Singapore. Many have never tried and others that have tried get to an intermediate zone and there they stay, stuck."

THE YEAR OF INNOVATION

In order to prevent that happening to Chile, Piñera has focused on what he knows best: business. An entrepreneur to the core of his soul, he has made efforts to cut red tape.

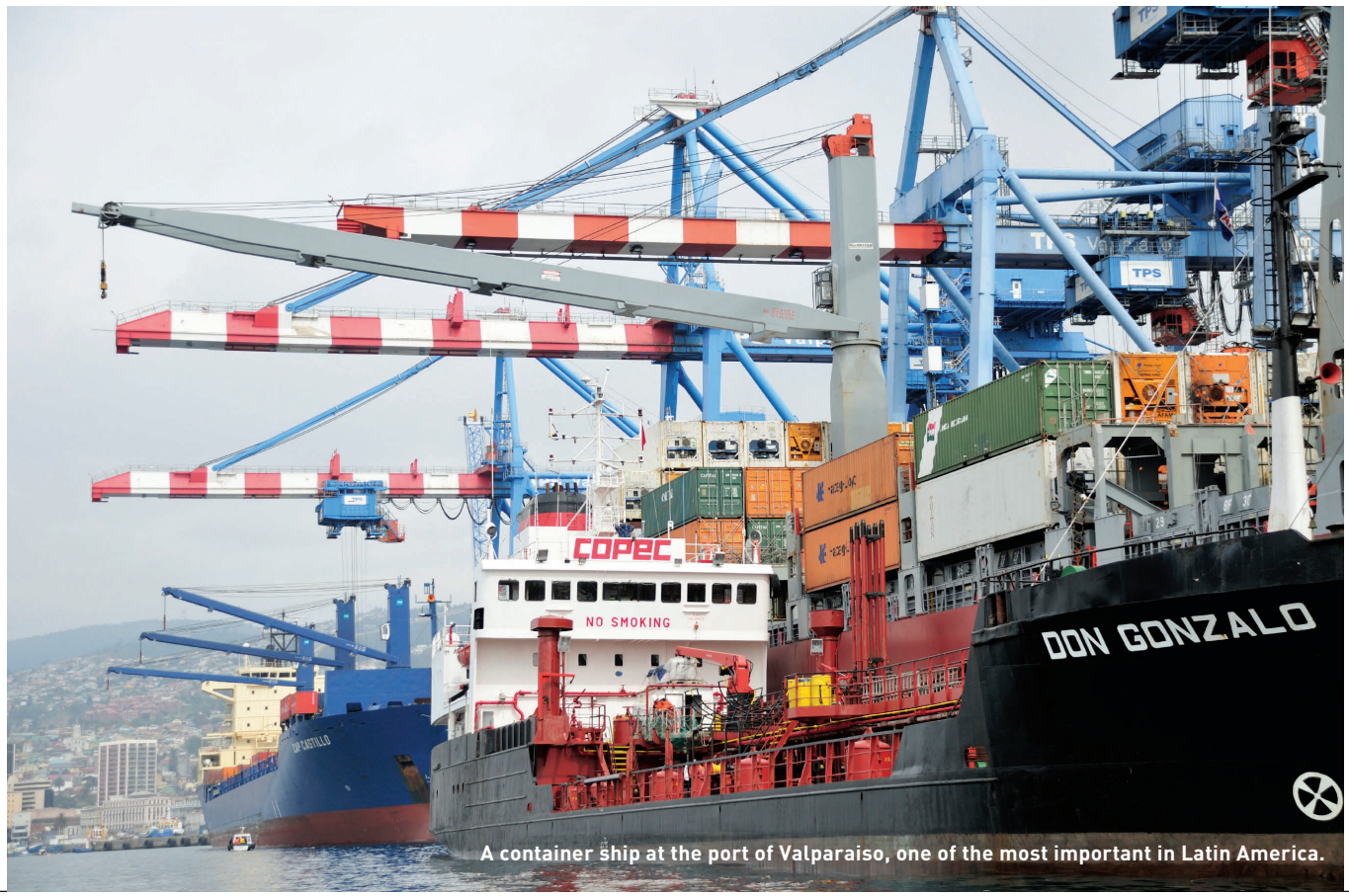
"When we came into government in 2010 it took an average of 27 days to set up a company in Chile," says Cristián Larroulet, Piñera's secretary-general. "We cut that to seven days and have just passed another law that will cut it again, to just one day. That will put us on a par with New Zealand as the fastest country in the world in which to set up a company."

Piñera declared 2012 "the year of entrepreneurship" and 2013 "the year of innovation". In a bid to prove that these are more than just slogans, his government has increased tax breaks to companies that invest in research and development, an area where Chile has a lamentable record. According to the OECD, Chilean companies invested the equivalent of 0.16 percent of the economy in research and development between 2008 and 2011, the lowest level in the 34-nation organization. The OECD average was 1.28 percent.

The government says its measures are beginning to bear fruit. The number of new companies formed in Chile last year rose to 68,000 from 58,400 in 2011. The target this year is 80,000.

The Piñera administration is continuing to fund Start-up Chile, a scheme that lures foreign entrepreneurs to Chile with the promise of $40,000 in seed capital with no strings attached, a one-year work visa and free office space. Launched in 2010, the scheme has been a success, inspiring similar programs elsewhere in the world. It is funded through Corfo, the government's economic development agency. Corfo's corporate manager, Matías Acevedo, says the

Per capita income is around $19,000, in line with Croatia, Russia and Poland



A container ship at the port of Valparaiso, one of the most important in Latin America.

PHOTO: ©ISTOCKPHOTO.COM/ LUIS SANDOVAL MANDUJANO

As Chile's flag flies overhead, pedestrians stroll through Constitution Plaza near "La Moneda" (Presidential Palace) in downtown Santiago, Chile.

PHOTO: ROB CRANDALL STOCK CONNECTION WORLDWIDE/NEWSCOM

Chile now receives 18 percent of all foreign direct investment in Latin America — more than Mexico, with a population seven times larger.

challenge has been to change the mentality of Chileans, who have a reputation in the region for being efficient and hard-working but rather staid and risk-averse.

"Chile always scores well in any measure of the strength of its institutions, but traditionally we've not been so good when it comes to innovation and entrepreneurship," Acevedo said. "Ten or 15 years ago, entrepreneurship was frowned upon in Chile. It was for people who'd done poorly at school. Young Chileans aspired to jobs in big companies rather than working for themselves. But that's changing."

These cultural shifts will take years to take root. So will the government's plans to overhaul vocational training, eradicate extreme poverty, tackle gender inequality, improve the country's much-criticized education system and reduce income inequality, all of which are essential if Chile is to become a developed nation.

But Osvaldo Larrañaga, an economist at the United Nations Development Program, says the country is at least confronting these issues. "If you take education, for example, it's now very much an issue in the public domain," he says. "But it's clear we have a lot of work to do."

The long, slow slog towards developed nation status is likely to inform the Chilean political and economic debate for the rest of this decade. In the short term, however, Chile is enjoying the good times.

UNINTERRUPTED GROWTH

For much of 2012, economists in Chile were braced for a slowdown as the world economy continued to flounder. But the slowdown never happened. Month after month, Chile produced remarkable economic results. The economy expanded by around 5.6 percent last year, making the it one of the fastest growing in the world. In Latin America, only Peru and Panama posted stronger growth rates, according to the United Nations, which forecasts an expansion of 4.8 percent this year, comfortably ahead of the regional average of 3.8 percent.

Unemployment fell to just 6.4 percent by the end of last year and in the Santiago area, home to more than a third of the population, it hit its lowest level since the days of Salvador Allende's public works schemes in the early 1970s. Much of the country is operating at full employment and indeed the problem is not a scarcity of work, but a shortage of skilled labor.

Foreign direct investment is going through the roof. It hit a record $28.2 billion last year, a 63 percent increase from 2011. That means that Chile now receives 18 percent of all foreign direct investment in Latin America — more than Argentina, Colombia and even Mexico, with a population seven times the size of Chile's. Brazil is now the only country in the region that receives more FDI. While mining still receives the lion's share of such investment, big foreign money is also being ploughed into energy projects, service industries, telecoms and transport.

With the economy booming, one might expect inflation to be a worry, but at just 1.5 percent last year, it was well below the regional average. And with wages rising by 4.7 percent in real terms during 2012, Chileans are undeniably richer than they were before.

And yet, despite this slew of good news, economists see some dark clouds on the horizon. Economic growth might be high, but consumer and public spending are higher still, points out Alejandro Fernández, economist at Gemines Consultores in Santiago. He sees a worrying "decoupling between internal demand and production" and believes the current economic boom is unsustainable. Like many economists (let alone exporters) he is concerned by the strong Chilean peso, which appreciated by 8.5 percent against the dollar last year and has continued to strengthen in 2013.

"In many ways this has all the classic elements of a party: a very strong currency that is stimulating consumer spending, plus low employment and high wages," Fernández said. "The only thing to suggest the party might not end badly is that levels of indebtedness in Chile are still relatively low."

Despite the efforts of successive gov-

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Mexico is also likely to grow as a destination for Chilean investment in years to come, thanks to the formation of the Pacific Alliance.

Trucks at Los Bronces copper mine, some 40 miles northeast of Santiago and 11,500 feet above sea level.

PHOTO: IVAN ALVARADO/REUTERS/NEWSCOM

ernments to diversify the economy, Chile remains highly dependent on copper exports, which account for over half of export revenue. As long as the price of copper remains high due to strong Asian demand, Chile will prosper. But if China falters, Chile will too.

"Chile is often held up as a successful example of export-led development but if you look at things with a more critical eye you see that our export structure hasn't changed much in 30 years," Fernández said. "It's still very much weighted towards commodities or production with little added value. As such, we remain vulnerable to international price volatility."

LOOKING ABROAD

One way in which Chilean companies have sought to grow is by venturing abroad. In a country of fewer than 17 million people, many of the biggest Chilean firms have simply outgrown their domestic market. That is particularly true of the country's four leading retailers, Falabella, Cencosud, Ripley and La Polar, and its two big forestry companies, CMPC and Arauco. Some of the most interesting Chilean business ventures are happening not in Chile but elsewhere in the region.

The forestry companies have bought up thousands of hectares of land in Uruguay and Brazil to complement their vast pine and eucalyptus plantations in southern Chile. CMPC is expanding its wood pulp plant in the Brazilian city of Guaíba at a cost of $2 billion, while in Uruguay, Arauco is soon to inaugurate its Montes del Plata plant, a joint venture with Scandinavia's Stora Enso.

The four retailers, which in Chile account for a third of retail sales, are making inroads into the Colombian and Peruvian markets, having already established a presence in Argentina.

In Peru, Chilean firms now account for 9 percent of retail sales while in Colombia, the figure is more than 4 percent. Falabella and Cencosud have long-standing investments in Argentina, where they account for 6 percent of sales.

For Falabella, Peru now brings in 20 percent of company revenue, with Colombia adding 7 percent and Argentina 6 percent. Ripley is planning to open at least 10 new stores in Colombia between now and 2015, while La Polar says it will open two or three stores in Colombia this year. Parque Arauco, a Chilean company that operates shopping malls, is due to open a mall in the Colombian city of Bucaramanga shortly and expand its MegaPlaza mall in Lima.

By the end of 2011, Chilean companies had invested $52.5 billion in countries across Latin America. Most of it was invested in Argentina and Brazil, but Peru and Colombia are catching up quickly.

Mexico is also likely to grow as a destination for Chilean investment in the years to come, thanks in part to the formation last year of the Pacific Alliance, a trade bloc grouping Chile, Colombia, Mexico and Peru. With a population of over 2 billion and accounting for over a third of Latin American GDP, the bloc has its eyes set firmly on trade with Asia. But the four founder members are also discussing greater integration among themselves, which is likely to result in further Chilean investment in the other three member nations.

ENERGY AND MINING

Back on home soil, the problems of becoming a developing country are all too evident in the mining and energy sectors. Gone are the days when companies could come to Chile and build mines or smoke-belching coal-fired generating plants with only a cursory regard for the environment or local communities. These days, Chileans are more assertive of their rights, more concerned about the environment and more likely to protest against plans with which they disagree.

The most notable example is the long-running battle over HidroAysén, a huge hydro-electric scheme that would involve the construction of five dams on two pristine rivers in Patagonia. The scheme

would be the biggest energy project in Chile's history, with an installed capacity of 2,750 megawatts — 16 percent of the country's current generating capacity. But it would mean flooding 5,900 hectares of land and the construction of an enormous transmission line to carry electricity from Patagonia to central and northern Chile. Environmentalists say the scheme is madness and have waged a successful campaign to raise awareness of its potential impact. Last year, Colbún, one of the two companies behind HidroAysén, effectively put it on hold by saying it would not seek approval for the construction of the transmission line until it received further assurances from the government. In the best-case scenario, the project will only be up and running in late 2023.

HidroAysén is not the only project that has run into problems. In August of last year, Chile's Supreme Court rejected the planned $5 billion Central Castilla thermoelectric power plant in northern Chile on environmental grounds. Castilla, a joint venture between Brazil's MPX Energia and Germany's E.ON, was the second biggest energy project in the country, behind HidroAysén, and would have added a further 2,100 megawatts to the grid. It has been definitively scrapped.

In light of these and other delays and adverse court decisions, Chile's business community says it is too difficult to get approval for energy projects. Mining companies have warned that if Chile does not build more power plants soon, the country's copper mines could face power shortages.

The government concedes there has been an increase in the number of cases that have gone to court, but says this is simply because the state is taking the concerns of its citizens more seriously.

"In itself, judicialization is not a bad thing," says Ricardo Irarrázabal, an undersecretary at the environment ministry. "The fact that someone can go to a court to lodge a complaint is positive."

He also points out that in the vast majority of cases where companies present either an environmental impact study or a declaration of environmental impact, the projects are approved without problems. Of the 980 such cases in Chile in 2012, only 10 ended up in court.

Nevertheless, data from the ministry shows that since 2001, 31.5 percent of energy projects and 13.4 percent of mining projects proposed in Chile have faced some sort of legal objection.

In response to industry complaints, the government launched Chile's first environmental court in January to deal specifically with such cases. Two more courts, one in the northern city of Antofagasta (close to many of the copper mines) and one in the southern city of Valdivia (close to several hydroelectric schemes), will start work in June.

Some mining companies have cited the

100 MW Solar Facility to be built in Chile by SunEdison for CAP Mining.

PHOTO: PR NEWSWIRE/NEWSCOM

Since 2001, 31.5 percent of energy projects and 13.4 percent of mining proposed in Chile have faced some sort of legal objection.

high cost of energy in Chile as a factor in their decisions to postpone major projects. State-owned Codelco has shelved the expansion of its Salvador mine in the Atacama Desert along with further investment in Inca del Oro, a gold and copper project it owns with Australia's PanAust. Antofagasta Minerals halted its Antucoya mining project in northern Chile last year, blaming rising costs, while Canada's Barrick Gold has pushed back the start date for production at its giant Pascua Lama gold mine on the border between Chile and Argentina.

The companies say they need cheaper and more reliable sources of energy. Mining consumes around a third of all the electricity generated in Chile and according to the national mining society, Sonami, energy now accounts for 20 percent of mine production costs, up from 11 percent a decade ago.

One potential solution lies in non-conventional renewable energy. Chile has tremendous potential for solar, wind, geo-thermal and tidal generation. As Piñera put it at his recent breakfast with foreign correspondents: "We are poor in the energy sources of the past, in fossil fuels, but rich in the energy sources of the future." If Chile could tap the sun that beats down on the Atacama Desert each day, it could solve the mining industry's energy problems for good.

But it will be years before that happens. At present, non-conventional renewables account for only 4 percent of Chilean electricity generation, although the state has pledged to increase this to 10 percent by 2024.

In the absence of feasible sources of renewable energy, the state continues to rely on coal-fired and hydro-electric power. The energy ministry says three coal-fired plants and six hydro-electric plants are under construction, with a combined installed capacity of 2,100 megawatts, or 12 percent of current capacity. That, he says, will guarantee that the lights stay on for now.

The irony, of course, of Piñera's pledge to turn Chile into a developed country by 2020 is that he is unlikely to be in power when the decade ends. His four-year term ends next March and he cannot seek immediate reelection, although he could stand in the presidential elections of 2018.

His immediate successor will be chosen on November 17 this year, with a second round (if needed) on December 15. The front-runner is the Socialist Michele Bachelet, who ran Chile from 2006 to 2010. From within Piñera's own centre-right coalition, the two candidates are Laurence Golborne, who shot to fame as the mining minister tasked with saving the 33 miners trapped in the Atacama Desert in 2010, and a former defense minister, Andrés Allamand.

Whoever wins, Chile is unlikely to stray far from the free market model that has served its economy so well for decades. It will remain one of the most attractive countries in the region for foreign investors, one of the most open to the rest of the world in terms of trade and one of the most politically stable. Whether and when it adds "developed nation" status to that list of accolades is another matter. LT

Gideon Long reported from Santiago de Chile.

Front-runner in the Chilean Presidential race, Michele Bachelet

PHOTO: ANDY RAIN/EPA/NEWSCOM