IS CHILE ABOUT TO LOSE ITS SHINE?


Former Chilean President Sebastián Piñera shakes hands with new president, Michelle Bachelet.

Bachelet, a socialist, was sworn in on March 11, four years after she left office, and her second government promises to be more radical than her first.

A deep tax reform and a hard-liner environmental stance could do harm to business conditions in the country.

BY GIDEON LONG

For years, Chile has been regarded as the safest country in South America in which to invest, but the return to the presidency of Michelle Bachelet has got some in the business community worried.

Bachelet, a socialist, was sworn in on March 11, four years after she left office, and her second government promises to be more radical than her first. She has vowed to increase corporate taxes, empower trade unions and give the state a role in Chile's private pension system.

The outgoing center-right government of billionaire businessman Sebastián Piñera said her proposals are a threat to Chile's economic health, just at a time when growth is cooling anyway.

At the heart of Bachelet's program is a pledge to increase the annual tax take by $8.2 billion, or three percent of gross domestic product (GDP). The president wants to spend most of that money on education reform. She wants to gradually increase the basic corporate tax rate from 20 percent to 25 percent over her four-year term.

Opinions are divided on what the impact of that will be. On one hand, it would leave the tax rate a full eight percentage points higher than in 2010 – a big increase in less than a decade. On the other hand, even at 25 percent, Chile's tax rate would be lower than in most countries in the region. In Brazil, Argentina, Perú and México, companies already pay between 30 percent and 35 percent, and according to advisors Kpmg, the Latin American average is 27.6 percent.

"Bachelet is planning to take the tax rate as a percentage of GDP to somewhere close to where you'd expect it to be for a country of this level of development," said Kirsten Sehnbruch, professor of public policy at the University of Chile. "It's not a major, groundbreaking tax initiative. It's simply a step in the right direction."

Others are more alarmed by the prospect, and (even more so) by Bachelet's proposal to scrap the Taxable Profits Fund, or FUT, a mechanism set up by the military government in 1984 to encourage investment. The FUT allows companies to indefinitely defer the payment of taxes on their re-invested profits. They pay taxes only at the moment they withdraw or repatriate their earnings.

Since its inception, companies have used the FUT to defer payment of around $50 billion in taxes – money that Bachelet said should have gone to the state. She has vowed to scrap the FUT in 2017 in her final year in office.

"It's a huge change," said Francisco Klapp, an economist at Libertad y Desarrollo, a think tank. "It's practically a re-write of the corporate tax laws." He sees the proposal as

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Socialist Michelle Bachelet was swept back into office on a platform of boosting education and narrowing the gap between rich and poor.

"a disincentive to saving and investment," and believes it could have a significant impact on economic growth.

But Bachelet's supporters say the FUT has been abused by private individuals who register their personal wealth as company profit to defer the payment of taxes on it. "It's abused by the upper-middle classes," Sehnbruch said. "It's an outdated funding mechanism, especially for a country that has sovereign wealth funds abroad."

Bachelet is also planning to increase a stamp tax on borrowing operations from 0.4 percent to 0.8 percent, and to scrap Decree Law 600 – another piece of legislation set up by the military government to encourage investment. It gives foreign investors certain guarantees such as fixed long-term tax rates, access to Chile's capital markets and legal protection in the event of disputes.

Bachelet argues that these provisions have been enshrined elsewhere in Chilean law and that Decree Law 600 is therefore now redundant. Klapp disagrees, and points out that a significant number of foreign companies still use the law when they invest in Chile, and may turn their backs on the country if it is scrapped.

The debate over Bachelet's tax plans are likely to rumble on throughout her tenure but, either way, the outlook is not particularly bright. Foreign investment has already fallen from the record $28.2 billion in 2012 due to delays to several big mining projects. After averaging 5.8 percent between 2010 and 2012, economic growth slipped to 4.2 percent last year, and the central bank warns it could drop below 4 percent this year. The Bachelet years, it seems, could be relatively lean for business. LT

Gideon Long reported from Santiago de Chile.

ENERGY AND MINING

One of the toughest decisions that Michelle Bachelet will have to make during her four-year presidency is what to do about HidroAysén, the biggest energy proposal in Chile's history. It involves building five dams on two rivers in a remote and beautiful part of Patagonia. The project has already been given the go-ahead by Chile's Supreme Court, but still needs final government approval. The outgoing government of Sebastián Piñera postponed a decision, saying the project was complex and needed further study. It will fall to the Bachelet administration to make a ruling. If she approves HidroAysén, she risks the wrath of Chile's increasingly vocal environmental lobby. If she does not, she will anger the business lobby, which warns that Chile's faces a looming energy crisis. HidroAysén would have an installed capacity of 2,750 megawatts and could provide Chile with around 17 percent of its current electricity consumption. But, it would also involve flooding a stunning Patagonian valley and building one of the longest transmission lines in the world to carry the electricity to Santiago. Bachelet has said the project is unviable as it stands, but that could change.

Other energy projects also face opposition in Chile. The Supreme Court has already forced Brazil's Eike Batista to scrap his plan for a $5 billion coal-fired power plant in northern Chile. Closer to Santiago, AES Gener faces vehement environmental opposition to its Alto Maipo hydro project.

The mining sector is being challenged by environmentalists and indigenous groups. Of the $100 billion of mining investment planned in Chile over the next decade, some $40 billion has been either delayed or blocked. Barrick Gold's $8.5 billion Pascua Lama gold project is completely on hold. El Morro (Goldcorp), Caserones (Nippon Mining and Metals), Pelambres (Antofagasta Minerals), Cerro Colorado (BHP Billiton) and Andina (Codelco) are other mines under scrutiny from the green and indigenous lobbies.

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