CREATING THE PATHWAYS TO PROSPERITY

ABOUT THE LEGATUM INSTITUTE

The Legatum Institute is a London-based think-tank with a bold vision to create a global movement of people committed to creating the pathways from poverty to prosperity and the transformation of society.

We seek to do this by raising up leaders of character, restoring an ethical vitality to all sectors of society, and developing the practical solutions and data tools that will help build inclusive and peaceful societies with open economies and empowered people.

• Our Centre for Metrics creates indexes and datasets to measure and explain how poverty and prosperity are changing.
• Our Research Programmes analyse the many complex drivers of poverty and prosperity at the local, national, and global level.
• Our Practical Programmes identify the actions required to enable transformational change.

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Note on Sources

In producing this report, we relied on four major sources of information. These have provided a broad, deep, and rich perspective on the challenges and opportunities that Chile faces to reach an inclusive society and competitive economy for all.

The first source was over 70 individual interviews and conversations with leading academics, researchers, key representatives from civil society, NGOs, business associations and national and local authorities in Chile. Likewise, several discussions with policymakers and Chilean experts based in Chile and abroad were conducted.

The second type of source includes secondary data and research analysis from academic articles, country reports, policies, strategies, regulations, and news articles, as well as participation in external in-person and online events about Chile and the country’s future after the referendum about the constitutional text and trust challenges in Latin America. All these elements provided a strong foundation and evidence-based approach to develop our study.

The third source of information came from small working sessions and discussions conducted by the Legatum Institute in Chile with experts, practitioners and former governmental authorities for an in-depth discussion of the main challenges and opportunities in the achievement of an inclusive society and competitive economy and thus further unlocking the potential to empower Chileans.

Fourth, we based our report on the Legatum Prosperity Index 2021, which uses global datasets from the World Bank, World Economic Forum, International Monetary Fund, the Organisation for Economic Co-operation and Development and several other world-known sources. We use this to benchmark Chile’s performance on a wide range of indicators.
List of Acronyms

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<th>Acronym</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ADP</td>
<td>Alta Dirección Pública (Government official selection process)</td>
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<td>AFP</td>
<td>General Fund Administrators</td>
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<td>APAC</td>
<td>Asia and the Pacific</td>
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<td>APEC</td>
<td>Asia Pacific Economic Cooperation</td>
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<td>APPI</td>
<td>Agreements for the promotion and protection of investments</td>
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<td>APR</td>
<td>Rural Potable Water Committee</td>
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<td>BEME</td>
<td>BancoEstado Microempresas</td>
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<td>BTI</td>
<td>Bertelsmann Transformation Index</td>
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<td>CAPEX</td>
<td>Capital Expenditures</td>
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<td>CChC</td>
<td>Chilean Chamber of Construction</td>
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<td>CMF</td>
<td>Comisión para el Mercado Financiero</td>
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<td>CNID</td>
<td>National Council for Innovation Competitiveness</td>
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<td>CNP</td>
<td>National Productivity Commission</td>
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<td>CONALOG</td>
<td>National Commission for Logistics Development</td>
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<td>CORFO</td>
<td>Economic Development Agency</td>
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<td>CPI</td>
<td>Council for Infrastructure Policies</td>
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<td>CPTPP</td>
<td>Comprehensive and Progressive Trans-Pacific Partnership</td>
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<td>National Direction of Water</td>
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<td>Regional Development Plan</td>
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<td>FET</td>
<td>Early Technological Phases Fund</td>
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<td>FOA</td>
<td>Extreme South Fibre Optic (Fibra Optica Austral)</td>
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<td>FON</td>
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<td>FNDR</td>
<td>Regional Development Fund</td>
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<td>Early Phases Fund</td>
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<td>FTA</td>
<td>Free Trade Agreement</td>
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<td>Global Innovation Fund</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GNI</td>
<td>Gross National Income</td>
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<td>Global Value Chain</td>
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<td>Human Development Index</td>
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<td>MERCOSUR</td>
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<td>MFN</td>
<td>most-favoured nation</td>
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<td>MoES</td>
<td>Ministry of Education and Science</td>
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<td>Ministry of Public Works</td>
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<td>MSME</td>
<td>Micro, small and medium enterprises</td>
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<td>ODEPA</td>
<td>Office of Agricultural Studies and Policies</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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PPP - Purchasing Power Parity
ProChile - The Export Promotion Bureau
PROT - Regional Land Use Plan
RIA - Regulatory Impact Assessment
SEA - Aysen Electric System
SEGRES - Ministry Secretariat of the Presidency
SEM - Magallanes Electric System
SEN - National Electric System
SES - Undersecretariat for Social Evaluation
SGI - Sustainable Governance Indicator
SII - National Tax Office
SNI - National Investment System (SNI)
SUBREI - Undersecretary of International Economic Relations
SUBTEL - Undersecretariat of Telecommunications
TA - Environmental Courts
TFP - Total Factor Productivity
UNASUR - Union of South American Nations
UNDP - United Nations Development Programme
VC - Venture Capital
VET - Vocational Education and Training
WEF - World Economic Forum
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UNLOCKING PROSPERITY IN CHILE

FOREWORD

Our mission at the Legatum Institute is to build a global movement of people committed to creating pathways to prosperity and the transformation of societies. Our work is focused on understanding how prosperity is created and sustained over time. Prosperity refers to much more than mere wealth and economic growth. It encompasses a society free from violence and crime, where people’s wellbeing is enhanced by the opportunities to create, innovate, grow and thrive. An inclusive, open, and competitive economy must be accompanied by an inclusive society, that has strong social ties, and empowered people who choose to trust one another.

Prosperity in Chile has been driven by an open economy, internationalisation, and inclusion in the global economy. In the last three decades, the country has made undeniable social, political and economic transformations, but institutions have not been able to keep up with the pace of evolving Chilean hopes and demands, leaving some people behind. The economy has been characterised by low levels of productivity and increasing capital deepening. Today the country faces stagflation and a negative forecast for 2023. The business environment is marked by economic opportunities concentrated in natural resources and business polarisation with a small number of large companies driving economic growth, and a long tail of micro, small and medium enterprises with difficulties to flourish.

Low levels of trust and social cohesion are endemic to Chilean culture, and these have been hindering its growth, innovation, and prosperity journey. At the same time, these have impacted the support and legitimacy of institutions and policies, as well as governments’ abilities to deliver long-term policies and their political agendas.

Chile in recent years has struggled to continue its pathway to prosperity. The 2019 social uprising, combined with the COVID-19 pandemic and the ripple effects of the Russian war, have worsened the economic situation. During these years the country has been marked by constant conflicts and increasing level of polarisation about how to respond to immediate social demands while moving forward to a renewed long-term development strategy. The country’s development agenda seems to have stagnated, the political elite is fragmented and living in its ideological tranches, meanwhile Chileans had put their hopes in a new constitution as the way to move forward. After the rejection of the constitutional text, the calling and demand for a common inclusive vision that allow everyone to prosper and move ahead as a nation has increased.

Although the country’s future might seem uncertain, the current circumstances provide a unique opportunity for creating a unifying country vision that includes an update to the Chilean political and economic model and a long-term economic growth strategy that is embraced across political and social spectrums. Under these circumstances, the political elite – including civil society, private sector, and academia – face a critical choice. They can decide to move towards building on the country’s strong foundations and strengthen state capacity for generations to come while unlocking a common renewed long-term sustainable path to prosperity, or they can just simply continue in their political tranches and polarised debates, far away from delivering lasting solutions.

Therefore, to unlock a sustainable future it is essential to build a new pathway towards an inclusive economy that places MSMEs, regional development, productivity, innovation, and people’s needs at the centre of its policies. This enhanced economic agenda would allow the country to build on its economic openness and institutional strengths, support the reduction of Chile’s vulnerabilities to external shocks and international demand for commodities, and rebuild social cohesion.

Stephen Brien
Director of Policy,
Legatum Institute
EXECUTIVE SUMMARY

Chile faces significant challenges that are shaping its pathway to prosperity. The country has a successful history of substantial poverty reduction and access to social infrastructure and safety nets, accompanied by achieving a high-income status as well as gaining relatively high levels of prosperity in different dimensions during the last 30 years. Over that time, Chile’s poverty levels plummeted, decreasing from 69% in 1990 to 11% in 2020 – one of the lowest levels in the region. Likewise, the gross national income (GNI) per capita increased by around 160% in the same period, and the country rose to the top of the Human Development Index (HDI). However, the last four years have been challenging for the country. Divisions and increasing polarisation have combined with hopes that elected authorities, the political elite and the constitutional assembly would work together to frame the principles for a better future.

Chile is at the leading edge of prosperity in Latin America and the Caribbean, ranking second after Uruguay in the regional outlook in the Legatum Prosperity Index and 38th out of 167 countries globally. The internationalisation of its economy has been the main component of its growth strategy and development in the last four decades; and this has driven the country’s transformations. However, this transformation has also led to economic and business concentration in particular sectors, high enterprise polarisation, as well as an excessive territorial concentration of opportunities and the emergence of some environmental issues.

Moreover, the effects of the riots and violence since 2019, coupled with the pandemic, have significantly worsened socioeconomic conditions in the country, increasing poverty and inequality. Its economy is experiencing stagflation. The IMF anticipates “Chile’s economic output is likely to shrink 1.3% in 2023.” Consequently, the country’s sentiment combines anxiety about the existing constitutional uncertainty, negative economic forecasts, together with high expectations (many believe that Chile can reach more inclusive levels of development in the short-term). These challenges are compounded by increasing social demands and the lack of a clear common vision on how to put Chile back on the pathway to economic growth and prosperity for all.

Although the country’s future seems uncertain, the current circumstances provide a unique opportunity for creating a unifying country vision that includes the necessary update to the Chilean political and economic model and a long-term economic growth strategy that is embraced across political and social spectrums. To this end, it is essential to build a new pathway towards an inclusive economy that places MSMEs, regional development, productivity, innovation, and people’s needs at the centre of its policies. This enhanced economic agenda would allow the country to build on its economic openness and institutional strengths and support the reduction of Chile’s vulnerabilities to external shocks and international demand for commodities and rebuild social cohesion.

Chilean Pathways to Prosperity

Over the last decades, Chile has experienced undeniable transformations, gaining global positioning as a safe and attractive destination for trade and investment. The approach of deepening Chile’s integration into the Global Value Chains (GVCs), accompanied by export-led policies, solid macroeconomic and financial institutions, and prudent regulations has marked the country’s pathway towards economic growth. In the Legatum Prosperity Index, the country ranks 1st in Latin America and the Caribbean and 43rd out of 167 countries on economic quality.

The Chilean economic transformation came together with a political focus on social and infrastructural investments. Social policies – with the state tripling its social expenditure between 1990 and 2015 – as well as investments in infrastructure allowed for better educational coverage, improved social services, healthcare access and coverage and the professionalisation of government
services. In the last three decades, not only has the investment and business environment become stronger but the country’s democracy has also consolidated along with the implementation of safety nets and social protection systems. All these factors have created the necessary conditions for Chileans to escape poverty, leading to a society composed mostly of the middle class. In 2022, Chile ranked 42nd in the UNDP HDI with a score of 0.855 – the highest in Latin America, and equal to that of Qatar. Furthermore, at USD$25,821 in 2021, the country has one of the highest GDP per capita in the region.

While the successes of the Chilean model have been multiple, the country faces chronic problems associated with its economic quality. Real GDP growth has experienced a slowing trend over time. Meanwhile, for the last 15 years, economic growth has been characterised by capital deepening, which has offset weakening productivity and innovation levels.

National and Local Development: Promoting a Prosperous and Inclusive Society

Chile has been marked by long-lasting low levels of institutional and interpersonal trust. Such low levels of trust not only distort policies that governments have prioritised and put in place but also hinder the degree of implementation. Furthermore, the low level of institutional and interpersonal trust has generated mistrust at every level of the policy cycle.

Over the decades, Chile’s state capacity has not evolved at the same pace as the country’s socio-economic transformation and its global inclusion, leading to an imbalance between the capacities of the private and public sectors. Hence, Chile is characterised by a weak civil service. The government selection system (Alta Dirección Pública, ADP) is only moderately institutionalised, as there is still an understanding that a successful candidate is a ‘government officer’ susceptible to be dismissed due to ‘loss of trust’. High rotation and changes in state officers lead to low institutional memory, as well as limited capacity to deliver short and long-term policy priorities. Additionally, Chile’s approach to policy planning and delivery is highly centralised and mainly follows an ‘unwritten’ principle of regional neutrality. As a result, this has translated into planning and delivery processes led by national sectoral policies rather than by regional needs and realities. This weak government effectiveness means that the country’s overall trajectory and future are driven more by responses to immediate challenges than constantly advancing towards long-lasting prosperity.

Creating a Thriving Entrepreneurial Ecosystem

The Chilean business ecosystem is marked by two particular characteristics: high economic concentration in natural resources-based opportunities, and strong business polarisation with a small number of large companies and a long tail of micro and small enterprises. Market access, ability to compete, innovate, work and growth differ considerably for MSMEs and large companies. Although the country ranks 39th out of 167 countries for its enterprise conditions, Chile is underperforming in areas such as labour market flexibility, burden of regulation and environment for business creation, and particularly labour skills. While the country has advanced significantly to remove the barriers to starting a business, the regulatory burdens are not just making it difficult to run and grow a business, but also disincentivizing formalisation.

Significant challenges for businesses in the country relate to the adequate availability of a workforce with qualifications and skill levels across different industries and sectors, as well as in the regions where enterprises operate. Although Chile has made significant progress in education, skill levels remain low and/or do not match the labour market needs, especially in occupations requiring medium skills. This mismatch is exacerbated by the absence of a functional system for competency development, uneven quality of the educational system and a narrow focus on preparing for some sectors such as finance and innovation.
For MSMEs to create, grow and innovate, a transformation of the Chilean educational system and a strong alliance between the public and private sectors and academia is necessary. Thus, for Chile to maintain its competitive advantages and to expand its opportunities, it is critical that the entire educational system from ECEC to tertiary education work together to build the right skills and capabilities for generations to come. Finally, the public and private sectors need to work together with the academia to ensure the country adequately invests in and prepares the human capital needed to tackle long-lasting productivity challenges and to align with current and future labour market needs.

**Enabling a Competitive Investment Environment**

Chile is recognised as a nation with a safe, stable, open, and attractive environment for domestic and foreign investors. The country’s policies are based on the principle of capital transparency and non-discrimination between domestic and foreign investors. However, two critical points are hindering its growth and further potential. Firstly, some environmental regulations, lengthy processes for permitting and consultation processes are generating some disincentives for investors, as more countries in the region are offering opportunities for investments. Secondly, increasing levels of insecurity and regulatory uncertainty due to the constitutional debate are impacting the country’s image, leading investors to rethink their projects and investments in Chile.

In Chile, the steps, time, and costs involved in registering a property are relatively low compared to other countries in the region and globally. Chile leads in the region ranking 33rd out of 129 countries. The main challenge seems related to the procedures for registering a property, where it ranks 63 out of 190. This issue is particularly associated with the structure of property registrars – ‘Conservadores de Bienes Raices’ – private entities in charge of registering properties.

Contract enforcement continues to be a challenge in Chile, and it has not seen any significant improvement over time. Access to justice and legal assistance in the country continues to be highly tied to the financial position of businesses involved in commercial disputes. Regulations and the quality of the judicial processes have not evolved at the same pace as the increasingly sophisticated and diverse Chilean economy.
Ensuring Broad-Based Finance

Chile has a mature but conservative financing ecosystem that is highly interconnected among bank and non-bank actors. The system is characterised by a large domestic non-bank financial sector (pension funds, mutual funds, and insurers) combined with a strong but concentrated banking sector. Overall, the ecosystem is well-regulated and capitalised. These conditions, combined with well-coordinated monetary and fiscal policy measures, allowed the country to ease the impact of COVID-19 and the associated financial crisis.

Chile has achieved important levels of financial inclusion, considering its level of economic development. By 2020 around 97% of the Chilean population had at least one financial product. Although the financial system is characterised by high levels of penetration of banking products and financial inclusion for individuals, access to credit and financial products is substantially different for enterprises. For most businesses, access, and affordability of financing through the banking sector is difficult, and it is highly related to the business and credit history of enterprises.

The difficulties of access to financing in Chile are associated with the size, maturity and sector of the business. In the case of medium and large enterprises, their main financing source is banks, followed by credit lines from suppliers. Access to finance and capital lines are identified as the main constraints for Chilean MSMEs, including digital ventures and start-ups. Hence, for micro and small enterprises, the main financing source comes from their own resources.

Supporting Trade and Commerce

Over the last 25 years, Chile has successfully implemented many key infrastructure investments to ensure economic development and the well-being of its citizens. Chile has achieved almost universal access to essential services, such as drinking water and sewage systems. Furthermore, the country has secured infrastructural development in the most critical sectors for economic growth, particularly in transportation, water, and energy. Over the last two decades, important critical and enabling infrastructure has been built, especially around water management, roads & highways, port systems and urban transport infrastructure. Chile has developed its infrastructure through direct public sector investments, concession agreements for specific projects and public-private partnerships.

Notwithstanding the progress achieved by the country in terms of infrastructure, several challenges are directly and indirectly impacting the access and quality of it. Chile is undergoing changes in the way its regions participate in the definition and governance of investments in infrastructure. A necessary change according to the OECD, as the country has the most centralised public sector around its investment framework, where 88% of the investments have been decided centrally, almost doubling the OECD average.

This centralisation combined with complex regulatory frameworks and permits, fragmented coordination and monitoring of plans and investments, and limited incidence of regions in the investments leads to inefficiencies and prioritisation challenges. It is also difficult to plan investments needed in other areas to fully strengthen the critical and enabling infrastructure in the country. Another challenge relates to the fragmentation and the existence of several infrastructure plans cohabiting in different ministries, divisions and even at the same ministry but without the necessary linkages and coordination.

The current and most pressing challenges related to infrastructure in Chile are around three critical lines of action: 1) long-term planning; 2) governance structures, and 3) regulatory environment and restricted participation.
Chile is facing a crucial time on its development journey, one marked by its citizens calling for a common inclusive vision that will allow everyone to prosper and move ahead together as a nation. Under these circumstances, the political elite – including, in the process, civil society, the private sector, and academia – face a critical choice. They can decide to move towards building on the country’s strong foundations and strengthen state capacity for generations to come while unlocking a common renewed long-term sustainable path to prosperity, or they can simply continue in their political tranches and polarised debates, far away from delivering lasting solutions.

Undoubtedly, Chile has done several things right, but institutions and policies have not changed at the same speed as Chilean society – its needs and hopes – leaving some people behind. At the same time, the State structures have become more complex, regulatory frameworks lengthier and conflicting, adding additional challenges for an efficient and citizen-driven approach to public service. Therefore, while the current and new constitution will define the rules of the game, the country needs to agree on clear mid- and long-term goals that will set up the country’s future.

Hence, the country has a unique opportunity to take the strong social, economic and political foundations that allowed Chile to substantially transform and create the additional building blocks that will allow the country to pass from an open economy to an inclusive one.

The following are some of the key priorities for transformation to unlock a competitive and inclusive economy that can lead to the achievement of an inclusive society and empowerment of today’s Chileans and of generations to come.

### Start a participatory strategic discussion to create a national consensus around a long-term growth strategy that is supported across the political and social spectrums to boost development across the entire territory.

- Define in a consensual manner a few clear key strategic priorities and building blocks for the short-, medium- and long-term development model to increase productivity, growth, and innovation.

- Create a long-term vision for the transformation of the education sector to focus on strengthening human capital so that young workers are prepared for the labour market in the areas most needed to reinforce the overall development strategy.

- Integrate in a systematic way the Regional Development Strategies’ challenges and priorities into the National Development Strategy to align approaches for policies and investments tackling the immediate, underlying and basic causes impeding regional progress and transformation.

### Strengthen state capacity through a mindset shift that puts citizens, end-users and beneficiaries at the centre.

- Strengthen the professionalism of the civil service at national, regional and local levels, clearly distinguishing state (administrative) officers from government (executive) officers to increase capacities, allowing governments to implement their agendas.

- Strengthen institutional coordination to increase harmonisation across programmes and policies in key strategic sectors, targeted groups and administrative levels (central, regional and local).
Advance the consolidation and coordination of a planning infrastructure process, ensuring a long-term vision and planning for levels of investments in critical infrastructure, transport and logistics and public works.

- Consolidate and coordinate infrastructure planning that translates into the development of a comprehensive long-term plan for investments that covers all the relevant sectors for inclusive growth and current investment plans (including the 2050 mobility plan).

- Establish a long-term investment agenda around water management and water scarcity with a regionally based approach.

- Launch a targeted plan to attract capital and investors to the telecommunications sector, especially to support critical transformations for ‘last mile’ projects.

- Develop and implement a long-term investment and transformation strategy to ensure the supply and reliability of the energy sector can cope with growth while simultaneously decarbonising and promoting the green hydrogen industry.

Create dedicated governance structures for water and telecommunications, as well as enhance governance and monitor the role of current and new institutions in critical and logistics infrastructure.

- Create an integrated national water governance framework that clearly defines an institutional structure responsible for the coordination, assessment, monitoring, adaptability and implementation of short-, mid- and long-term priorities based on local needs.

- Create an independent body for telecommunications to ensure neutrality in the telecoms regulatory environment to improve competition, monitoring and transparency.

- Strengthen the governance, role and coordination functions of the National Commission for Logistics Development (CONALOG) to deepen the integration of the country’s logistics chains with ports, transfer centres, cities, means of transport and customs, to ensure a competitive logistic performance.

Relieve the regulatory burden and limitations that hinder competition, investments and offers in the telecommunications and maritime transportation sectors.

- Enhance the independent telecommunications regulatory environment to improve competition, monitoring and transparency.

- Review the restrictions on maritime cabotage, especially the limitations on transportation of goods in national waters, to determine the best formula to increase competition and reduce transportation costs.
Enable a competitive investment environment, by simplifying and harmonising regulations and consultative processes, as well as improving institutional capabilities for the property registry system and contract enforcement.

- Simplify and rationalise processes and roles of institutions in the investment lifecycle to ensure proper coordination and reduce burdens and inefficiencies.
- Reduce burdens for compliance with environmental regulation – especially, but not only, for mining – by harmonising and integrating environmental permitting processes and criteria, as well as ensuring the appropriate resources for specialised authorities to fulfil their work.
- Clarify and institutionalise the criteria and requirements for the compliance of the indigenous consultation under the 169 ILO convention.
- Improve the transparency and accessibility of land registration processes by establishing a coordinated and digitalised property registry system.
- Review and reform the registry system to enhance competition and address inefficiencies.
- Enhance the capacity of civil courts to administer commercial and contractual cases by modernising procedures, improving efficiency, and providing focus by creating special units for debt collection.

Prioritise building a thriving entrepreneurial ecosystem to spread economic opportunities across the country.

- Ease the regulatory constraints that are disincentivising business formalisation, as well as hindering growth and opportunities for MSMEs in the country.
- Simplify and harmonise the steps, processes and requirements to start, run and legally operate MSMEs – including addressing the differences in prerequisites and processing times at a local level.
- Generate incentives and aggressive plans to promote entrepreneurship in regions and cities with limited access to services, as well as commercial and educational offers.
- Shift vocational education and training (VET) and university programmes to be more labour-market oriented – so that young workers qualify for the labour market.
- Review labour regulations and employment contracts to offer industry-pertinent instruments (i.e., lighter-touch contracts for sectors currently dominated by the informal economy; part-time contracts).

Ensure timely access and affordability of financing for MSMEs and promote digitalisation and financial inclusion.

- Prioritise the development of financial services to support MSMEs and Entrepreneurs – including the expansion of pools of risk capital such as FOGAPE, FOgain and other capital lines.
- Create incentives to attract fintech and angel investors to the Chilean market to develop microfinance.
Create a targeted strategy to unlock the untapped potential of service exports and make the most of the nation’s extensive network of trade deals.

- Establish a comprehensive and coordinated offer for capacity building, advisory services and business opportunity identification for export services.

- Create an entity that will lead the positioning of Chilean entrepreneurs for services that can act as a one-stop shop to boost service trade while supporting companies for export readiness.

- Increase the investments on Research and Development to create an innovative thriving service environment for the national and international offer, accompanied by a deepening of the skills and capabilities of the educational system in the country.
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Chilean women work together inside the garden centre.
Crédito: Shutterstock.
Introduction

This case study on Chile is part of a series of studies examining the links between a nation’s Economic Openness and prosperity, comparing the performance of over 160 countries. The purpose of this report is to provide a systematic analysis of the policy environment underpinning Chile’s economy, and in doing so, help identify specific actions that would improve the pathway to economic inclusion in the country. In addition, the aim is to further support key elements that can be the basis for the creation of a common long-term vision towards a prosperous Chile with an inclusive society and economy, as well as empowered people.

Context

Today, Chile faces important challenges that are defining its future. The country has been characterised by a successful history of substantial poverty reduction, achievement of a high-income status, as well as gaining important levels of prosperity in the last 30 years. However, it has a difficult road ahead. Currently, its economy is experiencing stagflation. The IMF anticipates “Chile’s economy shrinking 1.3% in 2023”. This challenge is compounded by increasing social demands and the lack of a clear common vision to put Chile back on the pathway to economic growth and prosperity for all.

Chile has managed to position itself as an attractive destination for investments and trade in the last decades. With its unique location, a natural resources-based economy, and a population of close to 20 million inhabitants, Chile is characterised by having a small internal market distant from global economies and major global value chains. The internationalisation of its economy has been the most important component of its growth strategy and development in the last four decades, and this has led to social, political, and economic transformations. Chile’s poverty levels plummeted, decreasing from 69% in 1990 to 11% in 2020 – one of the lowest levels in the region. Likewise, the GNI per capita increased by around 160% in the same period, and the country rose to the top of the Human Development Index (HDI). Chile is at the leading edge of prosperity in Latin America and the Caribbean, ranking second after Uruguay in the regional outlook in the Legatum Prosperity Index, and 38th out of 167 countries globally.

Important challenges need to be addressed to maintain the country’s progress while also ensuring it is able to tackle the endogenous and exogenous political, institutional, economic, and social structural demands under uncertain local and global conditions. While Chile has been successful in opening its economy and setting the initial building blocks for a prosperous nation, these results have translated unequally across sectors and regions in the country. This situation has led to economic and business concentration in particular sectors, high enterprise polarisation, as well as an excessive territorial concentration of opportunities and the emergence of ‘sacrifice zones’ and ‘environmentally saturated zones’. Hence, the country faces the challenge to go beyond simple economic openness and move toward a long-term strategy for economic inclusion that can lead to sustained economic growth.

At the same time, the country has been experiencing years of economic deceleration in its economic growth, caused by a slow-down in the global demand for commodities, negative Total Factor Production (TFP), and low levels of innovation and human capital development challenges. Chileans have also become increasingly frustrated by several collusion and corruption scandals over the past 10 years, which have raised questions regarding the role of the state in relation to citizens’ interests. Simultaneously, low trust has permeated into low levels of social cohesion and mistrust in institutions. Due to these scandals as well as the perception that governmental institutions do not represent the country’s interests and most recently the increased cost of living.
In 2019 the Chilean model – often called an economic miracle in Latin America – attracted international attention, due to the October social uprising. The riots and violent demonstrations – unprecedented until then – resulted in critical public infrastructure being burned down and destroyed. Even more importantly, these events led public opinion to question the success of the political and economic development model that Chile represented.

The events of October and November 2019 led to a historical political agreement for social peace and a new constitution, with the aim of creating a new document that would replace the constitution of 1980, thereby presenting an institutional solution to the crisis. The referendum was held in 2020, a constitutional assembly was elected in 2021, and the new constitutional text was written. However, finally in September 2022, the proposed text was rejected.

The effects of the riots and violence since 2019, coupled with the pandemic, have significantly worsened the socioeconomic situation of the country, increasing poverty and inequality. The duration and the particularities of the constitutional process have generated uncertainty by raising the question whether the result will ultimately be successful. Alongside the unpredictability of the final outcomes of the open constitutional process, President Gabriel Boric has sent to Congress a series of reforms to the tax, labour, pension, and healthcare systems, further increasing investors’ doubts about the future of the regulatory ecosystem in the country.

In recent times Chile has also been impacted by continuous external shocks from COVID-19, rising levels of inflation accompanied by job losses and emblematic closure of construction companies, along with ripple effects of the Russia-Ukraine war. These circumstances led to a cost-of-living crisis that came to reinforce the need for an ‘update’ of the Chilean model to ensure its resiliency, progress and unlocking economic growth and development.

Today, the country’s sentiment combines anxiety about the existing uncertainty, negative economic forecasts, together with high expectations (many believe that Chile can reach more inclusive levels of development in the short-term). Consequently, Chile seems to be immersed in a shadow of uncertainty and confusion, where the hopes for a new long-term vision are very associated with the constitutional process, rather than differentiating the role of a constitution – as the rules of the game – from a long-term national vision that needs to be developed to ensure further change. In fact, according to the BTI Transformation Index, “Chile must sooner rather than later think hard about a new economic growth strategy that can be supported across the political spectrum. To date, strategic discussion of these matters between political sectors has been non-existent”.

Although the country’s future seems uncertain, the current circumstances provide a unique opportunity for creating a unifying country vision that includes a necessary update to the Chilean political and economic model for the generations to come. This vision needs to focus on a new long-term economic growth strategy that resonates and is embraced across political and social spectrums. To this end, it is essential to build a new pathway towards an inclusive economy that places MSMEs, regional development, productivity, innovation, and people’s needs at the centre of its policies. This enhanced economic agenda would allow the country to build on its economic openness and institutional strengths, support the reduction of Chile’s vulnerabilities to external shocks and international demand for commodities, and rebuild social cohesion.

**Approach**

The analysis focusses on the key institutional, economic, and social drivers necessary to create sustainable pathways to achieving wellbeing and prosperity for all Chileans in decades to come. Our research has been organised around the key pillars and most relevant elements drawn from the three domains of the Legatum Prosperity Index – Inclusive societies (politics), open economies (economics), and empowered people (social) – as well as Chile’s performance in the global context. Through this lens, the analysis focuses on the areas where Chile needs to advance to unlock
the untapped potential and transition to an inclusive economy that can positively impact social capital and cohesion in the country.

Moreover, the approach is based on these dimensions to deepen the diagnosis of the key bottlenecks that limit progress and inclusion for everyone in the political and economic development journey of the country. The report aims to identify pathways to prosperity through tangible solutions for structural transformations. These changes aim to support structural transformations that will translate into functioning structures, institutions, and regulations to renew the foundations for inclusive growth and societal well-being for all Chileans.

**CHILEAN PATHWAYS TO PROSPERITY**

The first chapter of the report describes how the country has undergone significant social, political, and economic transformations in the last decades. It looks at the country’s main successes, at the same time identifying the bottlenecks and challenges for further growth and prosperity. The chapter concludes that, although Chile has a solid base on which to build a clear pathway to prosperity, the country lacks a unifying vision on how to move from an open economy to an inclusive one without staying trapped in ideological debates.

**NATIONAL AND LOCAL DEVELOPMENT: PROMOTING A PROSPEROUS AND INCLUSIVE SOCIETY**

This chapter starts with the trust and social cohesion issues that Chile is facing, to then analyse governance challenges around state capacity that are hindering the potential to reach an inclusive society in Chile. Particular attention is given to government effectiveness and regulatory quality, that have not evolved as fast as the country has transformed, leading to the loss of salient long-term policies against short-term issues. This situation leaves the country’s overall trajectory and future more driven by responses to immediate challenges, rather than constantly advancing towards long-lasting prosperity. Additionally, the chapter highlights the relevance to generate a national consensus around a common long-term country vision that puts territorial needs and realities at the centre to boost growth and productivity for generations to come. It addresses the need to strengthen institutional capacities at central, regional and local levels through the professionalisation of the civil service and the modernisation of the state to support the renewed national approach to a prosperous and thriving country. As well as acknowledging the need for a phased, accompanied, and funded transfer of competences to the regional governments.

**CREATING A THRIVING ENTREPRENEURIAL ECOSYSTEM**

The third chapter analyses the extent to which businesses and labour market regulations ensure a dynamic, competitive, and flexible environment to enable entrepreneurship and innovation in Chile, as well as the implications related to the country’s education system. It finds that to unlock the potential of Chilean enterprises it is necessary to ensure that markets are freed from burdensome regulations, and that legislative, policy factors, and the educational system are promoting the skills needed to deepen the entrepreneurial culture in the country. Additionally, it highlights the importance of unlocking labour market flexibility, as rigid systems directly impact innovation, labour market participation, performance, and productivity.

**ENABLING A COMPETITIVE INVESTMENT ENVIRONMENT**

This chapter focuses on the environment needed to foster an enabling business environment that supports domestic and foreign investments. In addition to considering the regulatory constraints on international investment, it also reviews the extent to which Chile can attract and protect quality investments through the guarantee of property rights and contract enforcement, as these elements play a crucial role in underpinning innovation, enterprise development and further expansion of export of goods and services from MSMEs.
ENSURING BROAD-BASED FINANCE

This chapter reviews the financial system in Chile and how conducive it is for business development. A sound financial system underpins prosperity, as it allows an efficient flow of funds toward their most productive uses, helping generate jobs and improve productivity. Capital markets help finance infrastructure and manage unforeseeable risk, as well as help governments raise investment capital. Access to finance in Chile is a critical factor to allow entrepreneurs to grow, invest, innovate, and take risks toward new business lines and to be at the front edge of a thriving MSMEs environment. The chapter concludes that although the financing ecosystem in Chile is quite diverse and large, important challenges remain for MSMEs and new ventures. Hence, to unlock the potential and spirit of entrepreneurship in Chile, revisiting financing opportunities and financial products with a focus on MSMEs and people will contribute to a thriving ecosystem.

SUPPORTING TRADE AND COMMERCE

This chapter discusses the core infrastructure that enables trade and investment flows in the country (including a deeper look into communications, water, transport, and logistics), as well as critical factors related to market access, especially for MSMEs. This analysis focuses on how to take advantage of the country’s open market, preferential agreements and low tariffs to further increase productivity, diversification, value addition, and connectivity to regional and global markets along with participation in Global Value Chains (GVC). In doing so, the chapter discusses key economic sectors such as mining, agriculture, and energy.

FIGURE 1: THE BUILDING BLOCKS OF PROSPERITY

Source: Domains, Pillars and Elements of Prosperity, Legatum Prosperity Index
Chilean woman sorts fresh peaches on a fruit packing line.

Credit: BearFotos.
Chilean Pathways to Prosperity

This chapter describes how a country that has undergone significant social, political, and economic transformations in the last decades has experienced challenges in creating an inclusive economy and society, where all Chileans can flourish. It looks at the country’s main successes, at the same time identifying the bottlenecks and challenges for further growth and prosperity. The chapter concludes that although Chile has a solid base on which to build a clear pathway to prosperity, the country lacks a unifying vision on how to move from an open economy to an inclusive one without staying trapped in ideological debates.

CHILE’S ECONOMIC QUALITY AND HISTORY OF INTEGRATION INTO GLOBAL VALUE CHAINS

Over the last decades, Chile has gained global positioning through its undeniable social, economic, and political transformations, making the country a safe and attractive destination for trade and investment. The approach of deepening Chile’s integration into the GVCs, accompanied by export-led policies, solid macroeconomic and financial institutions, and prudential regulations has marked the country’s pathway towards economic growth. In the Legatum Prosperity Index, the country ranks 1st in Latin America and the Caribbean, and 43rd out of 167 countries on economic quality.1

Chile’s approach to economic growth and development in the last decades has been conditioned by its small population – close to 20 million people2 – and its unique position in the southern hemisphere, leaving it far from the main global economies and financial centres.3 The Chilean market is small,4 heavily concentrated in urban centres near the capital.5

Chile is the longest (4,300 km) and narrowest (average width 180 km) country in the world, and benefits from every type of climate on the planet, except for tropical weather.6 These climatic conditions combined with its unique geography, natural resources, coastal line and its diverse flora and fauna offer unique opportunities for business development and investments in traditional economic sectors such as mining, agriculture, energy, manufacturing, along with tourism.

The export-led and liberalisation strategy, along with structural reforms – started in the late 1970s under Pinochet’s regime and continued with modifications since the return to democracy in 1990 – have been critical in opening economic opportunities. Consequently, one of the most important points in the agendas of multiple governments has been to strengthen Chilean integration globally through foreign and economic policies to position Chile as a destination for investment and trade.

Macroeconomic Stability (70th) and Fiscal Sustainability (21st)

THE COUNTRY’S ECONOMIC PERFORMANCE

Chile’s history and economic performance in the last 50 years have been tied to a liberalisation model started under Pinochet. In 1973, General Augusto Pinochet seized power in Chile in a coup d’état. Under his dictatorial rule, the country started structural reforms, underpinned by market liberalisation in the late 1970s and early 1980s, and enhanced since the return to democracy, resulting in steady progress and economic growth that lasted until the mid-2000s.7 The liberalisation policy supported a more open private-sector-driven and price-deregulated market economy, which was further augmented by the commodity boom, period driven by demand from China.8

In the 1980s, a new Banking Law established an independent Central Bank, eliminated foreign exchange controls, and adopted a floating exchange-rate regime.9 However, radical economic liberalism came together with a regime associated with systematic human rights violations, as the
state withdrew from its dominant role not only in the economy but also in terms of social policy. During this period, the fundamental principles of the socioeconomic model were established in the Constitution. The text also provided a framework that allowed a democratic opposition to organise, political parties to re-emerge, and eventually defeat Pinochet in the 1988 plebiscite.

In 1989, free presidential and parliamentary elections were held, with the victory of Christian Democrat Patricio Aylwin, representing the centre-left coalition, Concertación. In the subsequent years up to 2005, Concertación won all elections. The Aylwin government (1990-1994) achieved economic stability and reduced poverty, avoiding a relapse into authoritarianism. All of the following the Concertación governments – those of Christian Democrat Eduardo Frei Ruiz-Tagle (1994-2000), socialists Ricardo Lagos (2000-2006) and Michelle Bachelet (2006-2010) – sought to combine market-based economic growth, political and economic openness, and social inclusion through higher funding for education, housing, health care and pensions.

The reforms and policies taken by Aylwin and Frei Ruiz-Tagle led to fast economic growth averaging 6.0% p.a. during the 1990s. Although the Asia crisis, in the last years of Frei’s presidency, led to an economic contraction (Figure 2). From the 2000s until 2013, the country’s economy grew on average 4.5% p.a., supported by China’s commodity boom. In the decades where GDP per capita grew at a remarkably fast pace, higher wages expanded the Chilean middle class to more than 60% of the population. People became more empowered, and democracy was consolidated.

Likewise, several investments to unlock critical infrastructure for growth and development were made around connectivity, transport, and energy sectors, especially from 2000-2006 under the administration of Ricardo Lagos. In 2000, he assumed the Chilean presidency under a recession triggered by the Asia crisis. As part of his strategy to boost growth, President Lagos promoted an aggressive public and private investment plan in infrastructure, injecting dynamism into the Chilean economy. During the next four years, GDP grew on average 3.8%, as investments in infrastructure soared.

Meanwhile, macroeconomic predictability and sustainability attracted exceptionally large foreign direct investment flows into the country. Hence, Chile was the first country to reach high-income status in Latin America, and the second to join the OECD in 2010 – after Mexico. Chile also saw a political change in 2009, with the centre-right winning the presidency for the first time since 1958. President Sebastián Piñera assumed his term just 11 days after one of the largest earthquakes in the world, followed by tsunamis that impacted 7 regions where more than 80% of the population resides. The Piñera administration maintained the economic and social policies of previous governments, and focused on recovering economic growth, dynamism, and employment generation. However, in 2011, Chile experienced a new wave of protests organised by university students demanding free higher education and a thorough de-marketisation of the education industry.

The Chilean economic transformation came hand-in-hand with a political focus on social and infrastructural investments. Social policies – with the state tripling its social expenditure between 1990 and 2015 – as well as investments in infrastructure allowed for better educational coverage, improved social services, healthcare access and coverage and the professionalisation of government services.

The student movement and increasing social demands, pushed the centre left-wing coalition – Concertación – to move further towards the left, forming a new alliance called Nueva Mayoría, which included the Communist Party. In 2013, the new coalition won a majority in both houses of Congress, and Bachelet returned to power. Economic growth slowed as a result of external shocks, particularly the spill-overs of the financial crisis combined with reduced export demand and the lowering price of copper with the end of the commodities boom. In the six years in the run-up to the Covid-19 pandemic, Chile’s economy grew on an average of just 2% p.a., although above the regional average. Consequently, Bachelet’s Government quickly became unpopular, even though it delivered its main promises of tax and educational reforms.
During the Concertación and New Majority governments, the focus was to continue with the export-led model, opening the economy further with additional FTAs, while moving at the same time towards a social-market-oriented model. However, in the last decades, Chilean real GDP growth has shown a declining trend. The worsening economic conditions, increasing regulatory frameworks for businesses along with increased economic polarisation, led citizens to re-elect Piñera at the end of 2017. The president returned to power, promising renewed growth, investment attraction, job creation, as well as supporting entrepreneurship, business creation, productivity, and innovation.

The years prior to the social uprising in 2019 and the COVID-19 pandemic were marked by a continuous slowing of economic growth and were accompanied by lower productivity. Despite the slowdown of economic growth over time, the country’s economic performance has been above regional trends. This economic growth – although with variations – has led to an increase in GDP per capita (Figure 2). Better economic outcomes combined with better social policies and interventions adopted since the 1990s have translated into a substantial improvement in the quality of life of Chileans.

In summary, in the last three decades, not only has the investment and business environment become stronger, but the country’s democracy has also consolidated along with the implementation of safety nets and social protection systems. These factors have created the necessary conditions for Chileans to escape poverty, leading to a society composed mostly of middle class. In 2022, Chile ranked 42nd in the UNDP HDI with a score of 0.855 – the highest in Latin America, and equal to that of Qatar. Furthermore, at US$25,449 in 2021 the country has one of the highest GDP per capita in the region (PPP, constant 2017 international $).

The reforms and policies taken by the different governments have been based on the unwritten understanding that the export-led model and investment attraction are at the centre of the Chilean development path. Despite this shared approach, the political class and different governments have not focussed on developing a concrete vision for the country’s future that goes beyond presidential terms.
The macroeconomic stability and fiscal sustainability of the country are under pressure. Social demands and external shocks are testing the soundness of the Chilean development model. Furthermore, the country’s international perception of its solid economic bases and credit ratings has been deteriorating.

During 2020, Chile faced an unprecedented recession – with a sharp contraction of 6%[38] – caused by two large shocks, the social uprising towards the end of 2019 and the COVID-19 pandemic (Figure 2). Additionally, unemployment soared, increasing from 7.3% in 2019 to 11.2% in 2020 – the highest in a decade.[39] These shocks left the government with a two-fold challenge. First, it was necessary to build bridges to create a new social contract and agreement to manage the violence and discontent that rocked the country. Second, the Government needed to focus on the necessary reforms to address social concerns (pensions, healthcare, education, and others) and deal with the COVID-19 pandemic and its effects.

Chile’s policy response to the pandemic, according to the OECD, was swift and bold. The country had entered the COVID-19 crisis with the greatest fiscal space in the region, solid economic fundamentals and credible institutions.[40] Smooth coordination between fiscal authorities, the Central Bank and the financial market regulator allowed the Government to introduce unprecedented fiscal and monetary stimulus packages, among the largest in Latin America, to mitigate the effects of the global lockdown.[41] Given the political agreement between parties, a temporary emergency plan emerged in mid-2020 that included a comprehensive package to support the population and businesses for the next two years to support a swift and inclusive recovery and a commitment to fiscal consolidation thereafter.[42]

Because of a strong fiscal response, Chile’s GDP grew at 11.7% in 2021 – one of the fastest recoveries from the pandemic worldwide.[43] The growth was driven by consumption, fuelled by pension fund withdrawals and direct fiscal support of 9% of GDP.[44] Additionally, economic recovery was

**BOX 1: STRENGTHS AND SOLID FOUNDATION FOR GROWTH AND DEVELOPMENT**

The Chilean model and its success have been accompanied by several structural transformations that have unlocked economic growth and social well-being over the last three decades. All these elements have supported the undeniable social, political, and economic change in the country.

Chile has been successful in:

- The internationalisation of the Chilean economy through a strong set of bilateral and multilateral international trade and cooperation agreements.
- Creation and continuity of a solid and independent Central Bank, accompanied by consistent macroeconomic policies, have positioned the country as an attractive place for trade and investment.
- Combining the economic transformation with strong investment in social policies and the necessary infrastructure to ensure Chileans’ wellbeing.
- Followed across government the implicit – unwritten understanding – that the export-led model and investment attraction are at the core of the country’s development approach.
- Constantly investing in critical infrastructure (energy, water, and telecommunications); infrastructure for logistics and connectivity (transport and logistic services); and social infrastructure (healthcare, safety, education, among others).

**CURRENT MACROECONOMIC STABILITY AND FISCAL SUSTAINABILITY CHALLENGES**

The macroeconomic stability and fiscal sustainability of the country are under pressure. Social demands and external shocks are testing the soundness of the Chilean development model. Furthermore, the country’s international perception of its solid economic bases and credit ratings has been deteriorating.

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Because of a strong fiscal response, Chile’s GDP grew at 11.7% in 2021 – one of the fastest recoveries from the pandemic worldwide.[43] The growth was driven by consumption, fuelled by pension fund withdrawals and direct fiscal support of 9% of GDP.[44] Additionally, economic recovery was
also supported by one of the fastest vaccination rates in the world. Yet, job market recovery has not been as fast as expected, with only 60% of the jobs lost in 2020 regained in 2021, with many previously employed (mostly low-skilled) women still out of the workforce. Furthermore, the swift recovery led to a significant overheating of the economy, marked by an accelerating inflation, reaching 12.8% in October 2022, caused by strong demand pressures, commodity price increases, supply disruptions, and the peso depreciation. Additionally, high public spending led to the fiscal deficit reaching 7.7% of GDP in 2021, and public debt reaching 37% of GDP – the highest level in three decades.

Economic growth is projected to decelerate to around 2.1% in 2022, and subsequently shrink by 1.3% in 2023, fuelled by the reversal of the stimulus, tighter financial conditions, and persistent political uncertainty that is expected to limit investment. Consumption will be cushioned by high liquidity in households and the enhanced universal pension scheme. In 2023, headline inflation is expected to moderate but remains high due to the impact on energy prices of the EU oil embargo on Russia as the war in Ukraine continues. Simultaneously, the rate of poverty (US$5.50 a day) is expected to increase to 4.7%, and the Gini coefficient to 0.46 in 2022 (as compared to 0.44 in 2017).

The country’s credit ratings and the perception of its economic soundness have been affected by the fiscal and economic situation, combined with the current social challenges, the constitutional process, and legislative reforms. According to Moody’s, these issues “have generated concerns about the future government policies on property rights, rule of law, tax structure and the role of the government in the economy”. Challenges that resulted in a “downgrading of the Government of Chile’s long-term local and foreign currency issuer to A2 from A1, where the outlook has been changed to stable from negative. […] This rating downgrade was driven by fiscal and economic trends that have gradually but persistently weakened Chile’s credit profile, aligning with that of A2-rated peers. Although the country entered the coronavirus crisis with lower debt than peers and with fiscal buffers, its debt burden had been rising steadily before the crisis and the pandemic exacerbated the upward trend”.

Therefore, over the next years, Chile will have to address multiple challenges under a modest economic growth projection. Hence it will be imperative to build upon the country’s key strategic areas, competitive strength and enhance opportunities for inclusive growth putting MSMEs and the different Chilean needs across the territory at the centre of its economic model.

**Productivity and Competitiveness (64th out of 167)**

The country has one of the most resource-intensive economies of the OECD members and “is over-reliant on natural resources like copper, agriculture, forestry and fishery for delivering economic growth”. Chile’s authorities opted for an economic growth model that put exports at the centre, accounting for at least a quarter of the country’s GDP. International trade became the main driver of growth and economic development during the 1980s, 1990s, and reached its peak in 2007, when exports’ share of GDP reached 45%.

However, since the late-2000s the export-led model lost traction and their contribution has sharply declined to less than one-third of GDP for 2021. In the last 15 years exports have not been the main driver of economic growth, productivity, and innovation in the country. To counteract this decline, the second Piñera administration increased its efforts to position Chile for non-traditional sectors and expand the portfolio of services that Chile can provide to the world.
“This drop in exports is correlated and contemporaneous with the fall in the contribution of Total Factor Productivity (TFP) growth to overall growth”. Hence, the conducive environment that was being established by business-friendly frameworks, openness and higher levels of international trade was not enough to generate more private sector dynamism and improvements in productivity levels. Indeed, over the last three decades, economic growth in Chile has largely stemmed from substantial capital deepening.

These low productivity levels are not new to the Chilean economy and labour market. For at least the last two decades, economic growth has been characterised by a weak or negative TFP compensated by substantial capital deepening, with real GDP growth following a declining trend over time mainly due to a weak productivity performance in different sectors of the economy, especially in mining. The negative TFP growth has been driving the growth slowdown and delaying the convergence with the average OECD income level. The weak productivity performance is linked to the concentration of the export base in natural resource sectors and limited adoption of, and investment in, new technologies as well as limited competition, growing challenges in the regulatory framework, inadequate labour force skills, and a disconnect between labour market needs and secondary and tertiary education programmes.

LOW-SKILL LABOUR MARKET

These low productivity levels are holding back Chile’s prosperity, as most workers are employed in low-productivity activities that represent limited contribution to value-addition. The poor TFP performance has been constant since the 1990s, driven mostly by the dynamics of the mining industry, where TFP has declined on a yearly average 4.7% between 1993 and 2015. Additionally, the economic concentration and business polarisation have not resulted in a substantially high-skill labour demand.
HIGH ECONOMIC CONCENTRATION AND BUSINESS POLARISATION

Chile suffers from a high level of business polarisation, characterised by “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.”\(^7\) Currently, MSMEs represent 98% of the active enterprises in the country, where 62% are micro, 30% are small and 6% are medium-sized companies, representing 13% of sales participation and 44% of the employment.\(^2\)

On the contrary, large firms – 2% of total companies in Chile – share 87% of sales and provide 56% of employment.\(^3\)

This business polarisation and entrepreneurs’ limited investment capacity leads to a lack of a large vibrant group of midsize companies and further internationalisation of Chilean companies, hindering dynamism and competitiveness.\(^4\) Small firms were also more affected by COVID-19 than the larger ones, given under-utilised labour, capital weighing, the extent of growing informality and lower digitalization.\(^5\)

Today, Chile is one of the most industrialized countries in Latin America, and its key industries include mining (copper, lithium, coal, nitrate, and others), manufactured products (processed foods, chemicals, wood) and agriculture (fishing, viticulture, and fruit).\(^6\) While looking at the contributions per sector to GDP, without including the backward and forward linkages, the industrial sector is estimated to represent 31.4% of the country’s GDP, employing 22.3% of the working population.\(^7\)

The agricultural sector contributes much less to the Chilean economy. In 2020, agriculture comprised 3.8% of GDP, and it employed 8.9% of the working population in 2019.\(^8\) Although, studies from the Office of Agricultural Studies and Policies (ODEPA) have suggested that the sector’s contribution to GDP is greater than the estimate in the national accounts, reaching to over 14% by capturing backwards and forwards linkages.\(^9\) Agriculture has been one of the most dynamic industries, introducing technology, innovation and high-skill labour into the sector.\(^10\) Currently, these sophisticated value-addition processes tend to be included in the manufacturing contributions, particularly for wines, fruits, and processed meats (meat, poultry and seafood).\(^11\) Importantly, fruit and vegetable exports have been performing particularly well and reaching historic records, as a result of a deliberate strategy implemented in the 1990s targeting the European, North American, and Asian markets.\(^12\)

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**FIGURE 4: SECTORAL VALUE ADDED (% OF GDP) FOR 2021**

Source: World Bank

Note: The latest sectoral data available is 2020 and 2019 for Israel and New Zealand, respectively.
Finally, the services sector is the most significant contributor to the Chilean economy, accounting for 56.4% of the GDP and employing around 68.7% of the population. Chile’s economy continues to rely on traditional sectors. Chile is at least 10 points behind the global mean in terms of the contribution of services to GDP, and below selected countries with lower, equal, and better economic performance (Figure 4).

EXPORT DIVERSIFICATION

Chile is seen as a model of export diversification. During the last 50 years, the country has evolved from being one of the most highly concentrated commodity exporters in the world to having a much more diversified export basket. The diversification strategy came associated with Chile’s natural resources-based traditional comparative advantages, leading to important investments in physical infrastructure, knowledge, human capital development and an upgrade of logistic processes to support – especially – goods diversification. These transformations allowed fast growth and global positioning of Chilean fresh fruits, nuts, fish and seafood, forestry, cellulose, and the wine industry, and were possible through “sophisticated logistics, processing, and manufacturing-based value addition”.

MINING AND NON-COOPER EXPORTS

In the 1960s, mining represented over 85% of total exports. Manufacturing and agriculture grew during the 1980s, representing over 40% of total exports between them. Although in the last decade, mining has continued to be the dominant industry, with a share of total export at around 55%, greater domestic value addition in traditional mining has been highly relevant for the sector’s performance. Another clear example of the overall success of the diversification of export goods is the substantial growth of non-copper exports, showing an average annual growth of 10% since 1960. Indeed, from 1990 to 2020 these types of exports passed from US$4.6 billion to US$35 billion, representing an increase of 7 times its value. At the same time, through promotion strategies and private sector support, the number of products and services exported saw a relevant increase from over 2,700 in 1990 to 4,856 in 2020.
BOX 2: CHILEAN EXPORTS PERFORMANCE DURING COVID TIMES

COVID-19 impacted economic activities globally. A pandemic that led to lockdown and closing of industries, supply chain disruptions, border closures and substantial changes in consumption patterns. Despite all these challenges, Chile managed to continue as an export leader of at least 28 products in 2020. While the country continues to be the top global exporter of copper and lithium, it is also the leading provider of goods in agriculture, fishing, and silviculture (i.e., cherries, plums, salmon, cellulose, dry apples). During the pandemic, its wide network of trade agreements allowed the country to navigate border closures and sanitary restrictions in the destination countries by proactively – with the support of ProChile and other key governmental entities – looking for other opportunities and redirecting the goods to different markets without negatively affecting the results.

Importantly, 2022 has been characterised by a recovery in the trade flows after severe negative impacts and disruptions generated by the COVID-19 pandemic that resulted in the largest contraction in Chile’s GDP in almost 40 years. Chile’s trade exchange exceeded US$137 billion during the first 8 months of 2022, showing an increase of over 16% compared to the same period in 2021. While exports reached US$66 billion – showing an increment of over 6% – imports increased at least 4 times faster (26%) reaching US$72 billion and leaving a negative commercial balance. During this period Chilean exports went to 191 markets, and an increment in sales was observed in over 120 of these. The greatest increases in terms of export values were observed in China (+US$3,743 million), South Korea (+US$1,079 million), United States (+US$902 million), Mexico (+US$324 million), Brazil (+US$245 million), Colombia (+US$243 million), Peru (+US$195 million), India (+US$187 million) and Japan (+US$173 million).
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STRONG TERRITORIAL CONTRAST IN ECONOMIC AND SOCIAL OPPORTUNITIES

The national socioeconomic progress has been uneven across sectors, regions, and the population in general. However, compared with the 1990s and 2000s, the country’s overall socioeconomic conditions improved significantly, due to consistent economic growth accompanied by social policies. Starting from the 2010s, a changing trend in demands, accompanied by a sustained upward mobility to middle class, added pressure to improve social programmes in Chile (Figure 5). Consequently, the income poverty level (based on USD$5.50 per day 2011 PPP) plummeted to 3.6% in 2017. Despite these positive outcomes, almost 30% of the population continued in the group that is vulnerable to go back to poverty for the same year.

FIGURE 5: EVOLUTION OF POVERTY, VULNERABILITY AND THE MIDDLE CLASS, 2006-2017

Source: World Bank Group

However, these good socioeconomic indicators are confronted by a less prosperous reality associated with the deepness of inequality across the country. For instance, significant differences persist in life expectancy, education, and income distribution across the country, and within the metropolitan region. The life expectancy of a woman born in the western part of Santiago is significantly lower than in the most affluent areas – up to 18 years less than a woman born in the eastern area of the capital. This difference is lower in the case of men with an average of 9 years. A similar situation can be observed in the case of education levels, where the difference between the highest and lowest income quintile is around 5 years. Likewise in terms of income distribution, job opportunities, and quality services, the country faces substantial inequalities. According to UNDP, one-third of the income generated by the economy goes to the richest 1% of the total population. Thus, when Chile’s HDI is adjusted by inequality, the level of human development falls from 0.855 (in 2021) to 0.722, a level that is equivalent to the HDI value for Chile in 1994.

GEOGRAPHICAL DISPARITIES AND LOCAL DEVELOPMENT

The disparities are also evident by geographical area, where significant inequalities persist around the prevalence of low salaries, job opportunities, along with challenges in the access and quality of sanitary services, healthcare, and education. The contrast between the overall national data and a rural/urban and regional outlook shows that, despite the reduction in poverty and inequality levels, the pace of growth, prosperity and opportunities has not reached everyone at the same pace, and that the country today continues to witness significant levels of disparity. This reality can – in part – explain the reasons behind the social protests that marked the last quarter of 2019.

There is a critical gap in the levels of local development across Chilean regions, as there are systematic differences between the three main populated areas (Region Metropolitana, Valparaiso, and Biobío) and the rest of the country (14 remaining regions). According to the last Census, the first group encompasses almost 60% of the population, which is mainly urban and non-indigenous.
Notwithstanding the economic diversity in Chile, administrative fragmentation has been a challenge for an organic distribution of growth and opportunities at similar levels across the territory and its economic development. Besides a regional strategy and some regional planning structures – Regional Development Strategies (ERD), Regional Innovation Strategy (ERI) and Regional Land Use Plan (PROT) – there is a lack of plans to bolster development based on natural advantages with an intersectoral and interregional approach. Moreover, local political structures and geographic fragmentations are not usually accounted for in the national planning processes. Additionally, the regional and local administrative governance is fragmented, and regional divisions tend to generate friction and low cooperation among regions. These issues are also affected by the fact that Chile follows a centralised approach to investment and regional development based on national priorities, rather than encouraging cooperation and growth around macrozones or regional hubs.

Figure 6 shows that economic advantages are concentrated in a cluster of regions, and they go beyond the current regional administrative structure. The distribution of economic activities makes cooperation and a more comprehensive approach necessary to expand socioeconomic opportunities beyond the central part of Chile.

Source: Aravena and Duarte, 2021

**FIGURE 6: LOCATION QUOTIENTS OF GDP PER REGION AND ECONOMIC ACTIVITY (AGRICULTURE, MINING, TRANSPORTATION, AND MANUFACTURING)**

**SOME CHALLENGES AND BARRIERS TO OVERCOME**

Chile is experiencing uncertain times, particularly due to a growing demand for stronger safety nets and better services by the Chilean population. They are facing uncertainty under a difficult economic outlook marked by high inflation levels, a cost-of-living crisis and negative economic forecast. Further uncertainty has been created by a redefinition of the ‘rules of the game’ through the constitutional debate and the announcement of new reforms and legislations affecting critical areas and topics such as mining, water, and indigenous rights, as well as energy prices and corporate taxes. Companies across several industries have postponed some major investments and modernization plans scheduled for the near future.
At the same time, the country faces chronic problems associated with its economic quality, enterprise conditions, along with governance effectiveness and lack of long-term vision that have impacted the overall economic performance and limited its levels of inclusivity.

These challenges include:

- The macroeconomic stability and fiscal sustainability of the country under pressure due to social demands and external shocks that are testing the soundness of the Chilean development model.

- Economic growth characterised by capital deepening, real GDP growth experiencing a declining trend over time, and exports not being the main driver of economic growth, weakening productivity and innovation in the country for the last 15 years.

- Almost 30 years of weak and negative productivity (TFP) linked to the concentration of low levels of value-addition to the Chilean national and international offer.

- Conducive trade and commerce environment supported by a diversification strategy – especially for goods, leaving untapped potential for the services sector.

- High concentration of economic opportunities in specific sectors and business polarisation limit business dynamism, limiting the potential for increasing exports, productivity, and innovation.

- The efficiency and effectiveness of Chile’s regulatory environment have declined over time, and the system and institutional settings have become more complex, pushing even more MSMEs towards informalisation.

- Labour Market characterised by low-skill workers employed in low-productivity activities that represent limited contribution to value-addition, disincentivising investments in Research and Development.

- Strong regional divergences in socioeconomic opportunities, state capacity, and quality of life.
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Credit: Carlos M. Werner.
National Congress of Chile.
National and Local Development: Promoting a Prosperous and Inclusive Society

This chapter starts by examining the trust and social cohesion issues that Chile is facing. It then analyses governance challenges around state capacity that are hindering the potential to reach an inclusive society in Chile. Particular attention is given to government effectiveness and regulatory quality, which have not evolved as fast as the country has transformed, leading to the loss of salient long-term policies against short-term issues. This situation leaves the country’s overall trajectory and future more driven by responses to immediate challenges, rather than constantly advancing towards long-lasting prosperity.

Additionally, the chapter highlights the relevance to generate a national consensus around a common long-term country vision that puts territorial needs and realities at the centre to boost growth and productivity for generations to come. It addresses the need to strengthen institutional capacities at a central, regional, and local level through the professionalisation of civil service and the modernisation of the State to support a renewed national approach for a prosperous and thriving country. As well as acknowledging the need for a phased, guided, and funded transfer of competences to regional governments.

Trust and Social Cohesion as a Central Challenge for Chilean Growth and Prosperity

Low levels of trust and social cohesion are at the heart of Latin America and the Caribbean’s challenges around developing strong social ties. Trust levels across the region, including in Chile, are lower than in any other part of the world. For 2020, the region registered its lowest level of interpersonal trust since 1996, reaching just 12%, while Chile showed 17%.1 This low level of trust has direct and indirect impacts on growth, innovation,2 and overall prosperity.

Trust challenges are not a new phenomenon in Chile, and the Latinobarometer highlights that low levels of interpersonal trust are endemic to Chilean culture. However, in recent years the country has recorded concerningly low levels.3 Along the same lines, institutional trust presents mixed results among institutions, showing decreasing trends, particularly for organisations associated with the public and private sectors.4 Trust in institutions has varied and is explained by certain contexts or specific crises, as in the case of the Catholic Church, which in the nineties reached almost 80% trust, while in 2020 it fell to 31%, after various scandals. Likewise, Congress has also suffered a significant decline in confidence. After reaching 53% in 1997, today it only enjoys 13% confidence in Chile.5
The Three Branches of Power and the Political Elite are not Trusted by Chileans

Public trust in the central government is among the lowest, averaging 7% for the last two presidential terms. Likewise, for 2021 the trust levels for the executive (18%), judiciary (16%), the president (16%), and congress (13%) showcased the chronic mistrust faced by the foundations of the political structure. Notably, Chileans have the lowest level of confidence in political parties – institutions mandated to represent the interests of citizens in the public sphere – reaching 93% mistrust (Figure 7).

This mistrust impacts the support and legitimacy of institutions and policies, and in the long run, also ends up generating disincentives and externalities that impact public service efficiency. These are relevant for Chile, as trust is at the centre of social and economic prosperity. “Mistrust – between governments and firms, voters and firms, workers, and firms, and among firms – blocks the pathways to inclusive growth: entrepreneurship, innovation, and investment. It hinders the rapid flow of workers, capital, and ideas towards the firms and sectors with the greatest potential to grow”. Additionally, when relationships and interactions are marked by mistrust, citizens are constrained in their abilities to demand policies that support inclusive growth and society, and government institutions at every level cannot fully meet citizens’ expectations, hence suspicion plagues the interaction of public officials, politicians, and citizens.

Low trust levels in Chile, as well as in the region, not only distort policies that governments have prioritised and put in place but have also hindered their implementation. Policies in critical sectors and areas of strong social demand such as public safety, education, health, environmental and consumer protection, financial inclusion, decentralisation, and entrepreneurship are affected, as the low level of institutional and interpersonal trust generates mistrust at every level of the policy cycle. This situation, combined with rigid governance structures and conflicting developments of state capacity, impacts service delivery, quality and effectiveness of long-horizon policies as well as short-term priorities.
Stagnating Governance Conditions in Chile

GOVERNANCE (29th)

Chile ranks among the top 30 countries in the governance pillar of the Legatum Prosperity Index for 2021. The country has been characterised by a strong democracy, along with robust institutions, competitive elections, peaceful transition of power since the return to democracy, clear divisions of powers and executive constraints. Similarly, Chile has improved its political accountability processes and expanded public and social services nationally. Furthermore, in comparison with the rest of Latin America and the Caribbean, it stands out as one of the countries with strong state capacity.

These achievements have created a solid institutional base for the country to build upon for further prosperity. Despite that, over the decades state capacity has not evolved at the same pace as the country’s socioeconomic transformation and its global inclusion, leading to an imbalance between the capacities of the private and public sectors. State capacity, particularly government effectiveness and regulatory quality, has not changed and modernised quickly enough to cope with the increasing and diverse demands placed upon it.

THE CONSTITUTIONAL DEBATE – CHANGING THE RULES OF THE GAME

The October 2019 social uprising and violent social outburst accompanied by massive pacific protest under the expression ‘Chile despertó’ (Chile woke up), and then the further election of an important number of independent or non-traditional partisan candidates to draft the new constitution, were some of the symptoms of discontent with the traditional political class combined with unmet expectations. During the last three years, the country has experienced strong polarisation in views about the role of the State and the private sector, property and social rights, natural resources, decentralisation and the re-definition of the social, political and economic model for Chile. They were all elements that were integrated into the constitutional draft. However, finally, in September 2022, the proposed text was rejected. This result came as a clear sign that Chileans were looking for a more balanced constitution based on a broad consensus that focuses on improving a model that unites and leaves no one behind in Chile’s socioeconomic development, rather than a complete change in the country’s political and economic development model.

After the September 2022 referendum results, the country faces a divided public opinion on the best way to write the new constitution. Forty four per cent believe it is necessary to replace the constitution, versus 46% that prefer to modify the existing charter, and just 9% that would rather keep the current document as it is. Similarly, the political elite is divided on the best way forward. The ‘blank page approach’ as a starting point for the new constitution from the 2019 agreement no longer holds and certain principles must be respected. Hence, the parties in Congress agreed to 12 principles that will set the basis for a new social contract, including that the Indigenous communities are part of the Chilean nation, Chile is a social and democratic state and that the executive power is in charge of fiscal spending. Likewise, a new technical committee will oversee that these 12 principles are observed while redrafting the new charter. However, negotiations to define the mechanism for the drafting of the new text are ongoing and continue to be part of an intense debate, where the Executive has not been absent.

IMPROVING STATE CAPACITY – A PENDING TASK FOR A SUSTAINABLE CHILEAN TRANSFORMATION

A country characterised by a strong state capacity is one that has the ability to deliver for its people in an efficient, effective, equitable and transparent manner.

The Chilean state structure is large and complex, comprised of 24 ministries, 162 public services, 16 regions and 345 municipalities. At a regional level, an extra layer of complexity has been added, as newly elected governors (since July 2022) oversee regional policy formulation, strategies for regional development and budget in a dual system with presidential delegates. The first
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focuses on establishing the strategic priorities for regional development, including planning, and prioritising the investments under the Regional Development Fund (FNDR), as well as implementing its regional government priorities and promoting regional development following the Regional Development Plan (ERD). In the region, the presidential delegate coordinates safety and security, as well as sectoral offices and public services that directly depend on the central government.20

State functioning, policymaking, and budgetary allocations are – mostly – centralised.21 According to the Sustainable Governance Indicator (SGI),22 some of the long-term challenges that Chile has been facing for several years are underpinned by its state capacity. On the one hand, despite its length, and diversity of geography and economic opportunities, Chile continues to be one of the most centralised OECD countries, which hampers efficiency and effectiveness.23 On the other hand, "political and strategic planning are undermined by a lack of state capacities and instruments that would ensure that policymaking adopts a medium-to-long-term perspective, especially in the case of social, economic and ethical issues."24
GOVERNMENT EFFECTIVENESS

Since the return to democracy, the different administrations have sought to design and implement specific public sectoral reforms and policies with a long-term horizon in key socioeconomic issues, seeking broad consensus to ensure continuity after their terms are concluded. For example, the tax and labour reforms in Aylwin’s presidency; the criminal justice reform promoted during the Frei Ruiz-Tagle administration; the health reform launched during Lagos’ period, as well as other social and economic reforms during the Bachelet’s and Pinera’s two administrations.

The Chilean president leads strategic planning through formal and informal channels. Different line ministries are involved in the planning and policy process in the country, but most notably the Ministry of Finance (DIPRES) and the Ministry Secretariat of the Presidency (SEGPRES) play an active role in these processes. Although strategic planning is at the centre of the government’s agenda, “no long-term view of policy changes and viable solutions is necessarily presented – these are either limited in scope or depth of impact depending on the topic”.

Compared to Latin America, the country has a relatively efficient public system and there are technical agencies in key ministries that strengthen the strategic capacity of governments, generating the conditions to prioritise and project their key initiatives. Indeed, most relevant projects must pass through an experts committee, as well as be fully aligned with the guidelines of key relevant offices – such as the National Budgetary Office (DIPRES) and/or the National Investment System (SNI).

Chile’s strategic planning relies on the advice of experts, with technical institutions, specialists and practitioners playing a significant role in government decision-making. According to the GSI, experts from academia, the non-profit sector, think tanks, private sector representatives and business associations influence the preparation of presidential programmes, sector-specific policies, as well as the development of policy reforms. There is an ‘institutionalised’ (not legally binding) approach to creating technical commissions with a range of actors to develop proposals for policies in specific areas or for particular issues that may arise.

Lately it has been difficult for governments to carry out their policy priorities and government agendas. Recent administrations have faced increasingly strong opposition in congress and from the public opinion, forcing them to abruptly modify and reorient their priorities. In fact, this was evident in Piñera’s last administration, when the protests of 2019 generated increasing tensions with Congress that ended in less cooperation weakening his image and capacity for political management. At the same time, the need for an institutional exit from the uprising made the President shift his priorities from civil reform, productivity, and job creation, among others, to pension reform and to reach an agreement for the constitutional process. Likewise, exogenous factors also led Piñera’s administration to fully focus on a response to the global health crisis.

Considering that the presidential term in Chile is four years, without immediate re-election, presidents do not have much time to carry out a wide-ranging transformational agenda across the different issues proposed by their government programmes. For this reason, they are forced to prioritise a limited set of themes to be the main initiatives to mark their term in office, if they want to have effective results in the short term.

BOTTLENECKS FOR DELIVERING QUALITY SERVICES AND PROGRAMMES AT DIFFERENT ADMINISTRATIVE LEVELS

After Uruguay, Chile has exhibited one of the best levels of government effectiveness and state capacity in the region. However, not only has the political capacity to generate and maintain strategic priorities deteriorated, as the current political situation has become polarized, but there has also been a loss of salient long-term horizon policies against issues that are pressing in the public square.
Moreover, another bottleneck that impacts the design, implementation, adaptation, and evaluation of government policies and programmes is the State’s centralised and regional neutral approach to policy planning and delivery,\(^{33}\) that has translated into planning and delivery processes led by national sectoral policies, rather than by regional needs and realities.\(^{34}\)

**PUBLIC SPENDING ISSUES**

Although a study from the Inter-American Development Bank estimated that Chile has the lowest levels of state technical inefficiency in the region, it is equivalent to 1.8% of the GDP for 2018.\(^{35}\) The inefficiencies are substantially lower than the average of 4.4% of the GDP for Latin America and the Caribbean, with Uruguay doubling the Chilean level, and Argentina with the highest level (7.2% of its GDP) (Figure 8). For Chile, the main inefficiencies are around leaks on social transfers (poorly allocated), followed by mismanagement in public purchases (Figure 8).

**FIGURE 8: ESTIMATIONS OF TECHNICAL INEFFICIENCIES: TARGET TRANSFERS, PUBLIC PURCHASES, AND EMPLOYMENT REMUNERATIONS**

Additionally, the inefficiencies in public spending are also notable in the disparities of performance across regions in Chile. The levels of spending of the allocated budget show a dispersion of almost 29% between regional governments with the highest and lowest budgetary expenditure accumulated for the last quarter of 2021.\(^{37}\) These results are linked to human capital challenges, civil service, and the institutional capacities at a local, provincial, and regional level to implement policies efficiently.

**ISSUES WITH TARGETED POPULATION AND PROGRAMME DESIGNS AND SUCCESS MEASURES**

Furthermore, the development of strategies, policies, programmes, and plans are dispersed across several institutions, and sometimes present issues related to duplication, coordination, and targeting that lead to low budgetary expenditure and poor impact. The DIPRES has monitoring instruments for public programmes, where consistency in the design aspects associated with their organisation and management, as well as the final outcomes and objectives are reviewed. The most recent monitoring of almost 700 government active programmes conducted with the support of the Undersecretariat for Social Evaluation (SES) showcased that multiple programmes were addressing similar targeted groups and/or set of issues, and in several cases, they did not have the expected impact and ended with ineffective spending.\(^{38}\) Similarly, almost 16% of 700 evaluated programmes presented deficient formulations of targeted indicators.\(^{39}\)
WEAK CIVIL SERVICE

There have been significant efforts to professionalise civil service and to discontinue – to a certain extent – the political appointment of what should be career officials. Since 2003, the government’s civil service department has been selecting candidates based on technical skills and experience through a competitive system (Alta Dirección Pública, ADP). Currently, the ADP has different modalities targeting more than 5,000 different positions in public administration in 567 public institutions, showing a substantial increase in its adoption since its creation.40

“Nevertheless, the changes in government in 2014 and 2018 showed that the selection of candidates through the ADP is only moderately institutionalized, as there is still an understanding that a successful candidate is a ‘government officer’ (executive) rather than a ‘state officer’ (administrative). The monitoring of bureaucratic activities and executive agencies, especially at the subnational level, tends to be distorted by this effect.”41 In 2017, several measures were taken to address some of these challenges, including passing a law to limit the levels of freedom to fire candidates, limit the nomination of temporary substitutes, along with the promotion of a databank for applicants to be considered in other positions, among other improvements. These modifications have shown important results in increasing the quality of the applicants to the system as well as strengthening selection through competencies.42

Nevertheless, some challenges in the civil service and the ADP system remain, such as contract termination for ‘loss of trust’ or ‘trust reasons’ from the administration and hiring cycles and years of performance in the role.43 At the same time, there is still high staff turnover from state and government officers, and changes even during the same administration – led by a minister or other authority leaving the post. Constant changes that also impact the permanence of state officers in technical positions, leading to issues in the performance and functioning of different divisions at every level.

All these issues have impacts on maintaining sustainable levels of institutional memory within public services. Likewise, it has added difficulties to policy continuity, not supporting a coordinated and harmonised manner within and among sectors for technical delivery. These have translated into moving far away from an effective civil service that should continue working independently of leadership changes.
HIGH VARIABILITY OF QUALITY AND POLICY PERFORMANCES ACROSS THE COUNTRY

Policy design and implementation performance, including choice of target beneficiaries and harmonisation of programmes, varies widely in the country. “Ranging from excellent in areas where benchmarks and oversight mechanisms are strictly enforced (i.e., the general government budget) to weak in less rigidly monitored areas (i.e., implementation of some sectoral reforms).” Likewise, low budgetary expenditure, delays in administrative proceedings combined with weak local development policies with a territorial focus – addressing the needs identified in the ERDs – limit talent attraction to an important number of regions in the country.

PRIORITIES FOR TRANSFORMATION

It is key to start a participatory strategic discussion to create a national consensus around a long-term growth strategy that is supported across the political and social spectrums to boost development in the entire territory for decades to come.

• Define in a consensual manner a few clear key strategic priorities and building blocks for the short-, medium-, and long-term growth model to increase productivity, growth, and innovation taking into consideration the country’s strengths, competitive advantages, and limitations.

• Integrated in a systematic way the ERD diagnosis and priorities into the national growth strategy to ensure that the national consensus includes bottom-up and top-down approaches for policies and investments tackling the underlying and subjacent causes impeding progress and transformation.

There is an urgent need for a mindset shift putting citizens, end-users and beneficiaries at the heart of service delivery and the strengthening of state capacity.

• Professionalise the civil service at national, regional, and local levels, clearly distinguishing state (administrative) officers from government (executive) officers to ensure continuity and quality. This will lead to increased capacities, allowing governments to implement their agendas while building institutional memory.

• Revision of the ADP system to ensure that selected administrative officers with good performance stay in the public sector, including the promotion of horizontal and vertical mobility in the system.

• Strengthen institutional coordination to increase harmonisation across programmes and policies in key strategic sectors, targeted groups, and administrative levels (central, regional and local).
39. DIPRES and SES, 17.
44. Klein, Zilla, and Thunert, ‘Sustainable Governance Indicators: Chile’.
BUILDING A COMPETITIVE AND INCLUSIVE ECONOMY

Credit: Vitalii Karas.

Fish market in Santiago de Chile.

Credit: Vitalii Karas.
Creating a Thriving Entrepreneurial Ecosystem

This chapter evaluates business and labour market regulations in Chile to better understand how they can be improved to promote a dynamic, competitive, and flexible environment to enable entrepreneurship and innovation. Likewise, it discusses the implications for the labour market and the country’s education system. It finds that to unlock the potential of Chilean enterprises it is necessary to ensure regulations that create a conducive environment for businesses. Similarly, coordination between public, private and academia is needed to encourage the right skills and human capital formation to deepen the entrepreneurial culture in the country. Additionally, it highlights the relevance of domestic market contestability, especially the extent of market dominance and local market competition, which are crucial to enhance consumer trust towards the private sector, and for the empowerment of entrepreneurs and civil society in Chile. The chapter concludes that the country needs to transition to a model that focuses on coordinated and integral solutions which will support national and international commerce for MSMEs.

THE ENTREPRENEURIAL ECOSYSTEM IN CHILE

In Chile, private companies are seen as primary engines of economic production, and hence, they are guaranteed all the necessary legal safeguards. Nevertheless, the Chilean business ecosystem is marked by two particular characteristics: high economic concentration in natural resources-based opportunities and strong business polarisation with a small number of large companies and a long tail of micro (62%) and small enterprises (30%). While, MSMEs represent 98% of the active enterprises in the country, they account for just 13% of sales participation and 44% of employment. On the contrary, large firms – 2% of total companies in Chile – share 87% of sales and provide 56% of the employment. Hence, market access, ability to compete, innovate, work and growth differ considerably for MSMEs and large companies.

Although the country ranks 39th out of 167 countries for its enterprise conditions, Chile is underperforming in areas such as labour market flexibility, burden of regulation and environment for business creation. According to several studies, MSMEs in Chile – besides the endogenous characteristics of the entrepreneurial ecosystem – face three major barriers: financing, human capital and rigid and complex regulations. These three elements represent the key bottlenecks for MSMEs to survive, grow, innovate and to economically thrive.

During the last decade, government efforts have prioritised national policies for entrepreneurship promotion, and this has eased the processes for business creation (Your Business in one Day in 2013). The government’s support offer to MSMEs is large but fragmented in 6 ministries (Economy, Agriculture, Social Development and Family, Foreign Affairs, Women and Gender Equity, and Labour) and over 20 public institutions. During the second term of Piñera’s administration, the Ministry of Economy launched a platform ‘Quiero Emprender’ (I want to become an entrepreneur) to consolidate in one place the public offer for MSMEs, as well as facilitate access to information for entrepreneurs in Chile. This platform has six areas of focus: 1) support and incentives to formalise businesses; 2) facilitate creating a business; 3) public support schemes for entrepreneurs; 4) digitalisation; 5) reorganisation and business restructuring to prevent bankruptcy; and 6) cooperatives and associativity.

Government has made efforts to create programmes to support MSMEs and to develop platforms for easy access to information. However, these public programmes and schemes continue to be government-driven rather than considering the actual needs of entrepreneurs and businesses. Hence, MSMEs are still concentrated in metropolitan areas, generate few employment opportunities, exhibit low levels of innovation, and have a short business life cycle. Although these initiatives and government support are valued – to some extent – by entrepreneurs and Chilean experts, issues related to timely access to finance, advisory services, accompanied by different
degrees of difficulty to easily access, understand, and interpret financial information and regulations persist.

**TABLE 1: THE CONDITIONS OF THE CHILEAN ENTREPRENEURIAL ECOSYSTEM**

<table>
<thead>
<tr>
<th>Chilean Experts’ Assessment 2021*</th>
<th>Chilean Experts’ Opinion 2021</th>
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<tbody>
<tr>
<td><strong>Best rated conditions</strong></td>
<td><strong>Worst rated conditions</strong></td>
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<tr>
<td>Physical infrastructure</td>
<td>Primary and secondary education</td>
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<tr>
<td>Cultural and social norms</td>
<td>R&amp;D transfer</td>
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<tr>
<td>Government programmes</td>
<td>Financial support</td>
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</tbody>
</table>

* Based on percentage of experts who agree condition contributes positively to the entrepreneurial ecosystem.

Source: Global Entrepreneurship Monitor - Chile, 2022

Chile is among the countries with the lowest informality in Latin America at 27%.

However, its level is well above other OECD countries with similar income per capita, such as Poland, where informality stands at only 20%.

In the informal sector, most are either self-employed or work in micro and small enterprises.

Importantly, in Chile, more micro-enterprises are informal than formal, with the informal sector comprising 1 million micro-enterprises, and the formal sector 952,000. MSMEs are more likely to be working in the shadow economy than larger businesses. Furthermore, labour informality is higher in the regions outside the Metropolitan Region, with 64% of informal active persons located in remote regions. Informality rates are particularly high in the regions of Tarapacá (41 %), La Araucanía (40 %), and Los Ríos (38 %), illustrating that informality is distributed very unequally throughout the country due to the concentration of economic opportunities.

Informality remains high among microenterprises mainly due to bureaucratic barriers to formalise their activities in the country, as most entrepreneurs need to navigate complex processes across several institutions, and request municipal permits, sanitary permits and file tax returns at the National Tax Office (Servicio de Impuestos Internos - SII). According to the President of a large association of entrepreneurs and businesses in Chile, one of the critical factors that discourage micro and small businesses to become formal are elements associated with tax issues. Although the incentives to formalise are clear for the entrepreneurs, the tax situation and the potential burden of not filing taxes on time, or filing with mistakes are the main factors keeping micro and small enterprises in the shadow economy.
ENVIRONMENT FOR BUSINESS CREATION

Chile has a strong private sector which has benefitted from an accommodating and supportive policy environment. The creation of the platform ‘Your Business in one day’ (registry and tax ID) has positively eased the process of starting a business. Although this made a significant difference in the initial time and cost of registering a business, there are several steps across different institutions that a business needs to comply with to legally start operating that business. Several permits, registrations and local patents need to be requested from registration to being fully operational and fulfilling all the regulatory requirements.

Chile has gone through substantial transformations in the last two decades in the ease of starting a business, with the time, costs, and paperwork required dropping significantly. The time required decreased from 37 days in 2010 to 8 days in 2012 and 4 days in 2019. The Chilean performance is 5 times better than the world average, at 20 days in 2019. Similarly, the cost of procedures to start a business passed from 9.2% of GNI per capita in 2009 to 2.7% in 2019, compared to 19.8% world average. The number of procedures required to start a business has also seen a decline from 9 in 2009 to 6 in 2019. The use of ICT can be seen as one of the factors, leading to improvement, as in Chile a virtual one-stop shop allows the creation of business in one day, with a single step, minimal red tape and at zero cost.

However, separate processes are needed for the registration of a business, municipal patents, sanitary and building permits (if applicable), among others, making the process difficult to navigate and costly. According to a study by the National Productivity Commission (CNP) the average time between an MSME registering a new business at the tax office (SII) and obtaining the municipal operating authorisation is 223 days, varying significantly in relation to the company’s size. On average for microenterprises, it can go from 6 to 7 months, while for small and medium enterprises, it takes between 1 to 1.5 years, respectively.

Due to this long and complex process, the level of compliance with all the regulations varies across sectors too. The percentage of companies that registered their business in the tax administration office (SII) and finally obtained authorisation to operate by the respective municipality – where the enterprise is registered – is just 13% for microenterprises, 18% for small, above 30% for medium ones, and 90% for large companies.
Burden of Regulation (61st)

While the country has advanced significantly to remove the barriers to starting a business, regulatory burdens are not just making it difficult to run and grow a business, but also disincentivizing formalisation. Making sure that the private sector in Chile, especially MSMEs, is free of burdens will reduce the cost and difficulty of being an entrepreneur.33

The time, resources, and effort necessary to understand, fill, process, and comply with the regulations – regardless of whether labour, environmental or locally-related – are not proportional to the size and capabilities of companies. Such complexities make regulation compliance relatively more costly for MSMEs.34

An overly strict regulatory environment is one of the substantial barriers faced by MSMEs in Chile. The amount of time and money needed to comply with regulations is respectively greater for MSMEs than for larger firms.35 Consequently, that discourages scaling up.

Chile’s National Productivity Commission has reported that the regulatory system is characterised by low efficiency in the permitting process and a low degree of legal certainty.36 The low efficiency is caused by the lack of coordination between agencies – central, regional, and local – and the low use of technologies for tracking, resulting in long processing times.37 Furthermore, rules are inconsistent across governmental and legal entities, and there are areas of contradiction around the jurisdiction of different agencies.38 Hence, the limited legal certainty also limits the predictability with regards to permits, and the possibility of them being revoked.39 For example, the time to obtain permits is high – for a warehouse building permit, it stands at 195 days as opposed to 154 days of the world average.40

![FIGURE 9: BURDEN OF GOVERNMENT REGULATION](source: WEF)

Chile’s burden of government regulation is at the same level as the world’s average, but substantially worse than countries that are driving innovation through start-ups and digitalisation (Estonia and Israel) and service export leaders such as Singapore. Likewise, Chile has a lower performance than New Zealand and Malaysia, two of the nations that are part of the TPP-11 agreement.
GOVERNMENT EFFORTS

To ease the burden of regulation, Chile has been using ICT to help citizens and businesses easily access the information around the current legal framework and the requirements needed to obtain licences and comply with formalities, as well as accessing simplified platforms for some regulatory compliance.\(^4\) For example, an electronic invoicing system allows business taxpayers to issue and receive invoices that are immediately available to the revenue body, and provides free, simplified, and complete accounting system.\(^4\) Additionally, programmes such as ‘Chile sin Papeleo’ (Chile without Red Tape), ‘Citizens’ Office’ and ‘Escritorio Empresa’ (Business Desk) help reduce burdens and time needed to comply with government requirements.\(^4\) Over the years, the number of tax payments for businesses has been low and stable – 7 as compared to 23 world average in 2019.\(^4\) Yet, total tax and contribution rate has been increasing in the last decade, from 24.8% of profit in 2009 to 32% in 2019 (compared to 40.4% world average).\(^4\)

Moreover, the government has made other important improvements to its regulatory management tools\(^4\) in order to decrease the burden on MSMEs. For example, Presidential Instructive No. 3/2019 broadened the requirement to conduct regulatory impact assessments (RIA).\(^4\) It established a threshold for RIAs, as well as made it mandatory to consider alternative non-regulatory options and ‘assess the potential impact that proposed regulations might have on competition, small businesses, trade, environment, gender equality and other relevant factors, as well as likely distributional effects.’\(^4\)

Despite all these efforts, significant challenges remain, especially related to the time needed to comply with government regulations and obtain permits for operations as well as for relevant infrastructure.

PRIORITIES FOR TRANSFORMATION FOR A STRONG ENTREPRENEURIAL BUSINESS ENVIRONMENT

The political elite needs to prioritise building a thriving entrepreneurial ecosystem that spreads and boosts economic opportunities in the entire country. This effort can translate into reducing geographical inequalities and enhancing competition through strong MSMEs.

- Simplify and harmonise the steps, processes and requirements to start, run and legally operate MSMEs – including addressing the differences in prerequisites and processing time at a local level.
- Ease the regulatory constraints that are disincentivising business formalisation, as well as hindering growth and opportunities for MSMEs in the country.
- Establish entrepreneurship champions within governments (central, regional and local) to play a coordinator and facilitator role for a coordinated and comprehensive programmatic offer for MSMEs.
- Raise awareness through public campaigns about entrepreneurial platforms, programmes and business centres.
- Strengthen the collaboration and inclusion of different institutions, including municipalities and critical services in the Business in one Day platform, and its new sub-sections.
- Create specific programmes to support micro and small enterprises with tax, legal, labour, and social protection regulations advisory services.
Labour Market Flexibility (108th out of 167)

Chile ranks 25th out of 41 in the Employment Flexibility Index 2020 which looks at the EU and OECD countries. Importantly, labour market flexibility has stagnated in the Legatum Prosperity Index for the last 10 years. The country’s labour market is characterised by high levels of labour turnover and low average duration in a job (around 40 months). Likewise, while comparing with the median of OECD countries, there is a rapid transition between jobs in Chile. These characteristics combined with the nature of industries and clustered economic opportunities create challenging conditions to have adequate labour arrangements that are flexible while complying with national regulations. The regime and the regulations established in the Labour Code hinder flexibility for employers to hire and limit the opportunities to design flexible arrangements and split shifts. In fact, the code establishes a minimum limit on the distribution of ordinary working hours.

The country has different types of labour contracts, which have contributed to labour market segmentation. Likewise, sector-specific needs and seasonality of some industries explain that 25% of the private sector’s salaried workers are on temporary contracts. In Chile, it is allowed to terminate contracts due to redundancy if the third party is given a month’s notice. Additionally, severance pay due to redundancy is one of the highest among the countries in the Index, at 23.1 weeks, as opposed to 4.3 in countries like Estonia.

Regulations also generate some disincentives for more flexible contract arrangements, as “the cost of hiring a part-time worker for Chilean firms is proportionally higher than that of hiring a full-time worker in terms of both fixed and variable costs, affecting the demand of this type of employee.” In fact, this is one contributor to the gender gap in the labour market, with only 59% of working-age women participating in the labour market in 2019, compared to 79% of male participation rate. Women – as caregivers – often look for more flexible arrangements in the labour market, but the offer of part-time jobs is limited by the cost of hiring associated with it. Indeed, some of the most pressing barriers for higher female participation in the Chilean labour market are related to rigid hours, low degrees of flexibility, along with prohibitive childcare and elderly care costs.
Moreover, the issues around labour market flexibility in Chile focus on the high hiring costs and firing costs by international standards, relatively low-skill labour force, and low labour market participation. Additionally, another important challenge for MSMEs is the rigidity of working hours that are centred on weekly hours (45 hours), limiting extra hours and shift systems. This generates incentives to create alternative arrangements. In Chile, there are numerous non-regular work arrangements, such as cycles of temporary work contracts, the informal sector or work through commercial arrangements.

In 2022, the government submitted a labour reform to Congress reducing weekly hours from 45 to 40, and it is being discussed in the Senate. The proposal also includes a 4-day work week – when applicable – allowing for working 10 hours a day 4 days a week, as well as defining the exemptions. Different MSMEs and business associations have highlighted that government labour reform will hinder businesses, unless the changes are gradual, include government support, as well as acknowledging the differences across industries and sectors. Hence, the discussions and final approach to labour reform need to have MSMEs’ productivity, sustainability and growth, including a focus on part-time work and flexible arrangements.

Among OECD countries, Chile has one of the lowest levels of public spending devoted to active labour-market policies. Hence, the dynamism, development of human capital and building a strong and competitive labour market tend to be left to the private sector, with the government not playing a proactive role in enabling a stronger current and future labour market.

**PRIORITIES FOR TRANSFORMATION**

*Chile needs to advance towards a more flexible labour market. This will not happen if discussions only centre on the minimums and maximum of ordinary working hours, rather than focusing on enhancing an entrepreneurial business environment in Chile.*

- Review labour regulations and employment contracts to offer industry and MSMEs pertinent instruments (i.e., lighter-touch contracts for sectors currently dominated by the informal economy; part-time contracts).
- Create a more conducive environment for females to come back to the workplace, including flexible work conditions, hybrid modalities and extension of childcare and elderly care support.
Labour Skills as a Business Constraint (153rd)

The most critical challenges for starting a business, running it or expanding it in Chile are related to human capital, particularly with the adequate availability of a workforce with qualifications and skill levels across different industries and sectors, as well as in the regions where enterprises are operating. In fact, “widespread shortcomings in skills undermine the capacity of Chilean firms to innovate and thus reduce the productivity of the economy”. 67

Although Chile has made significant progress in education access, coverage and quality, the skill levels among its population remain low and/or do not match labour market needs.68 In the country, more than 7 out of 10 jobs facing skill shortage are in occupations requiring medium skills.69 Meanwhile, only 19% of jobs that are hard to fill are in high-skilled occupations – lower than in most OECD countries.70 Real estate, and transportation and storage are among the sectors facing the greatest skill shortage.71 On the other hand, Chile faces surpluses in most knowledge areas where other OECD countries experience shortages.72 Particularly, the main surpluses are in Agriculture, Forestry and Fishing and Arts, Entertainment and Recreation.73

According to an assessment by the OECD the country is facing significant gaps between acquired skills and those in demand in the labour market, as “the share of adults who achieve high levels of proficiency in literacy, numeracy, and problem-solving in technology-rich environments is relatively low”.74 Indeed, the country – among OECD nations – has one of the greatest mismatches between educational level, skills, and area of study. One out of three workers are employed in a position that requires a different skill set than the ones that they have, while half of them are working in a different field of work than the one they studied for.75 Overall, almost half of the workers in Chile are either over- or underqualified for the work that they are doing.76

The country faces four broad categories of bottlenecks that are leading to a labour market characterised by a mismatch in the current demand and supply of labour skills.

1. Absence of a functional system for competency development. A study from the National Commission of Productivity focused on workplace training concluded that there is a fragmented set of public institutions involved in workplace training that are not able to anticipate – and adapt to offer – the skills required by the labour market.77 At the same time, public and private training centres and systems are not equipped to cope with the increasing and changing demands around digital skills.78 In fact, “Assessments of Chile’s nonformal, publicly funded training programmes have concluded that these are ineffective in skilling workers for jobs and are poorly targeted at those who need them most”.79

2. Unequal quality and substantial rigidity of the educational system. The incremental access to secondary and higher education has not been enough to appropriately cover labour market demands.80 Intrinsic characteristics in the design, access, offer and structure of the educational systems in Chile have created challenges to adequately prepare students with the skill set for current and future labour needs.

3. Concentration of educational institutions in the same areas as specific job clusters, especially finance and the banking industry. There are persistent regional disparities in the offer and quality of workplace training as well as vocational training centres, professional institutes, and universities. Of the nation’s 54 universities, 37 have their headquarters in just three regions (Metropolitana, Valparaiso, and Bio Bio). Furthermore, according to the 2023 QS World University Ranking, nine of the top ten institutions in Chile are in these regions too. This polarisation contributes to the further concentration of labour opportunities in specific areas of the country, while smaller regions are becoming less attractive for studying and living. This has led to significant differences in education quality and the competitiveness of the sector.81
4. **Low levels of investment in research and development (R&D).** Chile has one of the lowest investments in research and development among OECD countries. Similarly, R&D expenditure in Chile, at 0.3% of GDP, is substantially below the world average (above 2%), including Argentina (0.5%) and Costa Rica (0.4%) for 2019 (Figure 10). This reality also impacts educational institutions and their role in the development of a strong-knowledge and innovation-based economy. Likewise, the attraction and retention of high-skilled workers for further development of sophisticated industries in the country will continue to be a challenge.

![Figure 10: Research and Development Expenditure as % of GDP](source: World Bank)

Equitable education system can lead to increased productivity, lower dependency on public aid, and increased interpersonal trust. In turn, high levels of institutional and interpersonal trust generate higher economic prosperity. Additionally, increased trust "predicts higher levels of political efficiency, greater participation in volunteering activities, and better health." Education plays a critical role in the development of societies and in promoting prosperity for all. Although the quality of education has been a long-term priority in the country and several reforms have passed, Chile has been unable to achieve quality education for all (Box 3). Additionally, these efforts have not translated into further progress and higher levels of learning and skills.

Primary school enrolment and completion has become almost universal, and gross tertiary school enrolment nearly doubled from 49% in 2005 to 93% in 2019. While Chile has one of the highest shares of participation in tertiary education in the OECD, proficiency is one of the lowest among OECD countries. Furthermore, "only 30% of public school pupils score high enough to enrol in University, whereas 43.5% and 79% of pupils from subsidised and unsubsidised schools respectively achieve the required scores," maintaining concerns about the differences in educational quality between public and private education systems. Therefore, it could be said that inequality in Chile begins at a very young age – with education – and carries into adult life, in that way creating further unequal economic outcomes. Without equitable education, Chile cannot achieve prosperity for all.
BOX 3: MAIN EDUCATIONAL REFORMS IN CHILE AND SOME LESSONS FROM LITHUANIA

For decades the Chilean educational system led to some degrees of socioeconomic segregation and inequity as systemic effects of school choices. Hence, several educational reforms focused on decreasing gaps around removing barriers to equitable access and improving quality.

During the 1980’s under the dictatorship of Pinochet, education was privatised via the universal educational voucher system, creating fee-based subsidised private schools in addition to the existing free public schools and non-subsidised private schools with tuition fees. The administration of public schools was decentralised and transferred to the municipalities. Some argued that privatisation gave parents the option to choose the best schools and hence led to competition for enrolment, subsequently improving the quality of schools. However, school choice was illusory, for these options were only available to families who could afford fees or tuition and for students who could pass the private schools’ admission tests, “leaving underfunded public schools as the only option for impoverished Chilean families”.

Main Educational Reforms

Educational reforms to improve quality and equity of the country’s educational system: Since 2005 Chile has undertaken wide-ranging reforms to improve early childhood education and care (ECEC), student selection and admission processes, public school governance and funding, teacher career pathways, vocational education and training (VET), and tertiary education.

Preferential School Subsidy Law to improve student achievement and reduce income-based gaps: In 2008 the Chilean Government passed the Preferential School Subsidy Law (SEP) aimed at improving student achievement – especially in schools with high concentrations of low-income students – and reducing income-based gaps. SEP increased subsidy (voucher) by 50% for “priority students” from families in the bottom 40% of the income distribution (and later 50%). Additionally, priority students would not need to pay fees and private schools could not reject them due to academic grounds. As a result of the increased choice, funding and accountability, the gap in academic achievements between the highest and lowest socioeconomic percentiles narrowed between 2005 and 2012.

Elimination of student selection in the school admission process and additional fees: An Inclusion Law passed in 2016 increased the number of “priority students” by 20% and eliminated selection processes in admission to state-funded private schools based on social, economic and academic background. It also required these establishments to become non-profit entities by 2018 and prohibited additional school fees.

Tuition-Free higher education policy for 60% of lowest-income students: A second equalising legislation, known as “Gratuidad”, was passed in 2016. It extended funding to include tuition-free tertiary education for the lowest 60% of the income distribution in private and public higher education institutions (technical, vocational and universities) that participate in this policy and meet accreditation requirements.

Creation of new regional agencies to administrate public schools: Under the New Public Education Law, passed in 2017, the municipally-run public education system comes full circle, returning to the purview of the Ministry of Education under newly-created local education agencies looking to improve the school’s quality and its access to public funds.
The Case of Lithuania

While trying to improve its educational system, Chile should look at countries with a similar development path that were able to increase equality and the quality of their education. Relevant lessons from Lithuania come from Early Childhood Education and Care (ECEC). As investing in ECEC generates many benefits for the future, in the form of social and financial capital, well-being, employability and higher levels of education. All children gain from high-quality ECEC, but disadvantaged children have fewer social skills and abilities, so the greatest potential to benefit from it. Additionally, studies have shown that high-quality ECEC brings social benefits to individuals which spill over into society, translating into safer surroundings and raising the benefit/cost ratio of investment in ECEC. And also positively impacts labour force participation, especially among working mothers, by providing a safe and stimulating environment for young children.

Lessons for Chile to consider

- **Preschool quality assessment**: To assess educational quality, preschools conduct an internal quality audit, under the guidance of the Ministry of Education and Science (MoES), and municipalities undertake comprehensive inspections to guarantee external quality assurance.

- **Boosting rural participation in education and ECEC facilities**: the Baltic State has opened multi-functional centres in rural areas to increase the supply of ECEC facilities, has made dedicated public transportation available to some rural families, and has made information on the importance of ECEC available to parents through a website intended to encourage parents to enrol their children in ECEC. Consequently, the number of kindergartens has been increasing over the years.
PRIORITIES FOR TRANSFORMATION

To improve labour market productivity, inclusivity and flexibility, education will be essential. The OECD has shown that education can foster stronger economic, democratic and social development. Boosting productivity by improving human capital and competencies in Chile is fundamental to advance towards an inclusive economy, where everyone that wants to be part of an entrepreneurial country, can start with similar educational foundations. For MSMEs to create, grow and innovate it is necessary for a transformation of the Chilean educational system and a strong alliance between the public and private sectors, and academia. Indeed, for Chile to maintain its competitive advantages and to expand its opportunities, it is critical that the educational system –from ECEC to tertiary education– start to build together the right skills and capabilities for generations to come.

To reach meaningful results in Chile, the public and private sectors need to work together with academia. This is the only way the country will adequately invest and prepare the human capital needed to tackle long-lasting productivity challenges. Indeed, the education sector – in collaboration with key stakeholders – needs to transform the system to be aligned with current and future labour market necessities.

- Create a long-term vision for the education sector that is aligned with the country’s vision for the future.
- Shift VET and university programmes to be more labour-market oriented – so that young workers are prepared for the labour market.
- Enhance cooperation, coordination and alliances between higher education institutions and the private sector to foster adequate labour skills, employability and opportunities for labour insertion to students.
- Create and extend incentives for the private sector to increase investment in research and development while working with local and national vocational training centres, professional institutes and universities.
- Target the educational programmes by macrozones and according to regional competitive advantages, rather than a broad set of programmes that are not necessarily linked with the industries and regional needs.
- Generate incentives and aggressive plans to promote entrepreneurship in regions and cities with a limited access to services, as well as commercial and educational offers.
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Enabling a Competitive Investment Environment

This chapter focuses on the conditions needed to foster an enabling environment that supports domestic and foreign investments. In addition to considering the regulatory constraints on international investment, it also reviews the extent to which Chile can attract and protect quality investments by guaranteeing property rights and contract enforcement. As these elements play a crucial role in underpinning innovation, enterprise development and further expansion of the export of goods and services from MSMEs.

Chile’s economic growth is highly connected with capital deepening and Foreign Direct Investments (FDI) plays a critical role in the country’s development. Chile is recognised as creating a safe, stable, open, and attractive environment for domestic and foreign investors. Since the 1990s – due to an aggressive strategy to liberalise trade and investment – Chile has become an attractive place for foreign investors. In recent decades it has become one of the leading countries in the region in terms of investment attraction, and currently ranks 33rd out of 167 countries in the investment environment in the 2021 Legatum Prosperity Index. The country’s policies are based on the principle of capital transparency and non-discrimination between domestic and foreign investors, creating an attractive environment to invest and reinvest profits.

Its richness in natural resources, accompanied by macroeconomic stability, its legal certainty, low-risk levels and high-quality infrastructure have been some of the strengths that allowed the country to attract extensive flows of FDI. Although the country has created solid conditions for investment, two critical points are hindering its growth and further potential. Firstly, some regulations and lengthy processes for permitting are generating some disincentives for investors, as more countries in the region are offering opportunities for investments. Secondly, increasing levels of insecurity and regulatory uncertainty due to the constitutional debate are impacting the country’s image. The October 2019 social uprising and the constitutional process have led to high levels of uncertainty about the country’s path, leading investors to rethink their projects and investments in the country.

BOX 4: FDI IN CHILE

FDI plays an important role in the economic growth of Chile. In 2019, the inward stock of FDI amounted to over 90% of GDP, compared with 50% and over 59% for Australia and Canada, respectively. However, FDI is still highly concentrated in natural resources, specifically in the mining and financial sectors, representing over 40% and 27% respectively.

Although COVID-19 has had negative impacts on the inflow and outflow of FDI in emerging markets, the results from 2021 showed a significant recovery of FDI, especially in developed economies “with an estimated 199% growth, whereas developing economies only project 30% growth.” In 2021, Chile experienced a 66% increase over the 2020 investments flow, with an accumulated net inflow of more than US$15 billion, and a 19% higher inflow than 2019. The most important component in the 2021 annual FDI flow was equity capital shares, with US$12.64 billion (83% of the total), followed by profit reinvestment, with US$1.54 billion. Finally, debt instruments were recorded at US$1.07 billion. All components presented positive numbers.”
Although FDI levels are showing a positive trend, uncertainties have impacted the investment ecosystem, the country’s image, and its risk levels. Factors that led to a downgrading of the Government’s rating as a long-term local and foreign currency issuer to A2 from A1. As a result, Chile’s position seems weaker and less attractive in comparison to other markets in the region. For example, Uruguay is a country that offers political, social, and economic stability with clear and guaranteed rules of the game, and is currently becoming more and more attractive to Chilean investors.

**Restrictions on International Investment (40th)**

There are almost no limits on foreign investments and no differentiation from local ones. Foreign investors and private companies can participate in any productive activity in the country, and the capital of the company can be up to 100% foreign. The only restrictions on foreign ownership are in the domestic maritime freight industry, where foreign ownership of companies is capped at 49 per cent. For national security reasons the country also imposes restrictions on foreign ownership in areas such as nuclear energy, hydrocarbons, defence, and mining.

Likewise, as part of the Chilean growth model, the country has encouraged foreign investment, as well as facilitated the investment of Chilean companies abroad. Currently, the country has 31 Agreements for the promotion and protection of investments (APPI), designed to protect the investments once these have been materialised in the territory of the respective signatory country. Likewise, Chile has negotiated two International Investment Agreements – with Hong Kong and Uruguay – that establish commitments to liberalise and protect foreign investment. Additionally, the country has 11 investment chapters included in its current free trade agreements (FTA) that focus on investment liberalisation, allowing the flow of capital, high protection standards and dispute mechanisms. Furthermore, the country has passed national legislation that regulate and provide a framework for foreign investment, such as Law 20,848 of 2015 which establishes the principles for FDI. All the regulations and agreements are based on the principles of economic freedom, non-discretionary procedures and without arbitrary discrimination.

“Chilean law allows the government to grant concession rights and lease agreements to individuals and companies for exploration and exploitation activities, and to assign contracts to private
investors, without discrimination against foreign investors". These conditions are particularly relevant for mining investments, but they have not been a real impediment for attracting substantial investments in exploration and exploitation projects in the sector. Nevertheless, there are some permit and regulatory problems. According to the latest U.S. Environment Climate report for Chile "environmental permitting processes, indigenous consultation requirements, and cumbersome court proceedings have made large project approvals increasingly time consuming and unpredictable, especially in cases with political sensitivities".

Some could argue that the delays are necessary to ensure environmental protection, the participation of civil society and the due process of the Chilean environmental institutions. In fact, Chile has made significant progress in environmental regulations to guarantee the constitutional right to live in a pollution-free environment. Likewise, Chile is the only country among the main mining nations – Peru, Argentina, Mexico, United States, Canada, and Australia – with a separate jurisdiction specialised in environmental matters ‘Tribunales Ambientales’ (TA), limiting the involvement of the executive on the judicialization and conflict resolution of environmental cases.

Noteworthy, the problem is not with the requirements or the existence of this environmental governance but rather with challenges associated with the implementation of the current country’s regulations – including the compliance with the indigenous consultations under the ILO convention 169 on indigenous and tribal people – and the resources needed for specialised authorities to comply with their work.

GOVERNMENTAL EFFORTS TO ENHANCE INVESTMENT ENVIRONMENT

During the last decade, the government has made efforts to simplify investment procedures, including the facilitation of processes to register a business and online registration of closed companies. In 2016, the government launched a dedicated Foreign Investment Promotion Agency ‘InvestChile’. This entity has focused on facilitating the attraction and establishment of investors in Chile. Since then, the agency has started to position the country’s different key industries and sectors with the highest competitive advantages and business opportunities including green energy, global services, venture capital, mining, food industry, tourism, and infrastructure. Lately, the promotion and potential in other areas have further expanded the levels of investment in sectors such as energy, telecommunications, chemical manufacturing and wholesale trade.

In September 2022, due to the negative economic forecast for Chile in 2023 together with national and international factors hindering investment, the government launched a new investment plan called ‘Plan invirtamos en Chile’ (Box 5). It consists of a package of measures framed on six key objectives with the aim of increasing investment by 5% during 2023.

BOX 5: PLAN INVIRTAMOS EN CHILE

Package of 28 measures to increase investment during 2023 under 6 strategic lines:

1. Tax incentives for private investment
2. Improve access to finance
3. Improve public investment in infrastructure
4. Promote Foreign investments
5. Improve the effectiveness of procedures in regulations and permits
6. Public-Private Partnerships for investment
**PRIORITIES FOR TRANSFORMATION TO FACILITATE FOREIGN INVESTMENT**

- Simplify and rationalise processes and the roles of institutions in the investment lifecycle to ensure proper coordination, and reduce burdens and inefficiencies.

- Reduce burdens for the compliance of environmental regulation by harmonising and integrating environmental permitting processes and criteria, as well as ensuring appropriate resources for specialised authorities to fulfil their work.

- Clarify and institutionalise the criteria and requirements for the compliance of the indigenous consultation under the 169 ILO convention.
Property Rights (39th)

Property rights and private property are embedded in the current constitution as a key principle. The definition of these rights and the regulation of the acquisition of property are designed to allow for a dynamic and open economy.

Property rights have been at the centre of the constitutional debate, generating different interpretations and approaches about how such rights will be ensured and protected in the new text. Particular attention has been put to expropriation of private property and its compensation, along with the ownership and inheritance of pension funds. Other critical points of the debate have been associated with the ownership and access to water rights and the exploitation of natural resources.

Although the topic has been controversial, in an opinion poll carried out in January 2022, 84% of the people surveyed agreed that property rights should be recognised as a fundamental right in the new constitutional text. This poll confirms that “respect for private property is a widely shared social and cultural norm”.

In Chile the steps, time and costs involved in registering a property are relatively low compared to other countries in the region and globally. The International Property Right Index (IPRI) shows that Chile leads in the region ranking 33rd out of 129 countries. The main challenge seems related to the procedures for registering a property, where it ranks 63 out of 190. Issue particularly related to the structure of property registrars – ‘Conservadores de Bienes Raices’ – private entities in charge of registering properties. In fact, a study by the National Economic Prosecutor Office (FNE) concluded that although the registry system has played a relevant role in providing legal security in the country, it is outdated, its cost is high, and it is inefficient. In the same line, the study shows that the system has important inefficiencies, sub-optimal resource allocations and its configuration leads to monopoly rents and high indirect costs.

PRIORITIES FOR TRANSFORMATION OF PROPERTY RIGHTS

- Review and reform the registry system to enhance competition and address inefficiencies.
- Improve the transparency and accessibility of registration processes through the establishment of a coordinated and digitalised registry system.
Contract Enforcement (48th)

Contract enforcement continues to be a challenge in Chile, and it has not seen a significant overall improvement over time. Access to justice and legal assistance in the country continues to be highly tied to the financial position of businesses involved in commercial disputes. Regulations and the quality of the judicial processes have not evolved at the same pace as the increasingly sophisticated and diverse Chilean economy.

In Chile, the time taken to resolve a commercial dispute through a legal procedure is relatively short compared to countries in the region and even when compared to the average of OECD countries. As shown in the World Bank Doing Business 2020 report, in Chile it takes around 519 days to resolve a commercial dispute, while in the OECD countries it takes on average about 590 days. Meanwhile, in other countries in the region such as Brazil or Argentina, the average number of days is even higher, reaching 995 days in the latest. However, it still takes four times longer than in Singapore, the best performing country in this issue (120 days).

On the contrary, when we take into consideration the cost of enforcement – in percentage of the claimed value – the reality is different. In the case of Chile, the average cost is above 25% of the claim – a higher cost than in Argentina (22.5%), Brazil (22%) and the average in the OECD countries (21.5%). Despite that, all of them take significantly longer time to come to a resolution of a dispute. As shown in the graph below, the costs for enforcing contracts in Chile are lower in Paraguay (30%) and Peru (41.2%).

Although contract enforcement and resolution of commercial disputes are key mandates of the Civil Courts, their main function is debt collection. During 2020, over 82% of the admitted cases in the courts were related to debt collection, while just around 5% were cases of contract enforcement, particularly due to challenges in access to justice and the opportunity costs involved for MSMEs to enter a long and costly legal process that does not necessarily guarantee a successful outcome. All these elements generate disincentives to take legal action involving high court and legal fees, along with limited access to the judicial system, and poor quality of the judicial processes.

The government passed minor reforms that have, to a certain degree, improved contract enforcement by allowing plaintiffs to file the initial complaint electronically. However, challenges in accessing justice due to the costs and time involved to proceed with the claims have made it difficult for MSMEs to fully take advantage of the legal frameworks established in the commercial code. Moreover, there are no systems in place that support and guarantee the access to judicial remedies for MSMEs, and that allow them to have clear lines to ensure contract enforcement and rapid, cost-effective and accessible commercial dispute resolution.

Today, access to justice for MSMEs’ commercial disputes and contract enforcement is limited, as the burden of the processes and the cost are unreachable. This is particularly relevant for the costs of the process – notifications, court official receivers, newspaper publications and testimonies from witnesses – and later the debt collection. This situation limits MSMEs’ decision to go to court to enforce a contract, generating even further gaps around access to justice.
PRIORITIES FOR TRANSFORMATION FOR CONTRACT ENFORCEMENT

Enhance the capacity of civil courts to efficiently determine commercial and contractual disputes by modernising procedures that reflect the entrepreneurial ecosystem reality.

- Pursue a modernisation of the civil court system to improve its efficiency, focus, structure, and proceedings.
- Review the role, effectiveness and cost of judicial contract enforcement, as today is prohibitive for MSMEs. Easing the burden for MSMEs to access justice.
- Create special units for commercial and debt collection, freeing civil courts’ capacity to facilitate access to justice and ensure contract enforcement for MSMEs. These will contribute to levelling the playing field for companies and entrepreneurs.
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Lead partner in tax law firm in Chile.
BUILDING A COMPETITIVE AND INCLUSIVE ECONOMY

Skyline of Santiago de Chile at financial district in Las Condes.
Credit: Jose Luis Stephens.
Ensuring Broad-Based Finance

This chapter reviews the financial system in Chile and how conducive it is for business development. A sound financial system underpins prosperity, as it allows an efficient flow of funds toward their most productive uses, helping generate jobs and improve productivity. Capital markets help finance infrastructure and manage unforeseeable risk, as well as help governments raise investment capital. Access to finance in Chile is a critical factor to allow entrepreneurs to grow, invest, innovate, risk new business ventures and to be at the front edge of a thriving MSMEs environment.

On the contrary, limited access to financing sources can lead to low levels of innovation, limited business growth potential and to high exposure to insolvency for companies in difficult circumstances. The chapter concludes that although the financing ecosystem in Chile is quite diverse and large, important challenges remain for MSMEs and new ventures. Hence, a critical factor to unlock MSME’s potential is providing timely access to financing opportunities and financial products.

Chile has a mature but conservative financing ecosystem that is highly interconnected among bank and non-bank actors. The system is characterised by a large domestic non-bank financial sector (pension funds, mutual funds, and insurers) combined with a strong but concentrated bank sector. Overall, the ecosystem is well-regulated and capitalised. These conditions, combined with well-coordinated monetary and fiscal policy measures, allowed the country to ease the impact of COVID-19 and the associated financial crisis. Notwithstanding the international situation – especially spillovers from the Ukrainian war – and inflationary pressure due to internal and external conditions, “the financial sector remains resilient, and banks have adequate profitability, capital and liquidity.”

The country faces challenges around the business climate for MSMEs versus large companies. Particularly, as the Chilean financial ecosystem is conservative and provides limited access to capital for MSMEs.

FINANCE INDUSTRY STRUCTURE

Chile’s financial ecosystem is large but characterised by a highly concentrated financial sector. The market for financial services is quite diverse, passing from being dominated by traditional banking four decades ago, to now encompassing several non-banking participants, including the Pension Funds (AFPs), the General Fund Administrators, insurance companies, savings and credit cooperatives and other players.

The most important participants are commercial banks, composed of 18 national and international banks, along with one State-owned bank. Of the 18 banks, 6 account for over 88% of the total banking sector assets, and the largest held 18% of the assets as of mid-2021. By mid-2021 the relative size of the financial system’s assets was more than double the country’s GDP, led by the banks (141% of GDP). All banking institutions operate under the same legal framework, including the state-owned bank, Banco Estado. The role of the latest is to “provide banking and financial services to promote the development of national economic activities”.

The second most important group is a large and mature domestic non-banking sector. The AFPs represent 63% of the size of the financial system assets, followed by life insurance companies (22%) and mutual funds. This sector is particularly relevant for Chile, as it represents a large investor base for domestic debt securities. Additionally, the saving and credit cooperatives play a key role as well. Entities that provide financial services to a particular segment of the population (7%), notably females, elderly people, and residents in the metropolitan area. In 2019, there were approximately 43 cooperatives with active operations, with 7 of them concentrating over 90% of credits from the sector.
The banking sector and the financial ecosystem are healthy and are monitored by the Commission for the financial market (Comisión para el Mercado Financiero – CMF). Over the years the Chilean financial ecosystem, along with its regulators, has become more solid and resilient to external shocks. The lessons learned from the 1986 crisis, followed by the Asian crisis, the subprime crisis, and the global financial crisis along with the country’s history have shaped the reforms to the banking system regulations. These have translated into a responsive and proactive regulatory framework to ensure a strong financial ecosystem that is prepared for external shocks, the characteristics of the Chilean economy and the relevance of attracting investments.

The latest major reform was in 2019, with the promulgation of the new general law for banks, initiating a new phase in the modernisation of banking regulations based on new international standards regarding supervision and regulations after the global financial crisis. This new law introduced modifications leading to the modernisation in three fundamental areas: 1) supervisory mechanisms and body; 2) standards of bank solvency; and 3) administration of critical situations.

Currently, the country’s financial ecosystem is under a new significant change with the recently approved fintech and new open-banking law aimed at promoting financial inclusion, through innovation and technology, in the provision of financial services. Once the new open banking law – passed by the Senate in October 2022 – is ratified by President Gabriel Boric, and it is published, the CMF will also have the mandate to monitor fintech operations in the country.
FINANCIAL INCLUSION

Chile has achieved important levels of financial inclusion, considering its level of economic development. According to Accenture, by 2020 around 97% of the Chilean population had at least one financial product. This penetration can be explained by the increasing number of people that have a bank account, due in large part to the creation of Cuenta Rut – a simplified demand account issued by Banco Estado – as well as access to prepaid cards issued by banks and non-banks, and retail membership cards that are associated with financial institutions. Nevertheless, some differences appear when considering access to specific products and financial services, where Chile is still above the regional average, but below more mature economies. The percentage of individuals above 15 years old reporting to have a bank account at a financial institution in the country was over 74%, higher than Argentina (48.7%), Latin America and the Caribbean (55%), Brazil (70%) and upper-middle income countries (73.1%). However, it is still below the OECD average of 94.7% and high-income countries (93.7%).

Moreover, there are gaps for those without formal employment, those with low levels of education (primary or lower), as well as migrants. Likewise, although 97% of the population has access to some kind of financial product, just one-third of the Chilean population has access simultaneously to credit, saving and a range of services to manage its financial resources.

Digital financing is becoming more and more important, and the pandemic accelerated this transition. E-commerce grew by 55% in 2020, having as the main payment method credit cards, followed by debit cards. Despite the efforts to track, measure and focus government initiatives on financial inclusion, digital financial inclusion is still weak in the country. Chile ranks 11th out of 55 emerging nations in the Global Microscope Index, falling 3 positions since the previous study.

The key barriers to promoting digital financial inclusion in Chile are related to allowing e-money to be issued by non-bank institutions; the presence of financial outlets and use of agents; and disproportionate due diligence requirements (risk-based customer due diligence). These barriers also reflect some of the challenges for digital ventures to grow.

PRIORITIES FOR TRANSFORMATION

To continue advancing financial inclusion in Chile, it is critical that President Boric ratifies the fintech and new open banking regulation. And that the country further focuses on cybersecurity, along with the promotion of digital adoption in financial services as well as user acceptance.

• Strengthen and implement the recently passed fintech bill, ensuring adoption and compliance
• Work further on data privacy and cybercrime protection; incentivize digitalization and the adoption of new technologies; and develop an industry of inclusive insurance.
• Advance towards a unified banking system platform that allows registration of key information.
• Expand credit score options to qualify for credits, including the use of technology for risk-based customers.
CREDIT FOR THE PRIVATE SECTOR

Although the financial system is characterised by high levels of penetration of banking products, priorities for transforming the sector is difficult, and it is highly dependent on the business and credit history of enterprises. In the 2020 Doing Business report, Chile ranked 94th in the getting credit category, despite its solid and large financing ecosystem. According to the Global Enterprise Monitoring for 2021, one of the sustained barriers to entrepreneurship in Chile is associated with finance. Chile scores poorly in ease of access to finance, ranking 17th out of 19 economies. For entrepreneurial finance conditions, it ranks 13th out of 19.

The credit market in Chile is based on consumer credit, and there is limited access and affordable offers to productive micro and small enterprise finance for businesses that represent over 90% of the total formal enterprises in the country. Currently, Chilean enterprises get financing through local bank and non-bank institutions that offer credits, as well as international offerings. Likewise, households and micro and small enterprises access credit through other formal channels like retail, credit and saving cooperatives, and insurance companies.

The difficulties in access to financing in Chile have several dimensions and complexities that are associated with size, maturity, and the sector of the business. In the case of medium and large enterprises, their main financing source are banks, followed by credit lines from suppliers. In addition, almost all large and medium companies (99% and 97% respectively) highlighted that they utilised financing sources for their operations, while for microenterprises it drops to less than 80%. For micro and small enterprises, the main financing source comes from their own resources (Figure 12). In the National Microenterprise Survey for 2019, around 19% of the micro businesses mentioned that they requested a credit (Figure 12).

**FIGURE 12: DISTRIBUTION OF TOP 5 Financing SOURCES BY TYPE OF ENTERPRISE**

Source: INE and Ministry of Economy

Consumer credit – from banks and non-bank lenders – has increased steadily over time, whereas the offer of microenterprise productive finance has decreased substantially over the last 10 years. According to the World Bank, traditional banking withdrew from this line of services and “only a few microfinance entities appear to be serving microenterprises currently, with operations on a small scale”. Interest rate caps and the lack of credit information have been identified as the key contributors to the withdrawal of banks and saving and credit cooperatives from productive microfinance.
BOX 6: REDUCTION OF THE OFFERING FOR PRODUCTIVE MICROCREDIT

Exit from Lines of Products

One example is Banco Santander, an entity that had an entire line of services focused on serving microfinance clients. However, since Law No. 20,715 of 2013 on Protection of Money Credit Debtors changed loan brackets for interest rate caps and its calculation formulas, the bank “was forced to close this business due to the impact of interest rate caps”. Similarly, the saving and credit cooperatives that used to serve microenterprises, “have mainly withdrawn from this market and turned to consumer payday lending”.

Limited Service

In Chile there are still some banks that serve microenterprises, particularly, Banco Estado via its institutional setting BancoEstado Microempresas (BEME). Here the offer is limited as the bank usually serves microenterprises on partial credit guarantee programmes such as ‘Fondo de Garantía para Pequeños Empresarios’ (FOGAPE) or ‘Fondo de Garantía para Inversiones’ (FOGAIN).

These issues are directly and indirectly impacting microenterprise conditions along with their future potential. As a result of the regulatory changes and other challenges, there has been a decrease in the quality of financial service offerings, combined with a withdrawal from productive microenterprise finance. Negative and uncertain scenario for micro and small enterprises as now there is a concrete gap in financing options for over 90%.

PRIORITIES FOR TRANSFORMATION

Access to finance and capital lines are identified as the main constraints for Chilean MSMEs. Therefore, the Chilean financial ecosystem – with the appropriate support from the government – to be a facilitator and promoter of a thriving entrepreneurial ecosystem needs to move towards ensuring timely access and affordability of financing for micro, small, and medium enterprises.

• Create the market conditions and flexibility for new lines of credits and financial products aligned with the needs of the private sector, with special focus on micro and small enterprises. For this it would be important to shift towards more tailored solutions rather than 2 or 3 products per line.

• Clearly define what MSMEs and the categories are, facilitating the distinction between consumption and production lending.

• Prioritise the development of financial services to support MSMEs and Entrepreneurs – including the development of pools of risk capital such as FOGAPE, FOGAIN and other capital lines.

• Review the role of Banco Estado along with MSMES to re-evaluate the best synergies and define where opportunities are.

• Create incentives to attract more fintech and angel investors to the Chilean market to develop microfinance.
VENTURE CAPITAL

Chile’s Venture Capital (VC) industry has grown significantly during the last decade, 48 with investments tripling, passing over US$1,300 million financing more than 280 companies 49 across 339 deals with an average investment ticket size of US$3 million. 50 Today it is one of the most developed in the region 51 but still far behind the US, Europe and Asia which represent 91% of the total VC investments. 52

In recent years, some Chilean entrepreneurs have disrupted consumption and production patterns, attracting international capital and starting to position the country as an innovative place. Despite these successes, most digital ventures in Chile do not grow. 53 Chilean start-ups face significant constraints in accessing finance and credit lines that will allow them to scale up. 54 They face “low levels of venture capital beyond the early stage and with high dependence on public support”. 55

The government has developed strategies to foster entrepreneurship through its Economic Development Association (CORFO) through direct and indirect funding sources, with mixed results. 56 Likewise, in 2010, the government launched the initiative Start-Up-Chile to incentivise the development of this type of venture. 57 According to the latest GIF Private Sector Report “this is partly due to bureaucratic and administrative constraints, and some of the instruments might not be fit for purpose”. 58

Currently, CORFO offers three lines of credits focused on VC: the Early Technological Phases Fund (FET), Early Phases Fund (FT), and Growth Fund (FC). 59 The VC funds supported by the government agency over time are an accumulated investment of US$953 million and have financed over 400 start-ups. 60 Numbers that showcase the relevance of public support in VC. CORFO has played a critical role in the industry, as it has been the organisation that allowed the initial development of VC in Chile. Recently VC is not just supported by the public sector, but national and international private sector investors are starting to become more prominent. 61

Moreover, risk-financing instruments that play a role to support investments in intangibles and innovative entrepreneurship have not fully developed in the country. In fact, most early-stage funds continue to be limited and publicly sponsored. 62 Therefore, the success of digital ventures has been unequal, in part due to financial barriers, and with substantial regulatory burdens, digitalisation and human capital challenges ahead.

PRIORITIES FOR TRANSFORMATION

• Increase instruments such as FOGAPE and others tailored to entrepreneurs’ needs
• Advance to a holistic offer that combines tax and financial advisory, with financial education for entrepreneurs.
• Promotion of digital entrepreneurship with further attraction of private investment to Chilean VC focusing on strategic sectors.
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UNLOCKING PROSPERITY IN CHILE

Ships in the port of Valparaíso, Chile.

Credit: Shutterstock
Supporting Trade and Commerce

This chapter discusses the core infrastructure that enables trade and investment flows in the country (including a deeper look into communications, water, transport, and logistics), as well as critical factors related to market access, especially for MSMEs. On the one hand, the chapter describes the main challenges around infrastructure planning, governance bodies and regulatory burdens. On the other hand, the analysis within this pillar focuses on how to take advantage of the country’s open market, preferential agreements and low tariffs to further increase productivity, diversification, value addition, and connectivity to regional and global markets along with the participation in GVCs. In doing so, the chapter touches on key economic sectors such as mining, agriculture, and energy.

Chile ranks 32nd for infrastructure and market access in the Legatum Prosperity Index, as it has been successful in creating an environment that enables trade and commerce to flourish. The policies allowed for a significant increase in international trade – from US$490 million in 1960 to US$73,485 million in 2020. Likewise, the Chilean government has been able through trade agreements to reduce tariffs and attract investments to further develop its export offer. These have created better conditions for trade, making the Chilean market more competitive despite being extremely distant from the main centres of global consumption and production. In fact, “Chilean exports must travel on average 13,593 kilometres before arriving at their destination – as the country is far away from its export markets – the discounts on import tariffs in countries of destination are essential for the competitiveness of Chilean exporters”.

INFRASTRUCTURE

Over the last 25 years, Chile has successfully implemented many key infrastructure investments to ensure economic development and the well-being of its citizens. On the one hand, Chile has achieved almost universal access to essential services, such as drinking water and sewage systems. And on the other hand, the country has secured infrastructural development in the most critical sectors for economic growth, particularly in transportation, water and energy. Over the last two decades, important critical and enabling infrastructure has been built, especially around water management, roads and highways, port systems and urban transport infrastructure.

The country’s strategy to enable growth and social transformations has been linked to infrastructure investments on three strategic axes: critical infrastructure, especially around water management, energy, and telecommunications; enabling infrastructure for logistics and connectivity (transports and logistic services); and finally social infrastructure (hospitals, prisons, and education). Chile has developed its infrastructure through direct public sector investments, concession agreements for specific projects and public-private partnerships (Figure 13).
FIGURE 13: CENTRAL GOVERNMENT INVESTMENTS AND CONCESSION AGREEMENTS IN INFRASTRUCTURE 2005-2021

Source: CPI, 2022

According to the OECD the planning of infrastructure along with a solid governance framework have allowed Chile to develop a range of high-quality and efficient infrastructure systems, such as intercity highways, deep-water ports, airports, transportation services and urban water.

Independently of the progress achieved by the country in terms of infrastructure, there are several challenges that are directly and indirectly impacting the access and quality of it. Chile is undergoing changes in the way its regions participate in the definition and governance of investments in infrastructure. A necessary change according to the OECD, as the country has the most centralised public sector around its investment framework, where 88% of the investments have been decided centrally, almost double the OECD average.

Additionally, this centralisation combined with complex regulatory frameworks and permits, fragmented coordination and monitoring of plans and investments, and limited incidence of regions in investments leads to inefficiencies and prioritisation challenges. In the same line, it hinders the planning of relevant investments needed in other areas to fully strengthen the critical and enabling infrastructure in the country.

Moreover, it is important to highlight the fragmentation and the existence of several infrastructure plans cohabiting in different ministries, divisions and even at the same ministry but without the necessary linkages and coordination. For example, in the Ministry of Public Works (MOP) there are 37 active infrastructure plans, some at national level, others at regional and local levels. At the same time, these plans usually relate to other ministries and sectors, making accountability, tracking of progress, and monitoring difficult.
Looking Ahead for Further Infrastructure Development

The country still must develop a substantial amount of infrastructure for years to come to unlock productivity, growth and increase its levels of participation in GVCs and keep up with the social demands for better services and social infrastructure. At the same time, the fast-changing global economic dynamics, Chilean demographics, and social demands make it crucial to plan and invest with a long-term strategy. Moreover, as the country rethinks and develops a long-term vision to tackle productivity, competition and low innovation that have resulted in low real GDP growth, there is an opportunity to focus on the type of infrastructure that will be needed to support the changes coming in the country and the global economy.

The decisions around infrastructure and its prioritisation will become increasingly more complex and will need to be highly targeted. In the past, Chile faced tremendous needs for critical, enabling, and social infrastructure, hence the most pressing needs were clearer. Nowadays and in the future those decisions will not be that simple, as different demands, needs, and expectations are rising and rapidly changing. Therefore, the country will benefit from consolidated and coordinated infrastructure planning that translates into the development of a comprehensive long-term plan for investments, that encompasses all relevant sectors for inclusive growth, as well as current investment plans (including the 2050 mobility plan).

Water (23rd)

Chile is a rich country in terms of water resources, with a per capita average of over 55 thousand cubic metres, putting the country above global and OECD average (over 31 thousand cubic metres). Despite this availability of water resources, the country is characterised by disparities in terms of water supply and demand among regions (Box 8), reality directly related with the country’s geography, climate and soil types, as clustered economic activities, and population distribution.

Chile has 101 hydrological basins across the entire national territory for human consumption, as well as for the functioning of key economic sectors such as industry, mining, agriculture, services and tourism. These basins present different levels of development, water management, infrastructure development and needs. Despite these differences, the Chilean government, through
extensive plans, has ensured almost universal coverage of sewage systems in urban areas (over 97%), and almost 100% get sewage treatment. Additionally, 99% of the households in urban areas are connected to drinking water supply systems, while in rural areas the coverage reaches 57%. For rural Chile, the government also supports access to potable water through drilng, water distribution and other mechanisms.

Notably, Chile has progressed significantly in the adoption of sophisticated irrigation systems (such as drip irrigation and sprinkler irrigation, among others). In fact, decades ago the country started the adoption of these irrigation techniques to improve the efficiency of water usage in agriculture, reaching 75% for sprinkler irrigation and over 90% for drip irrigation. Currently, the Copiapo Valley – located in the driest desert on earth – has the most developed irrigation systems for its agricultural production, reaching 95% of the total productive land, while the Huasco Valley 100 kilometres south of Copiapo, has just over 45% of its land irrigated.

Chile has seen a decrease in rainfall in the last decades in a range between 60% to 85% compared to a normal year for the central parts of northern and southern Chile, having significant impacts in the hydrological basins. The main dams in the country are just at 34% of their capacity, and the closest rivers are at historical minimum levels. At the same time, the country has different levels of water availability, management and demand depending on the macro-regions across the territory (Box 8). Chile is one of the most exposed countries to climate change, including droughts, as it met 7 out of the 9 conditions established by the United Nations to evaluate climate vulnerability. Therefore, the Ministry of Public Works (MOP) has identified 13 areas of the country’s basins as key priorities, due to the high levels of water scarcity and the potential impacts of climate change. The prioritisation of these areas is particularly important, as these represent approximately 89% of the inhabited area of the country and 95% of the agriculturally productive area that needs irrigation.

The current estimations for the investments needed in the sector for 2022-2031 are above US$12,300 million for the construction of large systems for water storage – including dams – and significant efforts for water management, increasing the investment in smart irrigation, grey water management and others.
Although the sector and investments have been crucial for the country’s development, there are persisting structural challenges around water management. In fact, water exploitation and management is one of the main bottlenecks in the sustainability of the sector. It is characterised by large losses in urban areas, deficient management of water usage in agriculture across the country due to limited adoption and/or efficiency of smart irrigation systems in some locations combined with increasing levels of difficulty to extract underground water because of the over-exploitation of aquifers.

Challenges around water availability and management are affecting human consumption in small locations and rural areas, as well as negatively impacting the agriculture sector and food security – as the industry is under constant contraction due to long-lasting droughts.

**BOX 8: MACRO-REGIONS – ITS CHARACTERISTICS AROUND WATER SUPPLY AND DEMANDS**

According to the National Direction of Water (DGA), there are four identifiable zones in the country with different levels of supply and demand of water for human consumption and economic activities.

1. **Macrozona Norte**: Area characterised by a concentration of mining activities, with a small proportion of agricultural activities. It has groundwater that is generally over-exploited. Due to the limitations on water resources, some mining companies have started to include in their investment plans the use of seawater for their production processes. Likewise, initiatives for water desalination have started to ensure human consumption in urban areas.

2. **Macrozona Centro**: It is one of the areas most affected by droughts, impacting agriculture especially, as well as human consumption of water - 60% of the population of the country resides in this macrozone. Due to population and rural settlement patterns, water needs to be taken to several localities utilising trucks, as their water availability has decreased over time. In fact, the Rural Potable Water Committees (APRs) that administrate water resources in rural areas cannot meet the demand for groundwater, as the levels of wells and aquifers have been decreasing due to constant droughts.

3. **Macrozona Sur**: This macrozone has water resources, but there are gaps related to water management – particularly storage and distribution – limiting their abilities to cope with future needs. Lately, some areas have started to use water trucks to provide water for rural communities.

4. **Macrozona Austral**: This area of the country has the highest supply and availability of water but with limited demand. Because of its location far from the macrozones with the most pressing challenges around water, it is not financially viable – yet – to supply water to the rest of the country.
GOVERNMENT INITIATIVES AND PLANS

Since the 1980s with the privatisation of water, the government has created institutions for water governance as well as laws and incentives for technological adoption in the use of this resource. One of the most well-known instruments for this purpose is law 18.450 for the Promotion of Private Investment in Irrigation and Drainage (‘Ley sobre el Fomento de la Inversion Privada en Obras de Riego y Drenaje’) from 1985. This law generates incentives and early adoption of irrigation schemes by farmers and exporters. Since its adoption in the 80s this regulation has impacted around 170 thousand hectares, benefitting over 330 thousand users (Box 9).

Since the 80s, to guarantee water supply for human consumption and economic activities several institutions have been involved in water management. Water management and governance are fragmented and scattered over 56 public institutions. Most of them – at different levels and degrees – have influence over its regulations, processes, investments, and monitoring. Hence, water governance in Chile has been dispersed across several public institutions in different ministries, making the coordination and administration of the resources extremely difficult. To address these challenges in 2019, the Piñera administration launched a National Water Commission (Mesa Nacional del Agua), a public-private body that involved all 26 key stakeholders related to water.

As a result of the work of this commission, in 2021 the government presented the National Water Strategy around three pillars: protect water supply, always prioritise human consumption; ensure water quality and protection of ecosystems; and modernise the legal and institutional frameworks around water and the water code. The government presented to parliament a proposal for the creation of a new Undersecretary for Water Resources under the MOP, but it has not seen any traction since the change of administration (March 2022). These results are linked to the constitutional debate, where water rights and water administration were at the centre of the debate.

Therefore, most of the previous governmental initiatives and plans were put on hold pending new water governance. While waiting for the reformed structure that will come from the new constitutional text, in April 2022 the Boric administration created an inter-ministerial committee formed by 6 key ministries to identify initiatives to deal with water scarcity, led by the Ministry of the Environment. The Boric Administration shifted the focus from an Undersecretary for Water (Piñera) to the development of Regional Basin Committees (‘Consejo de Cuencas’) where the executive will present governors with a new proposed structure for water management. Hence, the discussion around water, how to manage the resources and oversee the introduction of technology and smart systems is yet to be defined, showcasing the lack of long-term agendas that can survive changes in administration.

Notably, the Executive presented a motion to Congress in September 2022 so the modification of Law 18.450 can have impacts on agriculture productivity, competitiveness of the sector and the future potential of the Chilean agroindustry (Box 9).
BOX 9: LAW 18.450 CHALLENGES AND PROPOSED CHANGES

The current law – about to expire in December 2022 – does not prioritise investments for irrigation systems aligned with the basins and its characteristics (water supply, demand, and stress levels). Therefore, regions and valleys with higher water scarcity but smaller surface (northern Chile) compete in unequal conditions with the rest of the territory, as the final allocation for state financial support for irrigation factors is number of hectares, beneficiaries and costs. The latest being particularly higher in northern Chile due to soil characteristics, geography and the amount of water needed per hectare.\textsuperscript{42}

In September 2022, the government introduced to Congress a modification to the law to extend its duration for another 7 years and centre on water security, innovation and the continued improvement of irrigation systems.\textsuperscript{43}

Main modifications:\textsuperscript{44}

\begin{itemize}
  \item Shift the focus towards small and medium agriculture, water user organisations and agriculture, indigenous communities, and women, limiting the instrument to beneficiaries with income lower than 50 thousand UF (US1.9 million approximately).
  \item Extension on the eligibility of project types, innovation, the continuous improvement of irrigation systems and nature-based solutions.
  \item Traditional crops – included in the food basket – and crops with low water usage as new factors for the allocation of resources.
  \item Focus on protection of rural sanitary services – this instrument will not subsidised private irrigation investments in areas surrounding rural sanitary systems.
  \item At least 20\% of the water saved through irrigation projects must be returned to the basin.
\end{itemize}

Critiques and challenges of the modification:\textsuperscript{45}

\begin{itemize}
  \item Orientation towards the control over production decisions, particularly benefiting specific crops associated with the food basket.\textsuperscript{46}
  \item Aims to promote micro-scale production systems and the incorporation of complementary subsidies that are not associated with irrigation.\textsuperscript{47}
  \item Deterioration of water rights, as it required to reintegrate part of the water flows to the basins, despite the ownership of these rights\textsuperscript{48} and the flow fluctuations.\textsuperscript{49}
  \item It focuses on neglected sectors, thus eliminating the competitiveness attribute of the law, which has ensured transparency and efficiency in the use of resources,\textsuperscript{50} changing the core that has marked the success of these instruments for the last 37 years.
\end{itemize}
**PRIORITIES FOR TRANSFORMATION**

- Create an integrated national water governance framework that clearly defines an institutional structure responsible for the coordination, assessment, monitoring, adaptability and implementation of short-, mid- and long-term priorities, based on local needs.

- Prioritise critical investments to tackle water challenges following a territorial approach that takes into consideration different solutions for different macrozones and industries. And avoid a centralised approach with the notion of one solution fits all.

- Establish a long-term investment agenda around water management and water scarcity that is embedded in a long-term country vision that needs to be respected by administrations to come.

- Create incentives to attract investments for scaling up water desalination in high-stressed basins through public-private partnerships for human consumption and productive activities – when the social benefits and the associated costs are sustainable for the introduction of new technology.

- Develop public instruments and incentives to broaden the adoption of grey water usage for irrigation in urban centres, and in a future, expand the distribution of resources towards areas with productive land.
Communications (45th)

Over the last decades, Chile has built a solid telecommunications infrastructure, reaching high rates of penetration and good-quality services. According to the Undersecretariat of Telecommunications (SUBTEL), more than 67% of Chilean households have a fixed-broadband connection and 4G mobile internet connections will have reached over 21 million by 2021.

![Figure 14: Evolution of Access to Internet 2009-2022](source: Transport Ministry, 2022)

In 2015, the government launched an agenda focused on digitalising Chile by 2020 with five main goals: rights for digital development, digital connectivity, digital government, digital economy and digital skills. After an evaluation in 2020, the conclusions showed that the greatest progress was made around digital connectivity. The country has similar levels of penetration in mobile internet as the OECD average, but lower levels of adoption of fixed connections (Figure 14). COVID-19 and the emergence of working from home boosted the demand for fibre optic internet connections, substantially decreasing the difference with the OECD average. Despite the progress, a significant gap in fixed broadband connections remains (deficit close to 37%).

In terms of strategic projects and priorities, the governments in the last decade have launched a series of programmes and investment opportunities to expand the digital capacity of the country and make it more attractive for digital ventures and a hub in the region for data centres (i.e., Amazon data centres). Additionally, some landmark initiatives are the National Fibre Optic network (FON), Extreme South Fibre Optic Cable (Fibra Optica Austral FOA) and a strategic plan for the first subsea fibre-optic cable that will connect South America with Asia and the Pacific (APAC) and Oceania, called the Humboldt Cable.

Despite several improvements and higher penetration rates, telecommunication access and affordability continue to be an issue in the country. "Infrastructure gaps remain in fixed broadband in peri-urban and rural areas, while affordability issues limit access by lower-income households even within cities."

In July 2022 the Chilean Chamber of Construction (CChC) estimated that to continue with the development of the sector investments over US$27,800 million are needed for the period 2022-2031. This infrastructure is needed to enable the entry and implementation of new technologies for the fifth-generation (5G) mobile segments and to accommodate the strong demand for fibre optic service. To advance towards a digital economy the government recently awarded 5G to different operators, becoming the first country in the region to do so.
Nevertheless, levels of investments in telecommunications have decreased as a share of GDP during the last decade (Figure 15). In Chile, in 2020 the average investment per inhabitant was US$64, whereas the level in OECD countries for 2018 was almost 2.5 times higher (around US$150).

**FIGURE 15: TOTAL INVESTMENT IN COMMUNICATION**

<table>
<thead>
<tr>
<th>Year</th>
<th>Investments Telecom/GDP</th>
</tr>
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<tbody>
<tr>
<td>2020</td>
<td>0%</td>
</tr>
<tr>
<td>2019</td>
<td>0.2%</td>
</tr>
<tr>
<td>2018</td>
<td>0.4%</td>
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<tr>
<td>2017</td>
<td>0.6%</td>
</tr>
<tr>
<td>2016</td>
<td>0.8%</td>
</tr>
<tr>
<td>2015</td>
<td>1.0%</td>
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<tr>
<td>2014</td>
<td>1.2%</td>
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<tr>
<td>2013</td>
<td>1.4%</td>
</tr>
<tr>
<td>2012</td>
<td>1.6%</td>
</tr>
<tr>
<td>2011</td>
<td>1.8%</td>
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</table>

Source: CChC, 2022

**Competition, Regulatory Framework and Trade Restrictions**

The Undersecretary of Telecommunications (SUBTEL) provides the regulatory framework for the sector. The organism is not technically independent, as it is part of the Ministry of Transport and Telecommunications, a political centralised body. According to the OECD the governance of the sector needs attention and urgent upgrade, as the country stands out among members for lacking an independent sector regulator. On the one hand, the entity sets sector policies, and on the other, it performs regulatory, inspection and enforcement functions. Acting as the ruler and the controller generates reciprocal tensions and also limits the ability of the institution to concentrate and specialise in particular sets of tasks. Likewise, as the SUBTEL is part of the Ministry of Energy, it needs to perform additional functions that also limit the availability of specialised personnel.

The sector also has structural problems, especially related to fragmentation, where different authorities and entities are involved in the approval and monitoring of the services, as well as some regulatory burdens. There is a fragmentation in the concessions system that has been identified as the overall barrier to the development of the telecommunications infrastructure by the OECD. In fact, there are individual concession regimes for each type of service, generating substantial burdens for operations and limiting incentives and competition.

Recent regulatory changes have allowed the entry of new providers, increasing the levels of competition. Despite these changes, operators continue to have strong market powers. A similar set of issues related to governance structures, fragmentation, conflicting regulations, and coordination are identified as the main barriers to fixed and mobile communication network development. In the case of the first one, there is a lack of a centralised regulatory framework, along with insufficient coordination between national and regional entities; and the regulation for the disaggregation of local loops has not been implemented. For mobile networks, there is a complex governance structure – with multiple players and authorities – as well as regulatory burdens (i.e. Antennas Law and municipal work directorates).
Some of these challenges continue to hinder effective competition and further network development at the peri-urban and last-mile level. Likewise, some constraints remain around auctions, pricing and trading, as well as infrastructure sharing, which if removed could lead to better competition, coverage, and sector growth.

Another significant challenge is related with trade restrictions in telecommunications, particularly regarding areas of competition and domestic transparency procedures. This is mainly due to issues with limited access and availability of information, combined with the publication of changes, modifications, and critical information for service providers. Most of it is dispersed and sometimes not publicly available, hindering competition and timely access of information. Moreover, services trade is undermined by policies that, while not discriminating against foreign providers, inhibit transparency and competition.

The current restrictions put significant markups in the sector, accompanied by high transaction costs.

PRIORITIES FOR TRANSFORMATION

Create an independent body for telecommunications, to ensure neutrality in the telecoms regulatory environment to improve competition, monitoring and transparency. This will lead to better monitoring and transparency of concessions, as well as clear practices and publicly available information generating more dynamic and responsive public and private sector players.

- Enhance the regulatory environment – through the coordination and harmonisation of regulations – and remove markups for foreign investments in the sector in the trade of services and local policies that are inhibiting transparency.

- Create an environment where infrastructure sharing is an attractive option to increase competition, coverage and reduce prices, accelerating the transition to a digital economy.

- Launch a targeted plan to attract capital and investors to the telecommunications sector, especially to support critical transformations for ‘last mile projects’ ensuring fibre-optic connectivity for end users in unserved areas.

Energy (46th)

Chile has made significant progress in guaranteeing access to energy and its reliability. Despite its difficult geography and extreme zones, the country has managed to achieve universal energy access and improved its transmission systems substantially. In fact, the legislation has encouraged investments in generating capacity across the sector. Moreover, the State has taken a leading role in energy planning, helping to boost project developments, particularly in electricity transmission. The system has three interconnected grids. The National Electric System (SEN) represents 98.5% of the supply, which provides electricity to 14 out of the 16 regions. The Aysen Electric System (SEA) and the Magallanes Electric System (SEM) supply energy to the most geographically complicated regions in southern Chile (1.5%).

Chile’s electricity sector is privately owned and operated by foreign and local companies. During the last years, the energy sector has seen several investments in both generation and transmission. This has been driven by a more conducive environment and better regulatory frameworks in the sector that have encouraged competition. And at the same time, promoted further developments of the transmission system, allowing connection and integration of new generation projects into the national grid.
According to estimations from the Chilean Chamber of Construction, considering the installed capacity, the pipeline of projects to be developed in the short-term, as well as those projects that are under construction (more than 470 by October 2022), it will not be necessary to further invest in developing substantial infrastructure to fulfil the energy demand in the next 10 years. These estimations are under the assumption that a responsible energy transition is carried out and the investments that allow the expansion of the transmitted capacity and energy storage materialise as planned.

**FIGURE 16: CHARACTERISTICS OF THE ELECTRIC SYSTEMS IN CHILE**

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<tr>
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<tbody>
<tr>
<td>SEN</td>
<td>Arica y Parinacota 28 495 MW 99,3%</td>
<td>6 516 GWh 99,4%</td>
<td>6 450 GWh 99,4%</td>
<td>17 304 312 98,5%</td>
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<tr>
<td></td>
<td>Tarapacá 99,3%</td>
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<td></td>
<td>Antofagasta 99,3%</td>
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<td></td>
<td>Atacama 99,3%</td>
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<td></td>
<td>Coquimbo 99,3%</td>
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<td></td>
<td>Valparaíso 99,3%</td>
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<td></td>
<td>Región Metropolitana 99,3%</td>
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<td>Maule 0,2%</td>
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<td>Valdivia 0,2%</td>
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<td>Biobío 0,2%</td>
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<td></td>
<td>Araucanía 0,2%</td>
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<td></td>
<td>Los Ríos 0,2%</td>
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<tr>
<td></td>
<td>Los Lagos 0,2%</td>
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<td></td>
</tr>
<tr>
<td>SEA</td>
<td>Aysén 68 MW 0,2%</td>
<td>13 MW 0,2%</td>
<td>11,1 MW 0,2%</td>
<td>103 158 0,6%</td>
</tr>
<tr>
<td></td>
<td>(Dec-2020)</td>
<td>(Dec-2020)</td>
<td>(Dec-2020)</td>
<td></td>
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<tr>
<td></td>
<td>Magallanes 120 MW 0,4%</td>
<td>25 MW 0,4%</td>
<td>25,8 MW 0,4%</td>
<td>166 333 0,9%</td>
</tr>
<tr>
<td></td>
<td>(Dec-2020)</td>
<td>(Dec-2020)</td>
<td>(Dec-2020)</td>
<td></td>
</tr>
</tbody>
</table>

Source: CChC, 2022
Lately, the sector has become not just critical infrastructure needed for development, but also a sector that can lead to substantial economic transformations and export diversification. According to estimations from the Ministry of Energy, the decarbonisation and the competitiveness of Chile in renewable energy provides an opportunity to develop an economic sector that could equal the size of the national mining industry.

**ENERGY MATRIX DIVERSIFICATION**

**FIGURE 17: EVOLUTION OF THE INSTALLED CAPACITY PER ENERGY SOURCE 2010-2020**

![Graph showing energy source capacity evolution 2010-2020](source: CChC, 2022)

The energy matrix of the country has seen an increasing participation from renewable sources, particularly solar and wind power since 2014 (Figure 17), helping with the transition and commitment to be less reliant on gas and oil imports, and drought.

Chile is among world leaders in terms of its commitments to decarbonization, as the country has committed to carbon neutrality by 2050, to peak emissions by 2025, and to transition to a sustained decoupling of emissions from its economic growth. In fact, decarbonization of the Chilean energy matrix has been swift, due to well-designed regulations and consequent investments in highly competitive solar and wind projects, taking advantage of the country’s conditions for renewable energy generation.

**GOVERNMENT PLANS AND STRATEGIES**

The energy sector is one area where a long-term government vision has transcended different administrations. In 2015 the National Energy Policy was passed with a vision towards the development of the sector until 2050. This policy is revised and renewed every 5 years and has been at the centre of the energy matrix diversification, as well as changes in the generation, transmission and distribution of energy in the country.

The government aimed to have 20% of its energy coming from renewable sources by 2025. Nevertheless, the country has exceeded expectations, as by late 2020 non-conventional renewable energies contributed 27% of generated electricity. At the same time, by 2030, Chile aims to have 70% of the country’s energy consumption come from renewable power sources. To that end, the Chilean Law 20.571 passed in 2012 promotes power generation by residential owners with installed capacity of up to 100 kilowatts (KW).
Meanwhile, coupled with the commitment to increase renewable sources, the country has committed to shutting down coal-fired power plants by 2040. The process has already begun and Chile expected to close 8 out of 25 plants by 2024. Since 2020, the closure process has begun for 12 plants, which will reduce the country’s installed coal-fired capacity by one-third within five years.98

The Chilean government launched the Green Hydrogen National Strategy in November 2020, highlighting the country’s potential to become the “world’s top producer of green hydrogen, a new, clean fuel, by 2040”.99 Although the country’s potential is high, there are a series of challenges and strategic steps that Chile must follow to successfully develop the industry. To accompany the ambitious plan for green transformation, the country launched an electromobility strategy in 2021.100

INVESTMENTS AND CHALLENGES AHEAD

The projected – and already planned – investments needed for the period 2022-2031 are around US$11,525 million, mainly due to the strong entry of renewable energy projects and the incremental demand in transmission and distribution in the next decade. Investments in distribution will be needed to ensure the continuity of energy supply, constituting an enabling factor for the decarbonisation process by 2050.101 Likewise, investments will be needed to unlock the potential for green hydrogen in the country, especially in a new sub-sector characterised by high CAPEX investments needed for the industry to start.

Therefore, according to Daniel Olivaes from the Centre of Energy Transition, the new governance established in the Climate Change Law is expected to provide the Ministries of Environment and Energy with better and more flexible tools to implement a long-term sectoral vision aligned with emissions reduction and to improve the resilience of energy supply.102
**HUMAN CAPITAL CHALLENGES**

A critical challenge that the industry is facing is related to human capital, as over 70% of surveyed companies highlighted that they have had several vacancies in the last 12 months. And four out of five enterprises mentioned that they faced issues with the hiring for construction, where there are a limited number of applicants, as well as candidates that do not meet the necessary qualifications or technical skills.103

For the energy sector to further develop and fulfill the goals that the Chilean government has established by 2030, 2040 and 2050, it is critical to revisit educational plans and labour market offers to ensure that the necessary skills are present and available in the country.

**PRIORITIES FOR TRANSFORMATION**

The government needs to create the right conditions and strategically plan the closures of coal-fired power plants without risking energy supply, affordability, and its reliability for years to come.104 At the same time, it is relevant to promote the right conditions and plan investments in the necessary critical and enabling infrastructure that will support further development of solar, wind, and green hydrogen potential.105 To this end, it would be relevant for the State to assume a much more active role in the sector to support its development and transformation.106

- Review the role of the State in the transformation of the energy sector, along with key policies, initiatives, and institutions that need to be involved in the transition process to meet the 2030, 2040, and 2050 targets.
- Develop and implement a long-term investment and transformation strategy to ensure supply, affordability and reliability of an energy sector that can cope with growth, while simultaneously decarbonising and promoting the green hydrogen industry.
- Establish a public-private-academic partnership to define clear action plans for human capital formation around the critical skill sets needed in the energy sector now and in the future, particularly for renewable energy sources, electromobility and green hydrogen.

**Enabling Infrastructure for Logistics and Connectivity**

The response to COVID-19 highlighted the need to have strong and resilient enabling infrastructure for logistics and connectivity inside countries as well as networks that will minimise supply chain disruptions. In light of this international context, Chile’s internationalisation and export-led strategies, combined with the country’s location and geography, make this infrastructure even more critical. As Chile is far away from main consumption and trade centres, national products need to travel on average more than 12 thousand kilometres to reach destinations.107 Hence, having a competitive, efficient, and thriving logistics and connectivity infrastructure are key to maintaining Chilean goods’ comparative advantages and market positioning in several industries – such as agro-industries, manufacturing, mining, and energy.
Transport (48th)

Chile’s transport infrastructure is critical for economic growth and the country’s development. This enabling infrastructure for logistics and connectivity is centred on maritime ports, road networks and railways. These three means of transportation serve most national and international movement of produce and goods, especially through ports and road/truck transportation. There are three main ownership and operating models for infrastructure networks: state-owned, concessions, and privately owned for public and/or private use.

Maritime ports play a crucial role in Chile’s internationalisation and foreign trade, as over 90% of the trade cargo is mobilised by ports (94% for 2020). According to the latest publication from the Ministry of Transport and Telecommunications the ports system comprised 56 ports allocated across the entire Chilean coast. From this network of ports, 10 are state-owned for public use, 14 are privately owned for public use and 32 privately owned for private use. The functionality, efficiency and performance of maritime transportation is highly linked to other enabling infrastructure such as warehouses (cold, packaging, and storage facilities), port access points, along with main national and secondary roads and railways that ensure the connectivity of the logistic systems in Chile.

The national road infrastructure extends over 85 thousand kilometres. It is well maintained and of high quality, ensuring connectivity by road through the entire country, and MOP oversees its quality and development. Primary and secondary road networks are critical to connecting Chile – due to its geography – as well as to ensuring cargo and goods flow in and out of the national territory. The main mode of cargo transportation between ports and the point of origin/destination is by truck, representing 85% of the total cargo. In 2017 the OECD highlighted that the quality and coverage of the road infrastructure are unequal across the territory and that investment programmes are needed to ensure better coverage and future quality of the system. The entity identified that critical investments were required to tackle missing road connections and to improve secondary roads.

Utilising the findings and recommendations made by the OECD regarding infrastructure governance and planning, the Chilean government launched in 2020 the Infrastructure Plan for Mobility 2050. This plan focuses on 1) establishing a long-term national strategic approach for relevant infrastructure; 2) intercity mobility; 3) different means of transportation such as road, sea, rail and air; 4) contribution to the economic quality of the country, particularly GDP growth, competitiveness, and productivity; 5) environmental sustainability and resilience of the network. For roads, the plan considered projects for over 20,000 km in 4 longitudinal corridors and 58 transversal ones, along with orbital infrastructure around main cities (Santiago, Valparaiso and Concepción) and others. The estimated investment for the next 30 years is more than USD$30 billion, highlighting that 45% of the investments will be concentrated between 2020 and 2030.

The last critical piece in the logistic system in Chile is the railway sector. It has a low participation in cargo transport nationwide – representing less than 1% of the country’s foreign trade cargo for 2020 and just 15% of the cargo that passes through the maritime ports (enters/leaves). But it will be relevant to strengthen its infrastructure and usage to ensure multimodality and capabilities to cope with future cargo demands.

Main Challenges in the Transport and Logistic Sector

One of the key challenges around the transport and logistics sector in the country is related to its governance structure. According to the Council for Infrastructure Policies (CPI) “the institutional atomisation and dispersion of functions in Chile conspires to achieve a more efficient logistic sector.” The sector faces the challenge of how to decouple the planning of its development and the investments from the political cycle, as well as a fragmented governance and responsibilities, that also differ between public and private ports. In fact, there are several institutions and de-
portments in charge of planning and promoting the development of different modes of transport and logistic chains. However, there is a lack of coordination and planning that generates the synergies necessary for an integral development of the transportation system.

Nowadays, the organisation that plays this coordination role is the National Commission for Logistics Development (CONALOG). It is a presidential advisory committee comprising four key ministries, the president of the Committee of State-Owned Enterprises (SEP), the National Council for Innovation Competitiveness (CNID) as well as a consultative group of private sector representatives. Although the creation of CONALOG represents a good step forward, the committee’s recommendations are non-binding, and this governance structure has no decision-making power.

Maritime transport is the most critical part of the logistic chain for Chilean exports and imports. Currently, the sector faces three main issues that are hindering the competitiveness of Chilean exports and also have an impact on the final prices of imported products. These are infrastructure, regulations, and human capital and operation systems. These three issues impact the costs of logistic processes in Chile, where these costs reach 18% of the total sales value of a product, doubling the average OECD costs (9%).

The maritime industry and the sophistication of trade are changing rapidly, putting pressure on current infrastructure to adapt to new vessels, containers, and related support systems to ensure commerce and trade. Therefore, port infrastructure needs to be improved and adapted to increase capacity and efficiency to cope with future demand. At the same time, work is needed on mitigation measures and infrastructure development to limit the effects of surges that have resulted in several port closures and supply chain disruptions (83 days in Antofagasta and 68 in San Antonio just in 2020). Another important aspect that requires attention is the access to ports, as they are located near main urban centres. Vehicular flow is increasingly more difficult due to traffic congestion, leading to delays and increasing waiting times for vessels and trucks, negatively impacting logistic chains.

The maritime transportation sector has been identified as strategic leading to specific regulations and limits to foreign ownership of ports, as well as maritime cabotage. The latest has been one of the debate topics for the last decade, and there are divided positions about opening the maritime cabotage to international players. Under the current law for the Promotion of the Merchant Navy (Ley de Fomento a la Marina Mercante), cargo cabotage in national waters is limited to Chilean shipping companies. The cabotage restriction has led to a concentration of the service among a few players and has been hindering the incentives for other actors to enter the market. Currently, this limitation generates several inefficiencies. For example, if a Chilean port needs to close due to unfavourable weather conditions, foreign ships will leave the cargo in the port of Callao in Peru, instead of leaving the cargo in a closer national port.

According to a study from Agostini, Briones and Mordoj, the cost associated with not opening the cabotage oscillates between US$300 and US$400 million annually. Additionally, Agostini highlights that if the cabotage is liberalised allowing competition from foreign companies, the transport costs will drop between 40% to 50%, generating more efficiency in the logistic chain.

Moreover, another relevant factor hindering the effectiveness of the logistics sector in Chile and the competitiveness levels of Chilean products regarding other markets relates to human capital and inefficiencies in the operation system in ports and customs. The labour conditions in the sector are marked by high levels of seasonal and temporary workers (over two-thirds) and have been signalled by the OECD as one of the reasons for the latest labour conflicts and port strikes. Estimations from some business associations show that 20 days of port strikes in the country represent a loss of over US$500 million. Although ports are one of the most critical pieces of the logistic infrastructure for the Chilean economy, “the country does not have an explicit national port Labour Strategy”. This missing strategy generates impediments to successfully develop short, medium and long-term scenarios around port labour demand.
UNLOCKING PROSPERITY IN CHILE

UNLOCKING PROSPERITY IN CHILE

Opening the Country for Trade and Commerce

For more than a decade, Chile has been the top-ranked country for the open market scale in the Legatum Prosperity Index. Through deliberate efforts to expand and consolidate its global economic inclusion, the country today is one of the world’s more open countries for trade. According to the latest BTI report “foreign trade is widely liberalised, with uniform, low tariff, and few non-tariff barriers in place. The State does not intervene in free trade, but instead it supports national exports by means of a network of institutions linked to the economy.”

From the 1970s, Chile has embarked on a journey to liberalise the economy and has pursued progressive market-oriented policies and strategies, including trade and economic agreements that have allowed the country to expand its commercial ties reaching more than two hundred markets. The trade liberalisation strategy has evolved substantially over time, passing from unilateral efforts of tariff reductions to building a network of bilateral, plurilateral and multilateral agreements that have given the country “the greatest access to the global economy”. Currently, the country has negotiated over 30 trade agreements – covering 65 economies – that represent almost 90 percent of the world’s GDP.

This strong network of trade and economic cooperation agreements provides preferential market access and reduced or zero-rate customs duties. “As a result, Chile’s effective average tariff was a mere 0.5% in 2018, and the simple average of most-favoured nation (MFN) applied duties was 6% in 2019.”

While comparing the access to the global GDP – adjusted by Purchasing Power Parity (PPP) – obtained per country through its active Free Trade Agreement network, Chile has the highest access (61%), followed by South Korea (50%) and Australia (43%) (Figure 18).

Moreover, Chile has actively participated and tried to lead international forums and multilateral initiatives along with global discussions about trade, climate change, e-commerce, digital integration, and other key global challenges. It is a Member of the Pacific Alliance, The Rio Group, an associate member of MERCOSUR, full member of the Asia Pacific Economic Cooperation (APEC) and the Union of South American Nations (UNASUR). As well as being at the forefront of negotiating agreements focused on services, MSMEs, public sector markets and others (Box 10).

PRIORITIES FOR TRANSFORMATION

• Strengthen the governance, role, and coordination functions of the National Commission for Logistics Development (CONALOG) to deepen the integration of the country’s logistics chains with ports, transfer centres, cities, means of transport and customs, to ensure a competitive logistic performance.

• Review the restrictions on maritime cabotage, especially the limitations on transportation of goods in national waters, to determine the best formula to increase competition and reduce transportation costs.

• Develop a national port labour strategy – based on logistic demand scenarios – that includes policy guidelines, plans and incentives to attract, retain and generate a shared pool of workers across ports.
FIGURE 18: ACCESS TO GLOBAL GDP ADJUSTED BY PPP

Source: SUBREI, 2021

Vineyards producing Chilean wine near Santa Cruz in the Colchagua Valley. Credit: Steve Allen.
Despite its efforts, Chile has not been able to fully diversify its export basket, and transition to an economy based on services exports, rather than just traditional exports. For the last 10 years, the services sector has been decreasing its relative share of exports, moving in the opposite direction to global trends. With the rise of globalisation and the facilitation of global trade, services have acquired a more significant role in international trade. The share of services in world exports rose from 9% in 1970 to 25% in 2019. For Chile, services represented just 12% of total exports for 2019 (around US$9.8 billion), leaving the country significantly below the global average of 25% (US$31.3 billion).

BOX 10: CHILE AS A PIONEER IN MORE INCLUSIVE AND TRANSFORMATIONAL FTAS

The country has been in the pioneering group of nations negotiating and establishing the most transformational FTAs in decades. Starting with the Trans-Pacific Economic Partnership (P4) between Brunei Darussalam, Chile, Singapore and New Zealand signed in 2005, active since 2006 when 90% of trade obtained zero tariff, and by 2016 the 100% of negotiated products entered with zero tariff. The first agreement linking Asia, the Pacific and the Americas. Chile entered as one of the founding members of the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) under the same spirit, and drafted an agreement that reflects the deepness, interconnected nature of commerce and countries’ commitments, along with the current and future way of conducting business globally. This agreement originally involved 12 countries – the P4 nations along with Mexico, Japan, Australia, Canada, Vietnam, Malaysia, Peru and the United States. Finally, the United States – under Donald Trump’s presidency – withdrew US participation from the agreement, and 11 nations remained.

"The CPTPP is the most significant FTA in twenty years. [...] As it sets up a structural framework more soundly for future economic activity". This agreement is not just “about cutting all tariff lines to zero or opening services. It is the deep, interlocking nature of the deal that matters”. Although Chile has been one of the initiators of this agreement, and currently 9 out of the 11 countries have ratified and actioned it, the TPP-11 has been a source of political debate and disagreements. It was approved by the Senate in October 2022, but it is pending ratification from President Gabriel Boris. His administration, including the president himself, has made clear that this agreement was not part of its agenda, and that they are pushing forward for side letters with each signatory country to finally ratify it. Hence, the expectations are that the ratification will not happen in the short term.

Furthermore, the country has been a pioneer in adopting and establishing specific chapters for subjects that are relevant for its international partners as well as for Chilean citizens, such as gender, MSMEs, trade with the public sector, environmental conditions, and others. To increase business opportunities for goods and services, the country has included the subject of public purchases in its agreements in order to gain access to these markets with greater advantages. Currently, the country has 15 agreements or public procurement chapters with its key business partners. These negotiations have opened an important market for Chilean entrepreneurs, as they can also look for opportunities with the public sector in different countries.

UNTAPPED POTENTIAL FOR SERVICE TRADE

Despite its efforts, Chile has not been able to fully diversify its export basket, and transition to an economy based on services exports, rather than just traditional exports. For the last 10 years, the services sector has been decreasing its relative share of exports, moving in the opposite direction to global trends. With the rise of globalisation and the facilitation of global trade, services have acquired a more significant role in international trade. The share of services in world exports rose from 9% in 1970 to 25% in 2019. For Chile, services represented just 12% of total exports for 2019 (around US$9.8 billion), leaving the country significantly below the global average of 25% (US$31.3 billion).
Currently, export contributions to GDP continue to be heavily reliant on mining and agriculture (Figure 4). The success of diversification and inclusion of new companies and increasing the export basket by almost 40% has not been reflected in the export of services, keeping Chile below the global average in the contribution of services to GDP (Figure 19).

Diversification efforts have translated into the transformation of some industries, and the inclusion of sophisticated techniques and skill sets in the agro-industry and decades of knowledge accumulated in the mining sector. Both labour-intensive economic activities have been combined with deeper levels of innovation and adoption of new machinery and technology to develop the country’s potential as an agrifood and mining player globally.

The country has set strong foundations for trade, investment, and commerce to flourish. Through the diversification strategy and deeper sophistication in key sectors, SMEs have started to develop rich and comprehensive approaches to provide services linked to these key industries. Even though the country is still heavily reliant on services associated with traditional sectors, some Chilean enterprises have been gradually increasing their participation in the financial and Information and Communication Technologies (ICT) sectors. The export of services and companies taking advantage of the country’s potential in this area are still fairly limited, for in 2020 over 650 companies exported services, from which more than half were SMEs.
Although service trade is included in the country’s FTAs, according to some studies the efforts made by the Chilean government, and its programmes, to promote the export of services have been limited and fragmented across different ministries in the last decade.\(^{176}\) To this end, the Undersecretary of International Economic Relations (SUBREI) and the Institute of International Studies at the University of Chile elaborated and launched in September of 2021 the first Manual for Service Exports.\(^{177}\) And in March 2022, a series of documents laid the groundwork for unlocking the potential of service trade in general, as well as in the sectors where Chile has major opportunities (agro-industry, mining and ICT).\(^{178}\)

**POTENTIAL FOR SERVICE TRADE IN MINING AND AGRO INDUSTRY**

The export of knowledge-based services for natural resources industries offers a GVC scaling strategy for the country’s primary industries.\(^{179}\) Notably across mining, aquaculture, fruits, and forestry the value-added by national service providers is substantial, and at similar levels of other countries leading the good exports in these areas.\(^{180}\) Nevertheless, this expertise does not translate into service providers playing a relevant role in the export of services, where their exports are estimated to reach US$160 million, equivalent to 0.2% of the total export of services.\(^{181}\) In summary, while the goods produced by these four industries represent 68% of the national exports, services related to these industries represent just 0.2% for services. Showcasing the substantial potential and opportunities for internationalisation and growth for these providers.\(^{182}\) Therefore, their expertise can be exported to neighbouring countries or emerging markets that are working in similar industries.

**PRIORITIES FOR TRANSFORMATION**

Create a targeted strategy to unlock the untapped potential of service exports and make the most of the nation’s extensive network of trade deals.

- Establish a comprehensive and coordinated offer for capacity building, advisory services and business opportunity identification for export services.
- Create an entity that will lead the positioning of Chilean entrepreneurs for services that can act as a one-stop shop to boost service trade while supporting companies for export readiness.
- Increase the investments in Research and Development to create an innovative thriving service environment for the national and international offer, accompanied by a deepening of the skills and capabilities of the educational system in the country.
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Grandfather and his grandson walking in Chile.
Credit: Pablo Rogat.
Conclusion

Although Chile has made significant progress towards the prosperity of its people, some challenges remain to fully embrace a model that promotes an inclusive society and economy, while empowering everyone. In the last three decades, Chile has gained global positioning through its undeniable social, economic and political transformations, making the country a safe and attractive destination for trade and investment. Likewise, the country’s democratic consolidation came along with the implementation of safety nets and social protection systems. These are all factors that have created the necessary conditions for Chileans to escape poverty, leading to a society composed mostly of middle class with more diverse needs and demands. Chile now faces important challenges to agree on the key principles that will guide the country’s development.

Chile has been marked by long-lasting low levels of institutional and interpersonal trust. Such levels not only distort policies that governments have prioritised, but also hinder the degree of implementation, generating mistrust at every level of the policy cycle. Similarly, corruption scandals and collusion cases have undermined relations and interactions between government and the private sector, civil society with enterprises and among enterprises. These increasing levels of mistrust are blocking the pathways to prosperity and impacting innovation, entrepreneurship, investment, and social cohesion.

In the last 15 years, the export-led model has lost traction and exports have not been the main driver of economic growth, productivity, and innovation in Chile. The economic performance has been driven by capital deepening. GDP growth has shown a declining trend over time, and weak TFP has been linked to low levels of value-addition across the economy. The labour market is characterised by low-skill workers across most economic activities, accompanied by issues around quality of education and a mismatch of the educational offerings and labour market needs.

The regulatory environment has become more fragmented and complex, constraining the ability of MSMEs to survive, compete, grow and innovate as well as pushing them towards informality. This has been compounded further by centralised state functioning, policymaking and budgetary allocations. State structures have become more complex, adding extra challenges for an efficient and citizen-driven approach in public service. Political and strategic planning are undermined by a lack of state capacity and the right instruments that would ensure that policymakers follow a medium-to-long-term perspective for specific key foundational areas.

The Way Forward

Chile has a unique opportunity to take the strong social, economic, and political foundations that allowed the country to substantially transform its development levels and move forward to implement transformations that will allow the country to evolve from an open economy to an inclusive one. Undoubtedly, Chile has done several things right, but institutions and policies have not changed at the same speed as Chilean society, its needs, and its hopes. Therefore, while the new constitution will determine the rules of the game, the country needs to define a few clear specific goals that will set up the country’s future. This long-term unifying vision should be developed around the need to ensure an inclusive economy and society that will allow everyone who wants to participate and benefit from the country’s progress and prosperity to do so.

The vision should be centred around economic growth that is sustainable and inclusive: maintaining competitive conditions for investors and businesses of all sizes, allowing MSMEs and entrepreneurs to invest, innovate, grow, fail, and re-invent their businesses; as well as enhancing internationalisation and inclusion in the GVCs with goods and services.
This goal is viable if:

- The State – as it has done in the past – undertakes a facilitator role for economic connection and integration, rather than directly intervening in the economy generating market distortions.
- The economic system allows space for the labour market and productive development of MSMEs.
- Policies and institutions maintain and learn from institutional memory, but at the same time, are flexible to adapt to new market conditions and social demands.
- The government works hand-in-hand with the private sector and academia to unlock the potential of the new generations with the right skill sets needed for a country that is aiming to maintain and increase its leadership and global presence in traditional and non-traditional sectors where Chile has competitive advantages.
- The political and economic elite need to factor in long-term key strategic goals, rather than just focusing on short-term issues.
- Policies, programmes and strategies enhance opportunities across the country based on territorial needs and aspirations, rather than following a regional neutral approach.

For this development agenda to succeed, it needs to be built upon political stability and the political elite putting citizens' long-lasting prosperity at the centre of its decisions. This can be supported by creating a national consensus, across the political and social spectrums, to boost social and economic progress across the entire territory. It will also involve strengthening state capacity through a mindset shift that puts citizens, end-users and beneficiaries at the centre. Furthermore, it can be enhanced by greater integration of Regional Development Strategies with the National plan – so that the differences across the country can be accommodated and harnessed for the national good.

In the past, strong social, economic, and political foundations allowed Chile to progress substantially united. Hence, today the country has a unique opportunity to build further on these foundations to enable the country to pass from an open trading economy to a more inclusive one with a sustained development path.
# Chile: Prosperity score 69.0 (38th)

## Prosperity over time

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## Breakdown of performance

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