Executive summary

Chile has made impressive strides in terms of economic growth and living standards in recent decades. Yet, the country faces new and important sustainable development challenges. These include first and foremost stimulating productivity growth to sustain continuous improvements in the living standards of its citizens, reducing social inequalities and combating climate change. The 2019-20 social protest and the COVID-19 pandemic have made these challenges yet more pressing and addressing them will be crucial for Chile to become a more prosperous, equitable and resilient economy.

As a small, open economy rich in natural resources, Chile relies heavily on trade and FDI to sustain its economic growth. The importance of FDI for the Chilean economy has increased over time, as evidenced by the growing share of inward FDI stock in GDP, reaching almost 100% in 2020. However, FDI flows to Chile have decreased since 2012, in line with the global trend. Almost 30% of FDI stock is concentrated in finance, renewable energy, trade and medium- and low-tech manufacturing. Geographically, FDI is concentrated in the mining-rich regions of Antofagasta and Atacama and in the capital Santiago. Investors from Europe (the Netherlands, the United Kingdom, Spain and Italy) and North America are the main sources of FDI in Chile. Over the past five years, a significant amount of FDI flows have also come from China, although Chinese FDI is still marginal in the Chilean FDI landscape.

Foreign firms established locally contribute significantly to sustainable development in Chile. They are responsible for more than half of total exports in most sectors, including knowledge-intensive sectors. Moreover, they participate extensively in domestic value chains, as they source their inputs mainly from the domestic market, especially from Chilean SMEs, and sell their production mainly in the domestic market, especially to Chilean SMEs. Sectors with a high concentration of FDI (mining, energy, finance) are more productive and capital-intensive, but contribute less to R&D and have lower job creation potential than other sectors. In most sectors, foreign firms are, on average, more productive and engage more in R&D activities than domestic firms. They also create better paid and higher skilled jobs, including for women. Foreign companies also support Chile's transition to clean energy. They are on average more energy-efficient than Chilean companies and invest considerably in renewable energy (around 90% of FDI in the energy sector goes to renewable energy).

The positive contribution of FDI to sustainable development suggests that foreign firms can play an important role in helping Chile diversify its economy and become a knowledge-intensive economy. Economic activity in Chile is highly focused in services (professional services, trade, and public sector), medium- and low-tech manufacturing, and natural resources. Although these sectors have supported economic growth in Chile in the past decades, they now offer fewer prospects in terms of sustainable development. They contribute less to innovation, productivity growth, quality job creation and low carbon transition. FDI can help Chile develop new competitive edges in knowledge-intensive and green sectors, bringing in new and cleaner technologies and acting as a gateway to international markets.

The quality of the legal and regulatory environment plays a key role in ensuring that FDI supports sustainable development. Overall, Chile's economy is open to FDI. Investment-related policies are non-discriminatory and foreign-owned companies are provided with national treatment. Although Chile has a competition-friendly regulatory environment, a few 'behind-the-border' regulations affect market access conditions in several sectors where foreign firms operate. These include complex regulatory procedures, particularly for large investment projects in strategic sectors, and barriers to public procurement for foreign suppliers of goods and services. As Chile seeks to diversify the type of FDI it attracts, it will be important to improve regulatory procedures and remove barriers to public procurement for foreign companies. Efforts should also be made to mainstream sustainability considerations into Chile's international investment agreements (IIAs). Labour and environmental standards are increasingly part of free trade agreements (FTAs) negotiated by the Ministry of Foreign Affairs; however, more could be done to update "old generation" agreements that do not include sustainable development provisions and strengthen their effective implementation.

In recent years, InvestChile, Chile's investment promotion agency, has prioritised low-carbon and knowledge-intensive FDI. Although new initiatives have been set up to improve the quality of investment promotion services offered to foreign MNEs, monitoring and measuring the contribution of these activities to the Sustainable Development Goals (SDGs) is an area where further progress could be made. InvestChile's representation abroad could also be strengthened to generate contacts and investment projects that contribute to sustainable development, including by establishing overseas offices and strengthening co-ordination with ProChile, the agency in charge of promoting Chile's exports, and the Ministry of Foreign Affairs. The investment promotion action plans to be developed by InvestChile in early 2023 provide a good opportunity to strengthen inter-institutional co-ordination mechanisms for the implementation of the new national strategy on FDI promotion.

In addition, both direct and indirect financial support to knowledge-intensive investments could be better co-ordinated and targeted in order to promote Chile's strategic development priorities in the area of sustainable development and FDI diversification. Chile provides one of the lowest levels of total government support for business R&D among OECD and partner economies. The Government of Chile could consider ways to streamline and consolidate its financial incentives framework, including by strengthening co-ordination and the joint management of the incentives system through the Inter-Ministerial Committee for Sustainable Productive Development, or by leveraging the potential of a new public development bank or the already established Banco del Estado. These reforms should aim to make available a variety of funding instruments and network-building initiatives to crowd-in private investors, including foreign.

Foreign companies operating in Chile should be further incentivised to undertake training activities for their employees and local suppliers. Currently, skills development programmes are implemented by various governmental actors and are not sufficiently aligned with labour market needs. InvestChile should co-ordinate with SENCE, CORFO and Chile's labour intermediation offices to develop joint programmes that enable foreign companies to find the skills they need. The agency could also further promote sectors and activities in line with the existing skills base and provide investors with adequate information on labour market characteristics.

Creating a favourable environment for low-carbon investments is an important political priority for the Chilean Government. Chile's long-term goal of reaching 100% zero-emission electricity generation and 80% renewable energy by 2050 will require a sustained pace of investment in clean energy. Achieving this target should entail targeted policies, in particular for hard-to-abate sectors, and to attract private investment, including FDI, in emerging industries (e.g. green hydrogen). To this end, the current carbon pricing framework should be revised with the aim of raising carbon taxes to levels comparable to international standards and improving their sectoral coverage.

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