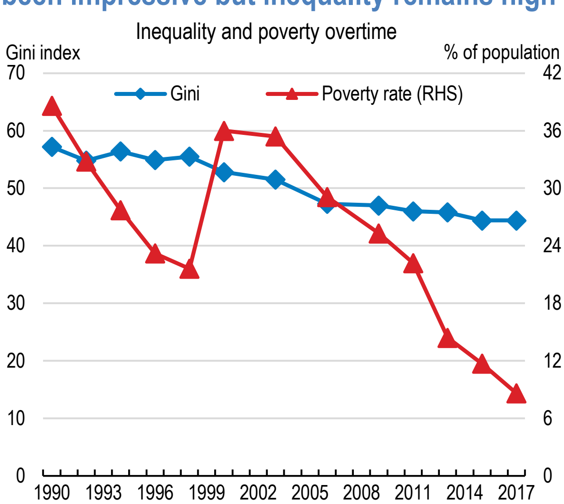
# Executive summary

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

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

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

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




Source: World Bank, World Development Indicators database.

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

### Table 1. Chile is set for a gradual recovery

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

Source: OECD, Economic Outlook 108 database.

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

**The outlook is bleak and subject to sizeable risks in a higher than usual uncertain**

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

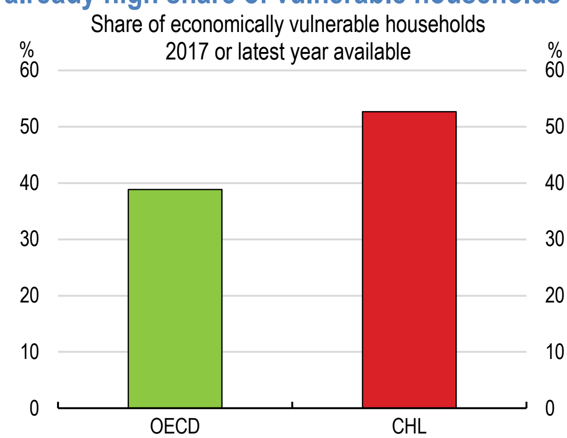
**The economic recovery should be accompanied by action to limit the threats from climate change**. Chile has a solid track record in this area, but the recovery will give a chance to integrate environmental improvements further in the economic landscape. The unintended negative environmental impacts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

## Avoiding hysteresis effects on inequality after the outbreak

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

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

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




Source: OECD, Wealth Distribution database.

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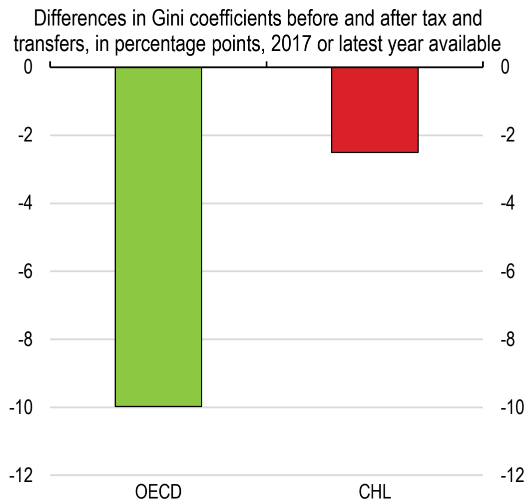
**The tax and transfer system could become a key means to reducing economic vulnerability.** Taxes and transfers do not provide enough protection against adverse economic shocks (Figure 3). The base of the personal income tax is narrow and broadening it once the recovery is well on its way would raise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

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

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




Source: OECD, Income Distribution and Poverty database.

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## Closing productivity gaps to support the recovery, notably through digitalisation

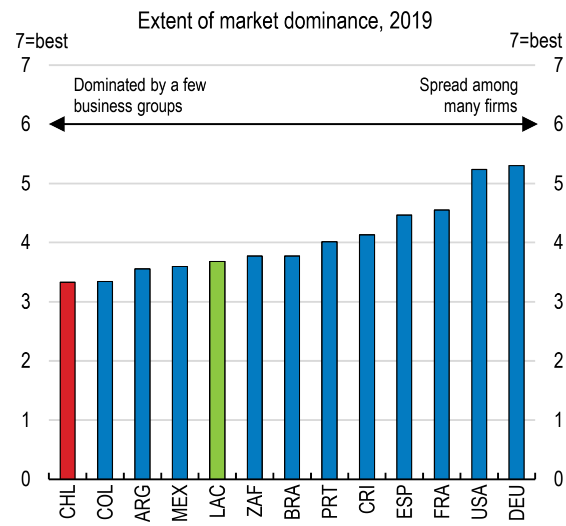
**Productivity is low, driven by business polarisation**. Chile has a persistent division between a small number of large and productive firms, and a long tail of micro, small and midsize companies with considerably weaker productivity performance. These small firms are likely to suffer more from the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

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

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

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

### Figure 4. Competitive pressures remain low




Source: World Economic Forum.

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

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

| MAIN FINDINGS | KEY RECOMMENDATIONS |
|---|---|
| **Containing the pandemic and its consequences** | |
| COVID-19 could continue to strike in future waves, costing human lives and amplifying further the economic consequences. | Increase capacity for extensive testing and tracing provide further support to health-care workers, and enhance the provision of masks, ICUs and respirators.<br>Continue transitory support to SMES and the most vulnerable families, including non-conditional cash transfers, tax deferrals and reductions, food baskets or suspension of payments of basic utilities for the poorest households, as long as needed.<br>Going forward the fiscal effort should be focused on making efficient reallocations of public spending, including the elimination of exemptions in the tax system, to support the recovery. |
| Headline inflation will remain contained. | With well-anchored inflation expectations, keep monetary policy accommodative until the economic recovery is well underway. |
| **Fostering inclusiveness** | |
| Educational achievements are low and access to good education is strongly linked to socio-economic status, posing the risk of a long-lasting effect of the pandemic on poverty and social mobility. | Step-up investment in high-quality early childhood, primary and secondary education.<br>Enhance the provision of childcare and early childhood public structures. |
| The tax and transfer system is ineffective in providing protection for vulnerable households and the base and redistributive power of the personal income tax are low. | Strengthen the redistributive impact of the personal income tax by lowering the thresholds at which the bottom and top bracket apply. |
| Individuals and workers often lack the foundation and digital skills necessary to flourish in a digital world. | Increase digital literacy in schools giving digital skills more prominence in the national curriculum, and enhancing the digital skills of teachers and school-directors. |
| Access of vulnerable workers to training courses is insufficient and many of their job profiles might change in the future or even disappear with further automation. | Embark on a full revision of firm-provided training programmes to increase relevance and quality of training and better target participation to vulnerable workers. |
| **Closing productivity gaps** | |
| The complexity of some regulatory procedures remains high, penalising mostly start-ups and SMEs. | Streamline permits and their process by implementing a zero-licensing procedure to encourage investment and simplify regulations for SMEs. |
| Adoption of digital tools lags behind other OECD countries, particularly for SMEs. | Boost public support to SMEs, in cooperation with the private sector, trough targeted programmes to facilitate the adoption digital tools. |
| R&D and innovation expenditure is low, especially in SMEs, and comes mainly from public resources. | Foster a collaborative digital innovation ecosystem by strengthening business collaboration and fostering open-innovation practices. |
| High-speed fixed broadband penetration is low compared to OECD average and rural/urban disparities are large. Entry barriers in the communication sector are high. | Ensure low barriers to entry to the communication sector by replacing the existing regulation for concessions. |
| **Strengthening green growth** | |
| CO2 emissions and energy consumption have risen in line with strong GDP growth. Chile has committed to achieving carbon neutrality by 2050 but the recovery after COVID-19 could jeopardise these commitments. | Carefully screen the environmental impacts of stimulus measures in the wake of the outbreak to avoid unintended environmental consequences. Condition direct financial support measures for pollution-intensive sectors that may be particularly affected by the crisis to cost-efficient and verifiable environmental improvements. |


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