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FEATURED Q&A

How Would Higher Corporate Taxes Affect Chile's Economy?

Q Chile's government is considering raising corporate taxes as a way to help pay for reconstruction after the country's massive earthquake, Interior Minister Rodrigo Hinzpeter said last month. How would higher corporate taxes affect companies operating in Chile and the country's economic growth? More broadly, are corporate taxes set at an appropriate level elsewhere in Latin America? Which countries have overtaxed or undertaxed companies and what can be learned from their experiences?

A Patricio Melero, leader of the conservative Independent Democrat Union (UDI) party in Chile's Chamber of Deputies:

"The UDI is divided on the topic of a tax increase. As a consequence, we will support our government's proposal on this subject, as long as the increase is small, temporary and won't affect the people, especially the middle class and poorest sectors of the country. Another condition is that the tax increase be part of a package of proposals, which includes the sale of shares in state-owned companies, the issuance of debt, the use of the country's international reserves and other measures to help finance the \$9 billion that Chile needs for national reconstruction of the public sector. We know we need \$30 billion between the private and public sectors once the insurance payments are taken into account. We haven't yet seen the president's tax propos-

al, but he more than anyone else will ensure that the impact on business and economic growth is the smallest possible. I believe the magnitude of the earthquake—among the largest ever recorded—requires us to make a decision on taxes because without them, the financing won't be enough. Chile has a tax level of about 17-18 percent of GDP, and we think the country's taxes are adequate. The emphasis should be on economic growth, development and the search for new business opportunities rather than on higher taxes. So even though we oppose

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In Haiti, U.S. First Lady Pledges Continued Support After Quake

U.S. First Lady Michelle Obama made a surprise visit Tuesday to Haiti, where she met with the country's president and said the United States will continue supporting the quake-ravaged nation. See story on page 2.

Photo: White House.

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NEWS BRIEFS

Mexico, Argentina Sign Anti-Nuclear Accords With U.S.

Mexico has pledged to work with the United States and Canada to remove high-grade uranium, which could be used to make nuclear weapons, from its nuclear reactors, officials said during a nuclear security summit in Washington, the Associated Press reported Tuesday. Also on the sidelines of the summit, U.S. and Argentine officials signed a deal to collaborate on preventing the smuggling of nuclear materials in the port of Buenos Aires.

Brazil Consumer Credit Rises 18.3 Percent in March

Demand for consumer credit in Brazil rose 18.3 percent in March from the month before as consumers moved to take advantage of an expiring tax credit, Brazilian credit rating agency **Serasa Experian** said Monday. The company recorded demand increases in all six income categories it tracks, and the overall figure was the highest since 2007. Consumer credit demand grew 32.5 percent year-on-year in March, which was due primarily to low 2009 levels, Serasa Experian said.

Chile's Andina Plans \$170 Million Investment in Bottling Operation

Chile-based **Andina**, one of Latin America's main bottlers of **Coca-Cola**, on Tuesday said it is planning to invest \$170 million in its operations, Reuters reported. The company will invest \$70 million in a new plant expected to be up and running early next year, said executive vice president Jaime García. The company will also invest \$50 million in its operations in Brazil, \$30 million in Chile and \$20 million in Argentina, he said.

Economic News**Drug War Fears Leading Would-Be Foreign Tourists to Bypass Mexico**

Mexico's escalating drug war is keeping would-be foreign tourists from visiting the country's main resort areas, according to airport statistics, Reuters reported Tuesday. International arrivals to the popular beach resort of Cancún declined four percent in the first three months of the year, according to airport operator **Asur**. The volume of international tourists arriving in Acapulco decline by nearly a quarter during the same period, said another airport operator, **OMA**. Mexico is still likely to welcome more foreign tourists this year than last year, when swine flu fears led to canceled vacation reservations in Mexico, the wire service reported. "The fall in foreign tourists in Cancún is certainly noticeable," Roberto Diaz, a boat captain who ferries snorkelers, divers and fishermen to nearby islands, told Reuters. The worst of Mexico's drug violence has happened near the U.S. border, particularly in Ciudad Juárez, which is far from popular seaside resorts. However, the image of drug violence in Mexico has kept tourists away, Diaz added. "Mexico's bad image abroad means tourists, mostly the

Americans, are not coming as much," he said. Mexico's drug violence has left more than 22,700 people dead since President Felipe Calderón began his crackdown against traffickers in late 2006, according to a new government report, the Associated Press reported Tuesday. More than 1,000 people were killed in March alone, so far the deadliest month since Calderón became president, Reuters reported. On March 13, three people with ties to the U.S. Consulate in Juárez were killed as they drove through the city. The U.S. State Department has warned Americans against nonessential visits to the border region, particularly in Juárez and Tijuana. Hotels' occupancy rates have fallen to about 30 percent in the area.



Calderón

File Photo: Mexican Government.

Political News**U.S. First Lady Michelle Obama Makes Surprise Visit to Haiti**

U.S. First Lady Michelle Obama and Jill Biden, the wife of Vice President Joe Biden, made a surprise visit Tuesday to

Featured Q&A

Continued from page 1

higher taxes, we think that given the exceptional circumstances and the magnitude of the earthquake the country has suffered, it's acceptable to raise taxes temporarily, as long as its part of a set of actions."

A **Alberto Pfeifer, international coordinator of The Business Council of Latin America in Santos, Brazil:** "Current estimates place the burden of the earthquake at 18 percent of Chile's gross domestic product. The Piñera cabinet is working on a stimulus package comprising seven to eight initiatives, including a tempo-

rary increase in corporate taxes, perhaps including mining royalties. The increase would focus on large companies. Small and medium enterprises and individuals would be spared from any direct burden. This extraordinary tax would last for two to three years. The Chilean business sector is in principle not in favor of tax increases and argues that the effect in terms of recovering the economy is questionable. For some, this is just a political measure of a newly installed government that feels the urgency of responding to the tragedy. However, it is justified on moral and social grounds; so the private sector will conform to a minor hike in

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Haiti, which included a helicopter tour of the country's earthquake-ravaged capital city and visits with children and other quake survivors, the Associated Press reported. "It's powerful," said Obama, who walked through an encampment of survivors living in squalid conditions. "The devastation is definitely powerful." International attention must remain focused on Haiti to help the impoverished country recover from the Jan. 12 earthquake, said Obama, who also met with Haitian President René Préval during the trip. "It was important for Jill and I to come now because we're at the point where the relief efforts are under way, but the attention of the world starts to wane a bit," she said. "As we enter the rainy season and the hurricane season ... the issues are just going to become more compounded." The earthquake is believed to have killed more than 230,000 people. Obama lauded U.N. peacekeepers and Haitians for their efforts in the quake's aftermath and said the United States, which has provided \$1 billion in aid since the disaster and has pledged in excess of \$1 billion more, would continue standing by Haiti. The next stop for the U.S. first lady is Mexico, where she will visit through Thursday.

Company News

Colombian Banks Saw 0.8 Percent Rise in Profits for January, February

Banks in Colombia collectively reported 909 billion Colombian pesos (\$U.S. 472 million) in profits for January and February, an increase of 0.8 percent as compared to the first two months of 2009, Colombia's bank regulator said Monday, Dow Jones reported. Bank lending increased marginally and banks' investments in local government bonds did not boost profits as they did last year, the regulator said. The country's domestically owned private-sector banks posted 516 billion pesos in profits for January and February, a decrease from 575 billion pesos last year. **Bancolombia's** net profit declined 2 percent to 229 billion pesos for the period. The figure does not include the profits of Bancolombia's subsidiaries.

Research Alert

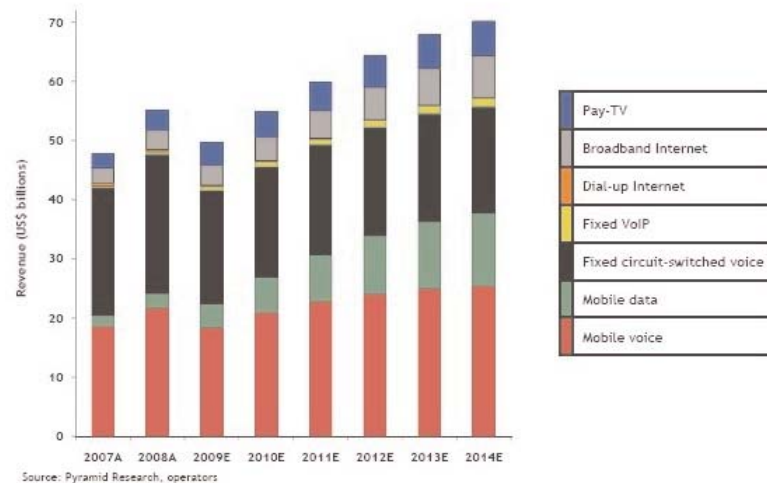
Mobile Data Expected to Fuel Brazilian Telecom Sector Revenues

Brazilian telecommunications companies saw revenues in 2009 drop 11.3 percent from the previous year to \$48.5 billion, but firms will see a significant rebound through 2014 on a strong expansion of mobile data services and broadband Internet access, **Pyramid Research** said in a report last month.

Telecom-sector revenues are expected to grow by 5.9 percent annually in the next four years, reaching \$69.3 billion in 2014, the consulting group said. Vinicius Caetano, a senior analyst at Pyramid Research and author of the report, said the deployment of 3G and the more advanced LTE technology will lead mobile services to overtake fixed-line offerings as companies' most lucrative business. "Data and video, pushed by the deployment of newer technologies, such as 3G, LTE, and IPTV, will keep growing as a larger portion of the population gain access to these services," Caetano said. Revenue from mobile services will more than triple to \$12.7 billion in 2014, from \$4.3 billion in 2009, surpassing fixed-line revenue in 2011, the report said. [Editor's note: See chart below.]

Low mobile penetration in Brazil relative to other countries in the region means there is still plenty of room for growth, representing a huge opportunity for tele-

Brazil communications market revenue, 2007-2014



coms. "The mobile penetration rate in Brazil is still low compared with countries such as Argentina, where it surpasses 130 percent; however, regulations making mobile operators deploy 3G service in the whole of Brazil over the next few years will significantly boost the number of mobile users," Caetano said.

According to the report, Brazilian companies are already regional leaders in triple-play offerings, which combine voice, television and Internet services. "The key players are **Oi** with its Conta Total bundles and **NET Serviços** with its Combos," Caetano said.

The report said consolidation will continue to shape Brazil's telecommunications sector, noting recent deals including Oi's acquisition of **Brasil Telecom**. That move triggered a revision of the country's basic telecommunications law which is currently underway.

Featured Q&A*Continued from page 2*

corporate tax rates for two to three years, which won't significantly affect profits or growth. Corporate rates in Chile are around 17 percent, the lowest among large Latin American countries, and have been so for more than 15 years. According to a 2007 KPMG study, corporate tax rates in Latin America have fallen just 2 percent on average between 1997

“Corporate rates in Chile are around 17 percent, the lowest among large Latin American countries.”

— *Alberto Pfeifer*

and 2007, from 28 percent to 26 percent, and are still high for global standards. Globally, same rates have declined from 33 percent to 27 percent. Countries who compete with Latin America for foreign direct investment, such as China, India, Southeast Asia and Eastern Europe, have either smaller rates or are working aggressively to reduce corporate tax rates and taxes in general. In Latin America, corporate tax rates have remained stable and high, except in Mexico and Colombia, which have been consistently reducing them. Several kinds of exemptions and compensation mechanisms, and indirect taxes, can alter the effective taxation for each productive sector. This varies a lot from country to country and over time, so it's hard to extract lessons to other situations."

A **Tasha Fairfield, researcher at the Stanford University Center on Democracy, Development, and the Rule of Law:** "Revenue from direct taxes on income and profits as a percent of GDP is low in Latin America relative to advanced industrial democracies and relative to countries of

similar development levels elsewhere in the world. Much of the direct tax revenue shortfall arises from individual income taxes rather than corporate taxes. In Chile, however, the corporate tax has a direct relationship to the individual income tax. Chile's income tax is integrated: the corporate tax (CT) acts as a withholding on the personal income tax (PIT) on distributed profits. Profits reinvested in the firm pay only the 17 percent CT. But dividends enter the recipient's PIT base and are taxed at much higher rates—the top marginal PIT rate is 40 percent. The CT already collected at the firm level is credited against the recipient's PIT when dividends are distributed. The low corporate tax rate facilitates tax avoidance and evasion. Capital owners find many ways to consume profits through the firm, without formally withdrawing dividends and hence without ever paying the corresponding PIT. Independent professionals can create 'investment companies' for the purpose of transforming income that would otherwise be subject to the high PIT rates into corporate income taxed at only 17 percent. Income tax evasion through under-declaration of distributed profits is also high. Piñera's proposal to increase the corporate tax would be a good way to raise revenue from upper-income groups in Chile who can most afford to bear the burden. Tax agency data shows that income and profits are extremely concentrated, but effective income tax rates are very low for taxpayers in the top percentiles of the income distribution. A moderate corporate tax rate increase probably would not discourage investment. Ironically, the right in Chile resisted initiatives to increase corporate taxation while the center-left coalition held power, despite modest compromises on tax reform in 1990 and 2001."

The Advisor welcomes reactions to the Q&A above. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.

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