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Chile—Preliminary Takeaways on Draft Constitution

- In Chile, the constituent assembly has completed drafting a new Constitution. The process isn't over, however, and much work (and uncertainty) remains.
- We provide answers to key questions on the draft Constitution, the next stage of the process, and the likely outcome of the September ratification referendum below.

On Monday, May 16, the constituent assembly delivered the draft of the new Constitution, ending the constitutional debate that lasted 10 months. The work of three new commissions now begins: the Commission of Harmonization, in charge of consistency and coherence; the Commission of Transitory Norms, which will ensure a gradual implementation; and the Commission of Preamble, which communicates the intentions of the framers and the purpose of the document.

Table 1: Chile—Key Events

Dates (Year 2022)	Subject	Details
June 13th	Final report of Commission of Harmonization	The report with explanatory notes to the bill is presented to the Plenary.
June 29th	Harmonization process concludes	End of voting on the harmonization process.
July 5th	End of the operation of the Constitutional Convention	End of operation that includes the extension of 3 months.
September 4th	Exit referendum	Plebiscite to approve or reject the text of the new Constitution.

Sources: Scotiabank Economics, Convención Constitucional.

The constituent assembly will conclude its work on July 5. President Boric will then call for an exit referendum, to be held on September 4 (table 1). We have received many questions regarding the process that we summarize in the following Q&As:

1) Did the central bank's objectives drastically change?

No, there are no changes in the objectives of the central bank (only administrative and accountability modifications).

- The central bank's objective continues to be ensuring the price stability and the normal functioning of internal and external payments.
- The mandate to make decisions consistent with the general orientation of economic policy is maintained.
- The prohibition of financing public spending is maintenance. Furthermore, the recent modifications requested by the central bank regarding the possibility of acquiring or selling public debt instruments in the secondary market, in exceptional and transitory situations, are included.
- The number of Board members is increased from five to seven. Several studies from the IMF (including Berger et al. 2006¹) point out that "larger and more heterogeneous countries, countries with stronger democratic institutions, countries with floating exchange rate regimes, and independent central banks with more staff tend to have larger boards (the average board has 7–9 members)".
- The possibility of Congress requesting the dismissal of a Board member by a simple majority is included, which must be resolved by the Supreme Court.

¹Berger, Nitsch and Lybeck (2006). "Central Bank Boards Around the World: Why Does Membership Size Differ?". IMF Working Papers.

2) Are the concepts of fiscal responsibility and fiscal sustainability included?

Yes. In contrast to the previous Constitution, the principle of sustainability and fiscal responsibility is explicitly included as the driver of fiscal policy.

- The principle of sustainability and fiscal responsibility will guide the actions of the State in all its institutions and at all levels.
- However, the president loses the exclusive initiative in terms of fiscal spending, enshrining what has been observed since the social unrest in October 2019. The Lower House could also present spending bills, although they can only be approved if the President of the Republic gives his sponsorship.

3) Would there be any significant changes to the mining industry's regulation?

The rejection of the nationalization of mining interests has been received as good news by industrial associations. However, the draft of the new Constitution introduced some elements that, if ratified, could hinder the development of new mining projects and also establish higher levels of uncertainty. Specifically, private participation in the mining sector will be defined by a simple law, since it does not refer to concessions. In case of nationalization or expropriation, it is established that compensation will be for a “fair price”, a concept that admits interpretation. In addition, the draft ends the current notion of “water rights” and makes it non-negotiable, which could introduce rigidities for its efficient use and make it difficult to start up new projects. Regarding this point, specialists point out that despite being non-negotiable, water rights could be transferable if it is determined by a future law.

4) Would the new Constitution destroy the private pension system based on pension fund administrators (AFPs)?

The new Constitution puts an end to the private capitalization system managed solely by AFPs and rules out a new solely government-managed solidarity system. Consequently, a mixed system could be implemented. However, the Constitution establishes the “public” character of the social security system, which will allow the intervention of private administrators in the management of social security. Specifically, the Constitution will allow the participation of the AFPs, among other managers. Given the recent signals from the government, and if the new Constitution is approved, we consider it likely that the government will present a pension reform that establishes a mixed system in Q3 2022.

5) Are there any changes to the parliamentary system?

Congress will continue to be bicameral, although the current Senate will be replaced by a Chamber of the regions. The political system will be based on two asymmetric chambers, where the greatest weight will be in the Deputies (155 members), while the regional representatives will only intervene in some laws (by regional agreement).

On the other hand, the assembly retained the presidential system, in which the president of the republic will have a four-year term and may be re-elected.

6) How did the quorums change to carry out constitutional reforms?

The assembly rejected the proposal to set the necessary quorum for constitutional reforms at four sevenths. In the absence of an agreement, for this type of procedure, the normal quorum for the formation of the law would apply: either a majority of those present, or a majority of the parliamentarians in office. Consequently, autonomous institutions such as the central bank could be reformed by simple majority. In this respect, some parliamentarians are studying initiatives to give temporary stability to the new Constitution. In our view, economic or institutional reforms would be more dependent on the political cycle.

7) Is there any impact of the restitution of lands considered ancestral?

The new Constitution does not indicate what the land restitution process will be. This is an identity norm that was certainly influenced by the situation of violence in the South of Chile. In a joint reading with the consecration of the property right (Art. 20), it would imply an important fiscal burden assuming that the interpretation of “fair price” corresponds to the advance payment of the market value of the lands that are registered as ancestral indigenous property. All in all, we see negative effects on the forestry industry that, although it could receive market compensation, would likely see an impact on its production levels given the uncertainty regarding the consideration of ancestral land that will be mandated if the new Constitution is approved. On the other hand, the provision could be transformed into an opportunity to pacify the South of Chile in cases where land demands are indeed the problem. There is disagreement on this point.

8) How to interpret two justice systems, one for indigenous people and the other for the rest of the population?

One of the questions that has arisen is how the courts of the indigenous people should be established so that they function effectively and in coordination with the National Justice System. The constituent assembly has explained that the details will remain in the law and not in the Constitution. Some members have pointed out that the Constitution establishes the need for coordination with the justice system with common crimes excluded. Other experts contend that such issues will be part of the implementation process of the new Constitution. There is a minor risk of generating opportunities for arbitrage between the indigenous justice system and the system for the rest of Chileans, which would accentuate the problems of animosity towards indigenous minorities.

9) What is the likely outcome of the referendum on new Constitution?

Currently, the polls show more people in favour of rejecting the new Constitution (46% according to the Cadem poll). However, we expect a tight result in the exit referendum on September 4.

10) How would markets react to the new Constitution? Have they priced in the related impact?

The last two weeks before the end of the plenary voting for the drafting of the new Constitution, members of the assembly from the socialist party began to vote against extreme proposals (nationalization of mining sector, a pay-as-you-go pension system, among others), all of them originated from minority groups. In this context, the expected scenarios for asset prices have eliminated the probability of a new Constitution with dramatic changes. Thus, it is reasonable to expect a decrease in the risk premia on Chilean asset prices. In any case, a high degree of uncertainty persists with respect to the work of the harmonization commission, which will merge articles and could even lead to new votes on the plenary. The fact that the polls are pointing to rejection will probably lead the socialists to maintain a conservative position, but there is no guarantee of that.

11) Are material changes likely to come from the commission of transitory norms or harmonization?

The harmonization process will conclude its work on June 13 (table 1 again). Although the regulation allows the presentation of rejected norms in the transitory norms commission, particularly those that were not reviewed in a second proposal after their rejection, we assign a low probability of approval.

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