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## **The Economy and Job Market in Chile: The Effects of a Long-Lasting Crisis**

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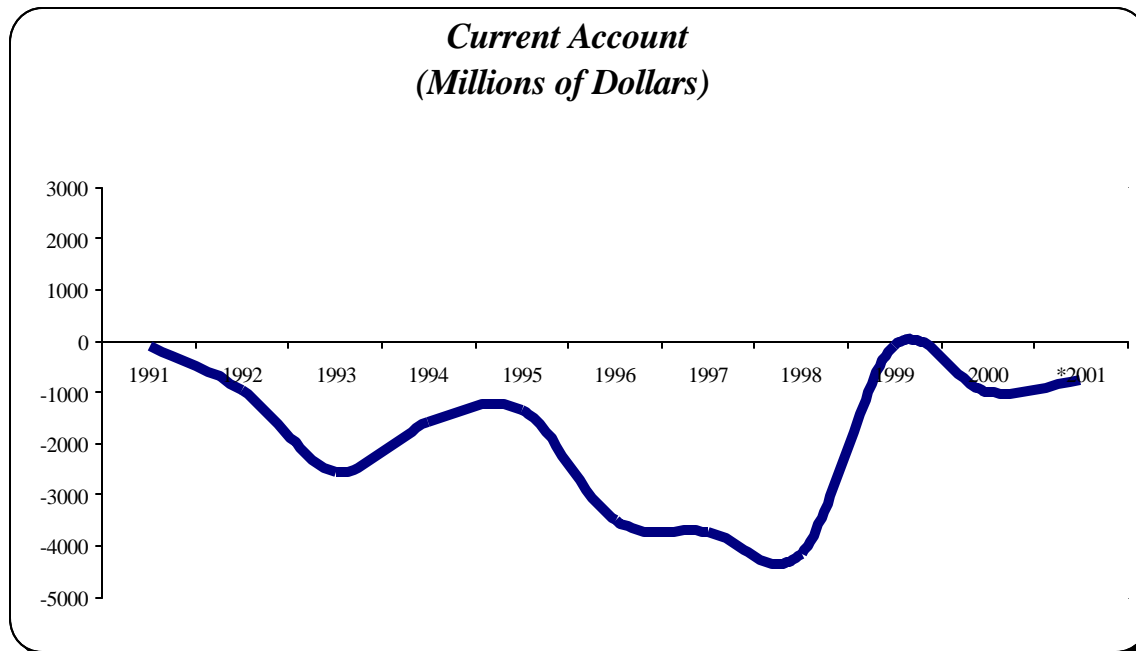
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## 1.-Background: The End of a Growth Cycle

In 1998, the Chilean economy reached the end of a growth cycle that began after the external debt crisis at the beginning of the 1980's. Subsequently, Chile underwent—earlier than in the rest of the region— a major neo-liberal structural reform. To be sure, moves in this direction had a long history, going back to the 1975 coup, but. in the beginning of the 1980's, Chile finished the work of laying the foundation of a new economic model.

The Chilean economy currently finds itself in a different situation, one tied to the Asian debt crisis of 1997. These events, though, simply served to trigger a crisis and contraction that had already begun to manifest itself. The Chilean economy found itself with its smallest current account of the decade, a process that originated in the middle of the 1990's with a large commercial deficit.

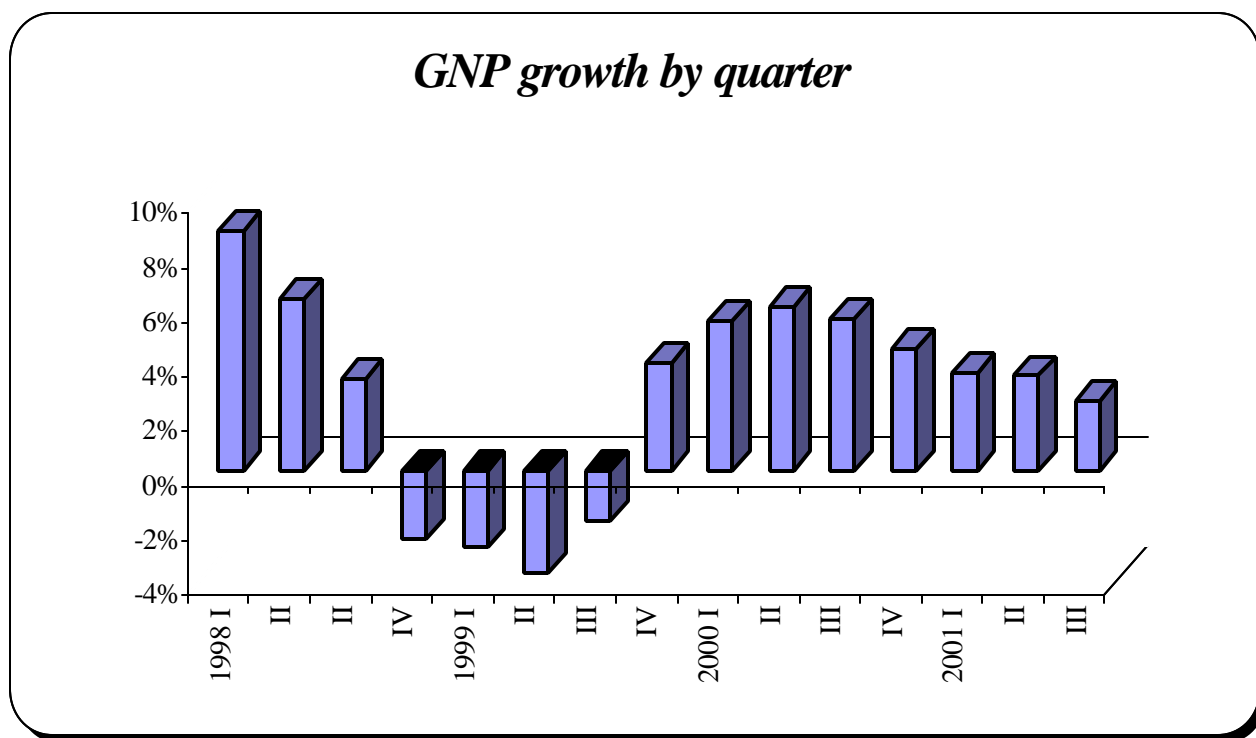
Chart No. 1



Source: Central Bank of Chile. 2001 Statistics until 3<sup>rd</sup> Quarter

The adjustment policies followed by monetary authorities precipitated a recession that began in the fourth quarter of 1998 and lasted through the third quarter of 1999, contributing to a 1.1% drop in GNP during 1999. The performance of the current account, whose 1998 deficit represented some 6.3% of the GNP, was somewhat tempered, for a large part of the decade, by positive flows in the capital account, due to large investments in the primary sector, specifically, in copper mining.

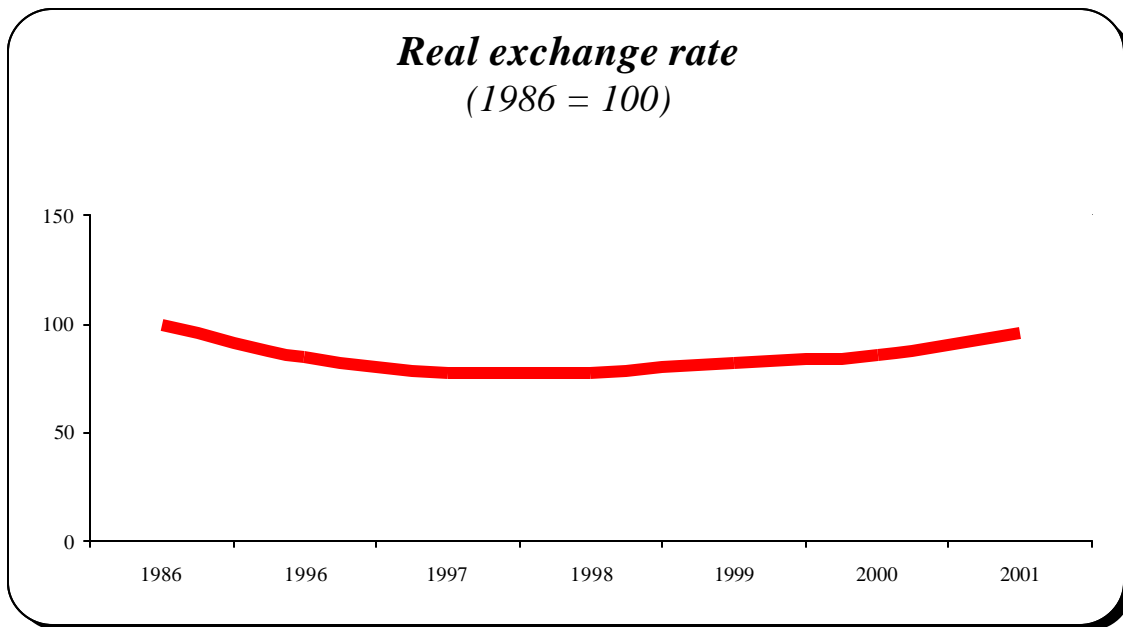
Chart No. 2



Source: Central Bank of Chile

The influx of resources during the 1990's not only distracted the economic policy-makers from the dangers of the declining current account, but also contributed decisively to a rising exchange rate, which is the root of the trade deficit that Chile experienced at the end of the 1990s. The following chart reflects these circumstances. The recovery during 2000 and 2001 responds in large part to the speculative activities of the financial sector in the face of the recent Argentine crisis.

CHART No. 3



Under these conditions, the adjustment policies drove the economy towards a significant contraction where both output and internal demand suffered greatly. These factors also contributed to rising unemployment and the negative expectations regarding the economy and its ability to recuperate fully. The nature of the period immediately following the crisis left the country in a situation in which the prospects for escaping contraction and stagnation are grim.

## **2.- The year 2000: From Slight Recuperation to Stagnation**

As shown in Chart Number 2, output of the Chilean economy began to show signs of recovering the fourth quarter of 1999, reaching its highest level of growth, 6%, in the second quarter of 2000. Nonetheless, from that point forward, growth decelerated markedly, as is reflected in the poor performance of the internal demand and in the general monthly economic indicators published by the IMACEC.

CHART No.4

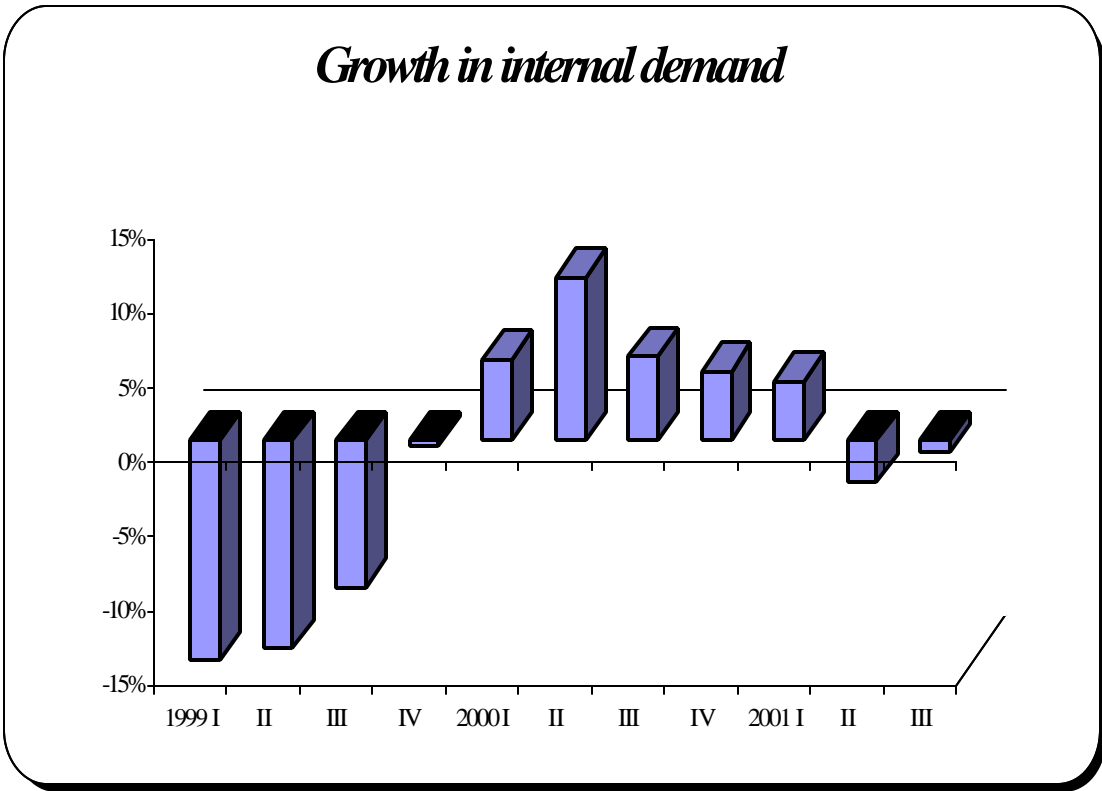
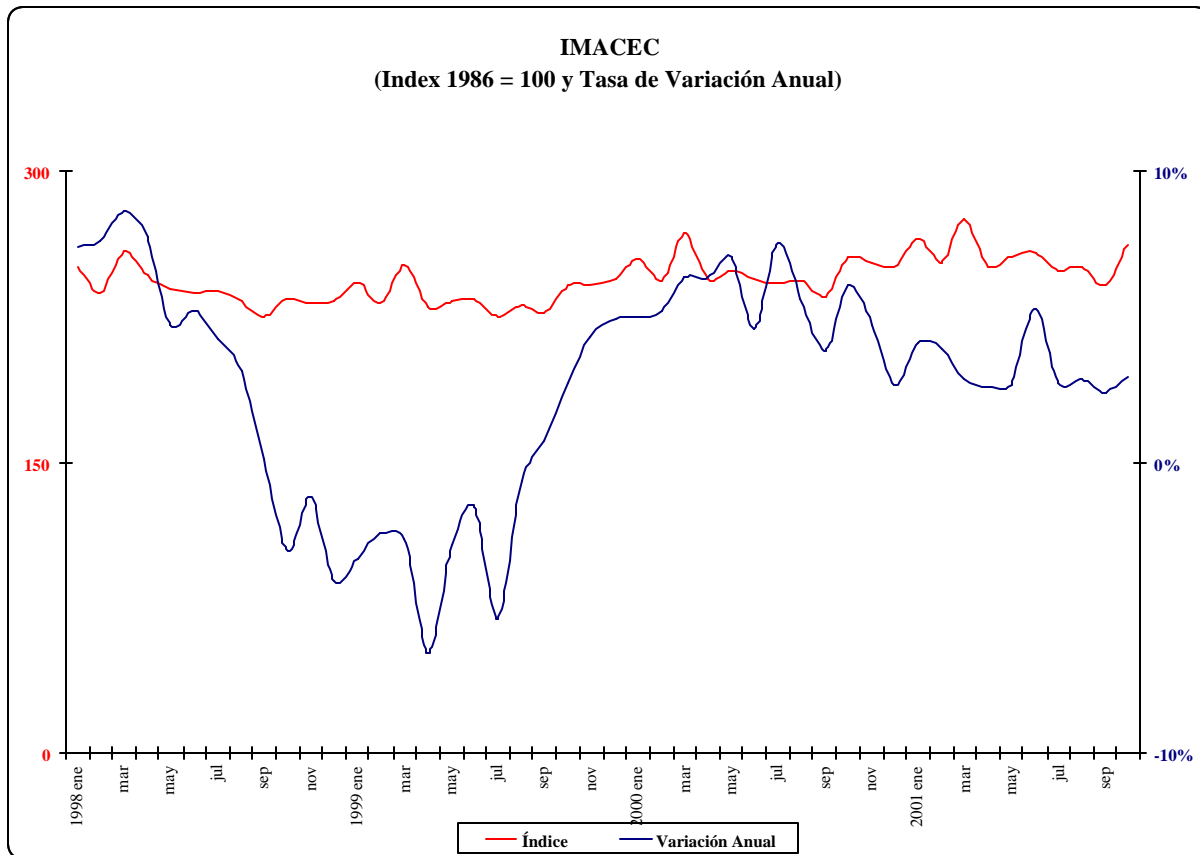


CHART No. 5



As with output, internal demand also experienced a period of recovery during 2000. In the second quarter of 2000, internal demand rose at an annual growth rate of 11%. Nonetheless, after the second quarter, growth decelerated significantly, and actually declined during the second and third quarter of 2001.

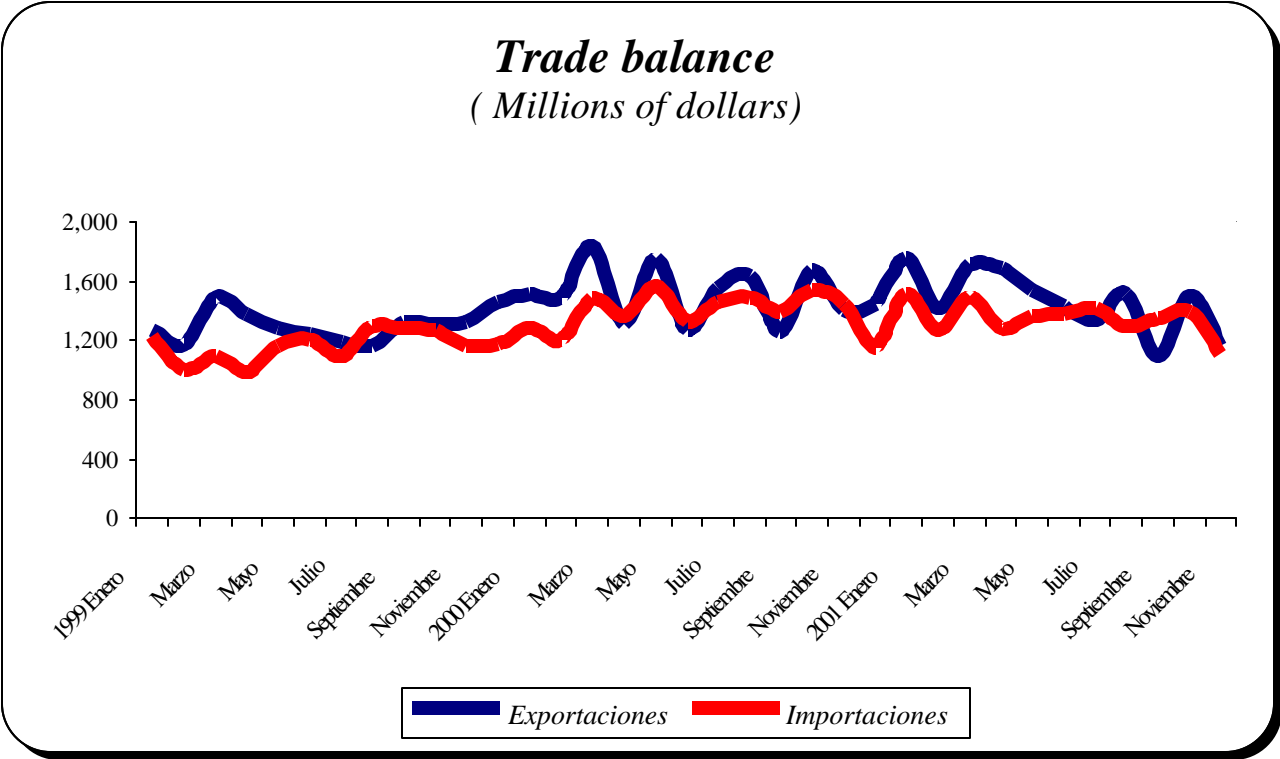
Two linked external factors help to explain recent poor performance: first, the economic recovery was based on a fragile expansion of exports, and second, the US economic slow down at the beginning of 2001, and the overall drop in the price of copper.

The 5% growth that the US economy managed in 2000 helped to maintain a stable global economy that was favorable for Chile and its export markets, but the situation ultimately proved fragile. When the world economy was healthy, Chilean output grew at a 5.4% annual rate, but this strong growth did not translate into higher investment and employment.

Given these conditions, it is apparent that external factors, not internal growth, were primarily responsible for the brief recovery of 2000. The fragile nature of this sort of growth explains the slim chance for sustained positive conditions within the Chilean economy.

Since 2000, the worldwide economy has found itself on the brink of a grave recession, one that clearly affects Chile's economic future.

CHART No. 7



The current situation is one of dangerous deceleration. In November 2001, exports declined 16.9% with respect to the same month in 2000, and imports dropped 23.2% over the same period. These figures indicate the seriousness of the contraction in internal demand. In the third quarter of 2001, accumulated internal demand grew 0.09% compared with the first three quarters of the previous year. Over the same period, consumption dropped by 1.6%.

**3.- The Effect on the Job Market**

The effects of economic contraction have had their biggest impact in the job market. Workers have borne the brunt of the weight of the current economic crisis with problems for both employment and earnings.

An analysis of the employment situation within the Chilean economy demands an understanding of certain structural factors. The first factor is that of a marked seasonality of employment demand, especially in agriculture, which is labor intensive. Agricultural employment increases during the harvest, and declines drastically during the winter. This work is notoriously precarious, due to both low wages as well as the transitory nature of work in the sector. I

CHART 7

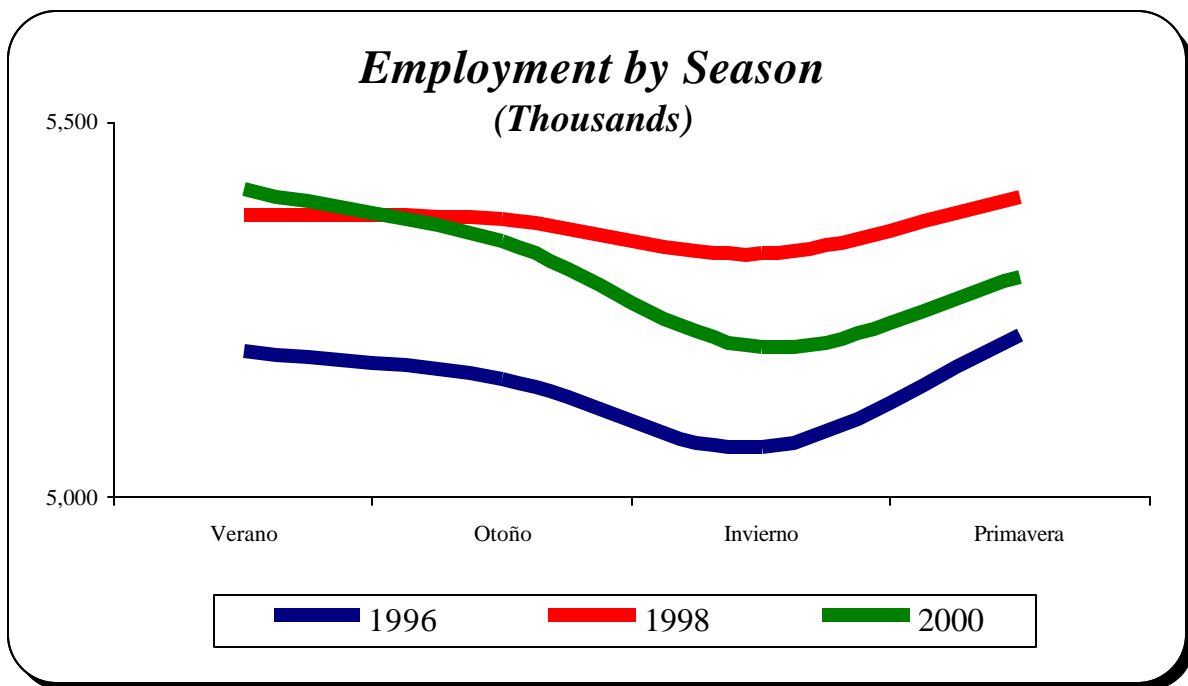
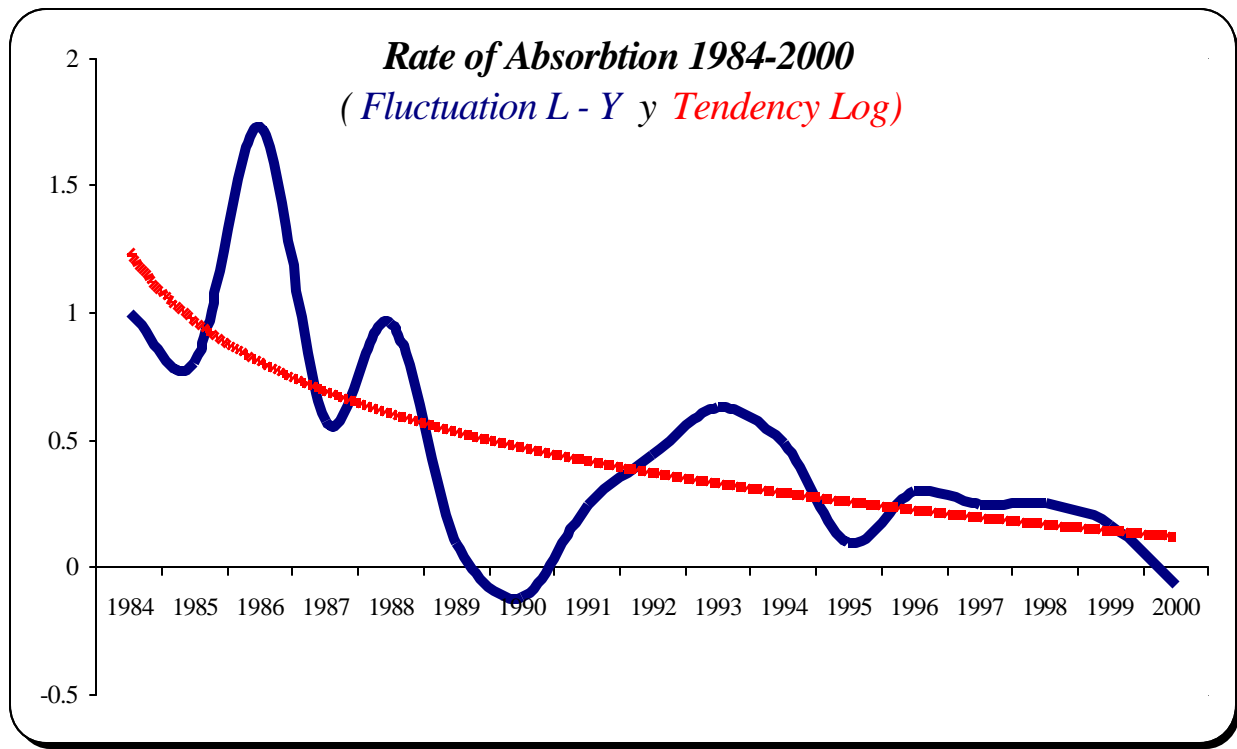


Chart number 7 shows the stagnation discussed earlier. The year 1998 stands out as one when the usual seasonal trend was muted, but, in 2000, the traditional pattern was evident. The chart demonstrates clearly that unemployment reaches a peak during the winter.

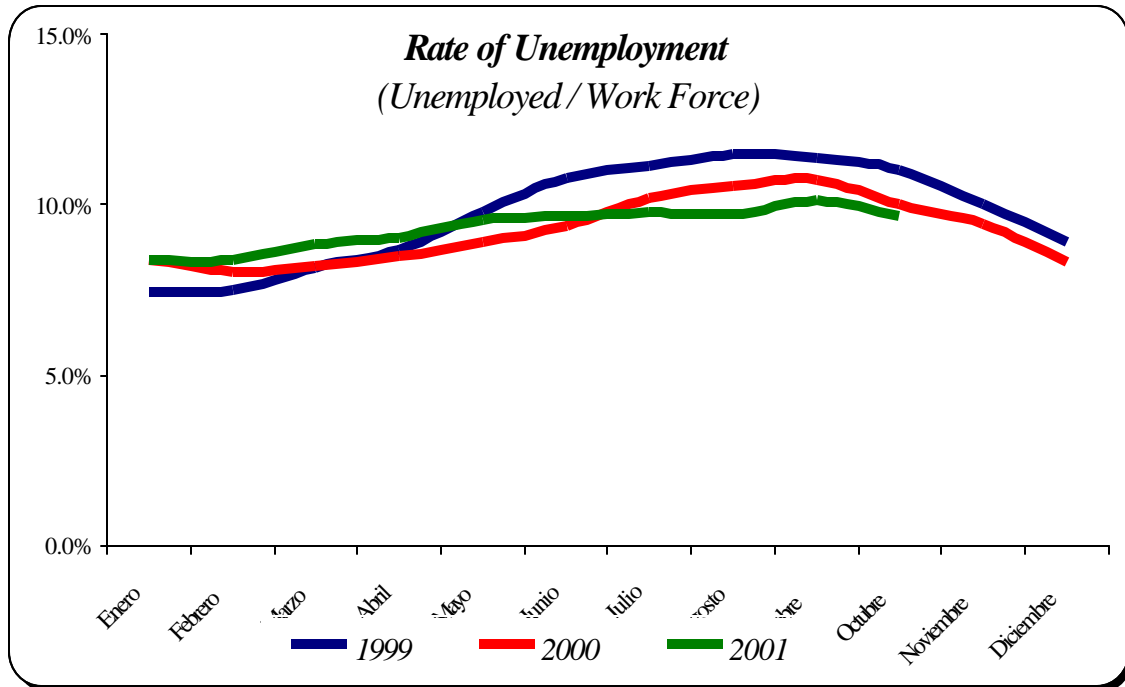
The second structural factor affecting the Chilean labor market is the steady decline in the absorption rate of the Chilean economy. At any given level of economic growth, the economy has become increasingly less able to create new jobs, casting serious doubt on the ability of the current structural model to address the national unemployment problem.

CHART 8



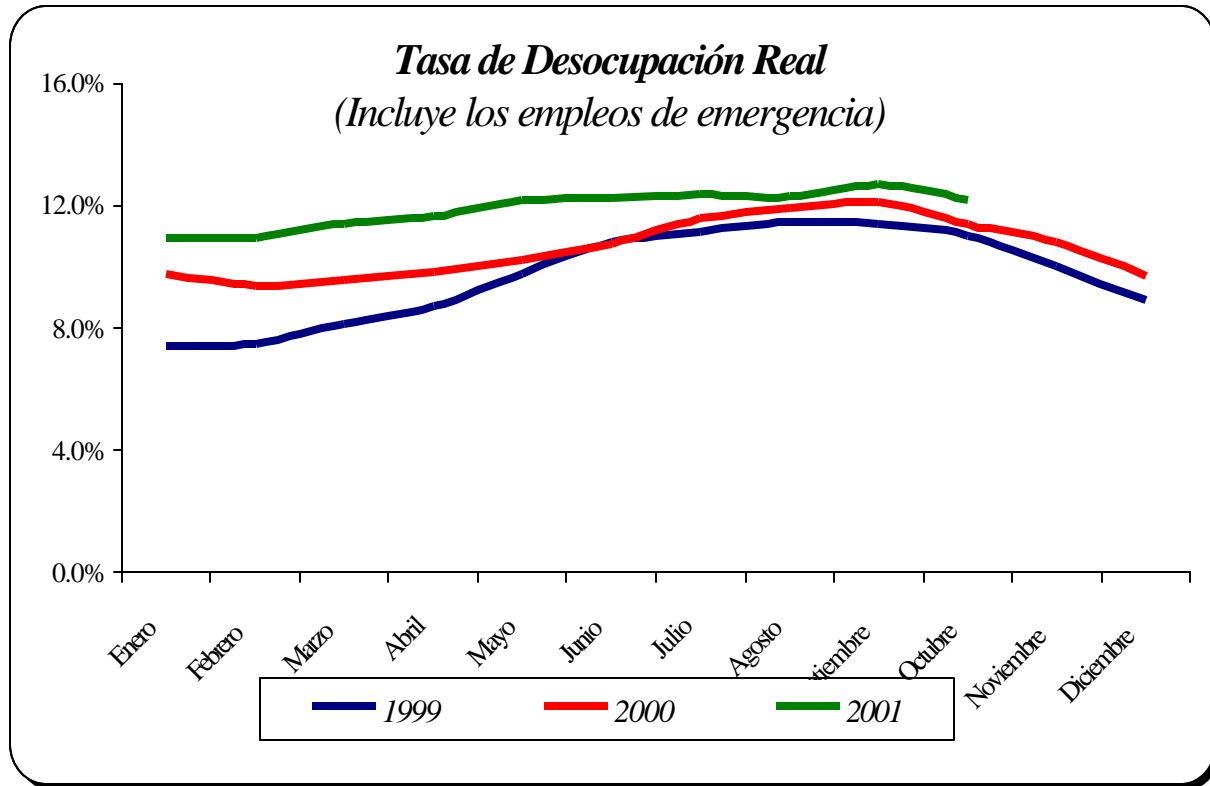
Generally speaking, the problem of a steadily declining absorption rate is typically a problem facing developed economies experiencing rapid productivity growth as the result of technological innovation. In Chile's case, the falling absorption rate, however, responds to a shift in economic activity toward sectors of the economy, such as mining, with low levels of labor intensity. As a result, growth means few jobs and can actually lead to a *rise* in poverty.

These underlying structural problems, combined with the ongoing national and international economic deceleration, together explain the current depressed job market situation.



We can see from the chart above that, in 1999, the unemployment rate was above 10% for six consecutive months. The same occurred for four consecutive months in 2000. In 2001, however, unemployment rose above 10% in only one month. This may suggest that the unemployment picture is improving, but this is not the case.

Since 2000, under new social assistance policies, the government has engaged in a program to create emergency jobs to assist the unemployed in areas most affected by the crisis. While these programs may be of some assistance to beneficiaries, who receive a modest income in exchange for performing odd jobs and menial work such as maintaining public land and repairing infrastructure, the programs by no means represent a fundamental improvement in the job market.



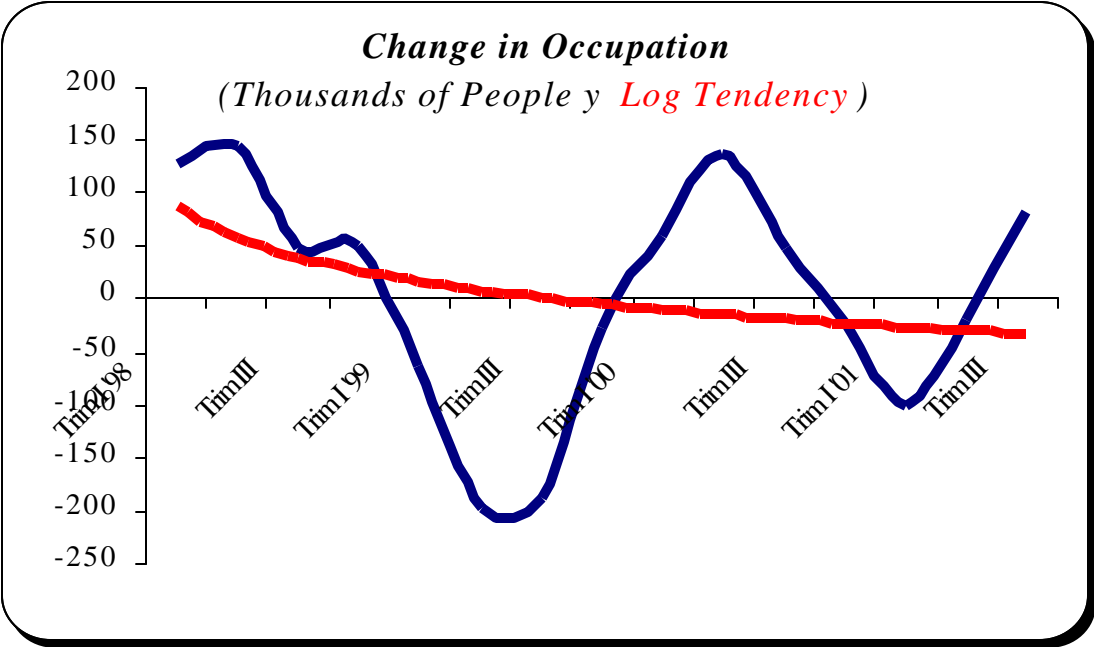
In 2000, the government created approximately 80,000 of these emergency jobs; in 2001, the figure increased to 150,000. Given the unstable nature of the job market and that these employment arrangements do not change the basic nature of the job market, we could reasonably count "emergency job" holders as part of the nation's unemployed. If we do this, the situation is drastically different, as seen in the chart above.

These new figures reverse the outcome in the immediately preceding chart. In 1999, unemployment reached double digits in six different months; in 2000, unemployment – including "emergency" jobs – was above 10% during seven months. Through October 2001, unemployment, by this alternative measure, was above the 10% level in every month. In fact, since May, unemployment has never dropped below 12%.

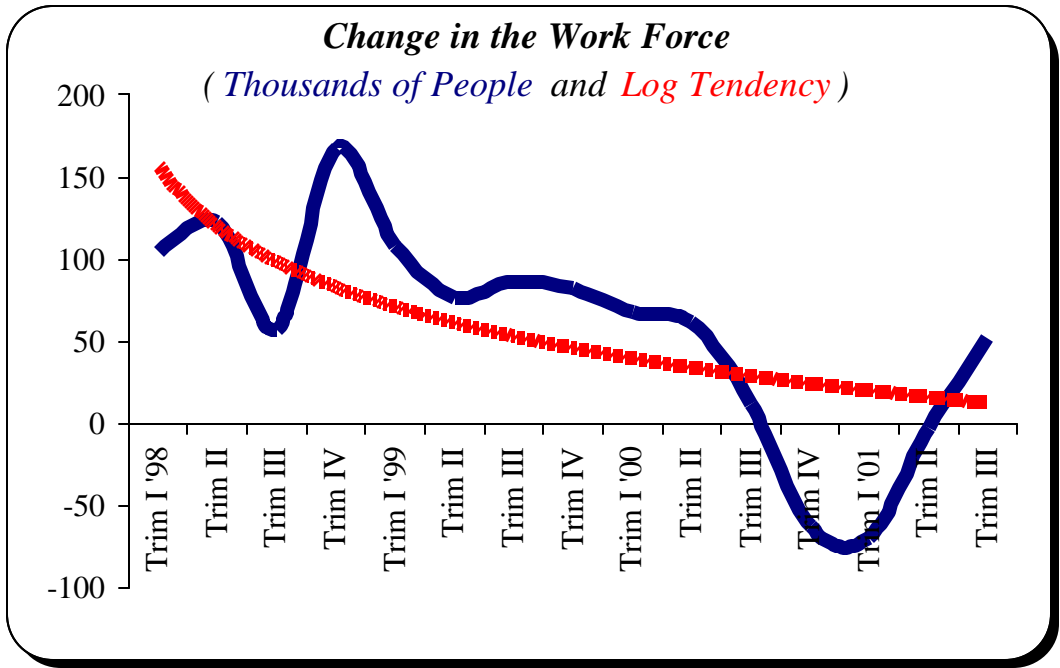
Thus, a more careful look at the labor market, including data on unemployment and employment, demonstrates the problems with many of the official statistics that attempt to monitor the labor market situation in Chile.

Among other problems, the INE's national labor-market survey underestimates the extent of unemployment in the national economy. The Chilean National Institute of Statistics (INE), consistent with the recommendations of the ILO, declares survey respondents "unemployed" only if they worked less than one hour during the week prior to the survey

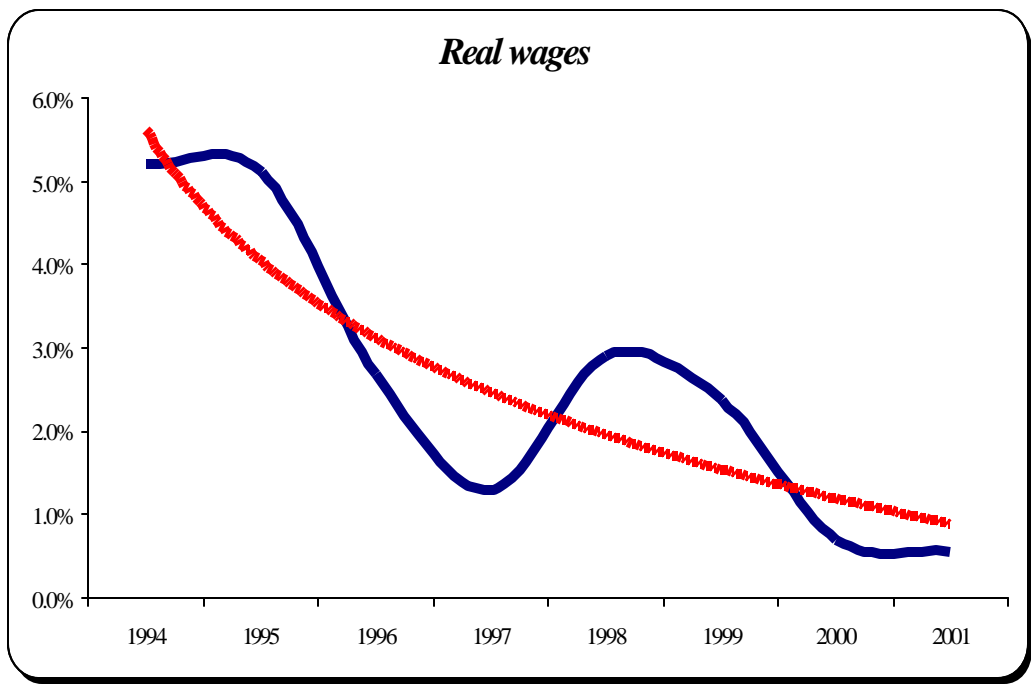
interview and if they have looked for work at some time in the month prior to the interview. Many Chileans who lost their job at the beginning of the economic crisis and who were not able to find work thereafter, however, gave up looking for work. These "discouraged workers", would not be classified as unemployed by the INE and ILO definition because these individuals have not looked for work in the previous month. INE and the ILO classify



The employment situation is subject to the same distortion given the previously outlined statistical methods. In this case, the INE categorizes as employed all people who have worked at least one hour in the week prior to the survey. This leads to an overestimation of the employment rate since various forms of sub-employment fall under this category. Overall, the statistics show a significant drop in the creation of new jobs. This is consistent with statistics found in chart number 8 concerning the absorption rate of the Chilean economy.



Finally, the same problems evident in the employment data also manifest themselves with respect to wages. The large supply of workers relative to demand has led to a steep decline in salaries (see chart number 13), exacerbating the country's already serious social problems.



The graph above shows the inflation-adjusted change (December-to-December) in the value of the average wage in Chile. (In 2001, the change refers to the period between December 2000 and October 2001). The graph underscores that 2001 has been very difficult and gives little hope that 2002 will see any improvement. The lingering North American crisis has had and will continue to have an important impact on the Chilean and the world economies. Internal factors are also an issue. The model of open economy implemented in Chile has had dire effects and there does not appear to be any desire to modify the existing structural model. Instead, the powers-that-be have subscribed to the strictest neo-classical agenda; in the face of crisis, the best political decision is to do nothing.

#### **4.- *The Current Socio-Political Context***

During the month of December, the economy and the troubled labor market found themselves caught up in a hotly contested electoral process, in which half of parliament was up for election. Naturally, the economic crisis and the problem of unemployment were at the center of the parliamentary campaigns.

From the point of view of the right and business, the solution to the economic strife is found in what is called a "microeconomic revolution" that looks to further economic deregulation, specifically relaxing environmental standards, financial controls, and employment regulations. From this point of view, the government has not properly confronted the economic crisis and taken the needed measures.

Government circles have not taken a clear position. Some defend the existing course of economic action, while others call for further measures to be taken. Those who support the government see the current situation as responding entirely to external forces; Chile is simply an innocent victim. Political leaders seem to hope that 2002 will be a much more positive year for the Chilean economy, and thus have concluded that the best decision is to "do nothing."

The results of the December 16 elections, which left a delicate balance between the government and the right, but the hard right made significant advances. The antiquated defenders of the Chilean dictatorship increased their representation in Parliament by almost 50% and significantly increased their presence in the senate. The election of Joaquin Lavin as president in the year 2005 and the resurrection of the fascist right is practically a fait accompli.

***December 2001***