

ECONOMY AND THE LABOR MARKET IN CHILE: The behavior of salaries in the midst of the crisis

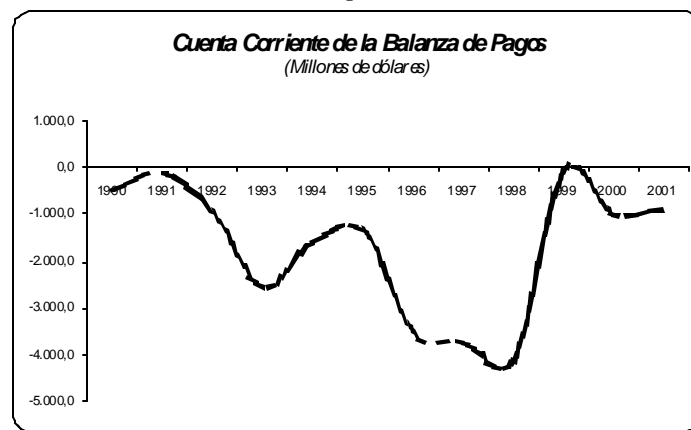
Patricio Escobar S.¹

1.- The economic conditions before the crisis

As we have shown in previous reports, in 1998 the Chilean economy ended an extended period of growth that began after the external debt crisis of the early 80's. Following this crisis, a profound neo-liberal structural reform process was undertaken, earlier than in much of the region. This process entailed the deepening of policies that had been implemented during the previous decade, beginning with the military coup in 1973. Thus, from the beginning of the 80's the workings of the economy that we now know have been delineated.

The situation in which the Chilean economy now finds itself is related to the balance of payments crisis that faced the Asian economies in 1997. The crisis found Chile's economy at its worst point of the decade with respect to its current account balance. This negative result originated primarily from a significant trade deficit that has dragged on since the mid-1990's.

Graph N° 1



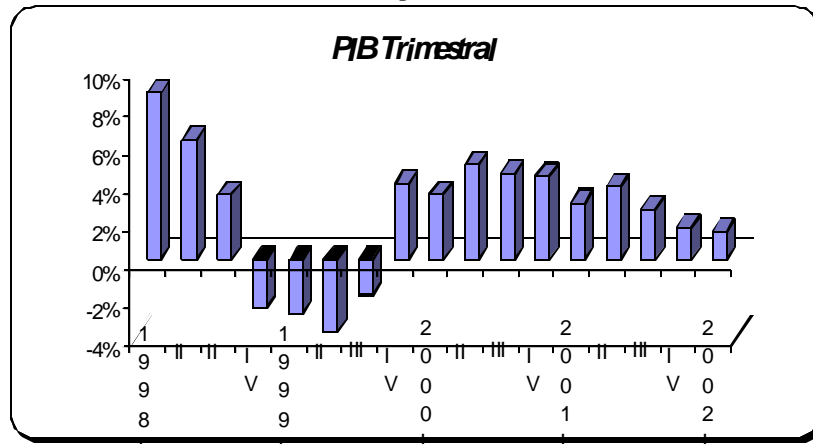
Source: Central Bank of Chile.

The adjustment policies followed by monetary authorities provoked a recession that lasted from the fourth quarter of 1998 to the third quarter of 1999, resulting in a decline of

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1.1% in GDP. This behavior in the current account, whose deficit in 1998 was 6.3% of the GDP, was partially compensated for during much of the decade. A positive balance in the capital funds had originated from an abundant flow of external investment in the primary sectors, particularly copper mining.

Graph N° 2



Source: Central Bank of Chile.

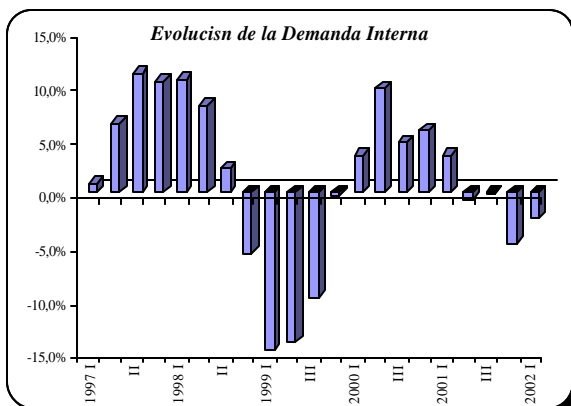
The fluctuation of resources entering the Chilean economy during the 90's has not only distracted the attention of the economic authorities with regard to the danger of a large current account deficit, but it has also contributed to a significant appreciation in the exchange rate. This appreciation, in turn, came on top of a trade deficit during the final years of the past decade.

In the fragile context described, the politics of adjustment via interest rates led the economy into a significant contraction, during which both production and internal demand suffered profoundly. Also contributing to this situation was an increase in unemployment and negative expectations about the economy's performance and chances for a solid recovery. The qualities of the period immediately preceding the crisis shape the current situation and the economy's incapacity to emerge from the current contraction and stagnation.

2.- *A fragile recovery leading to stagnation in the year 2001*

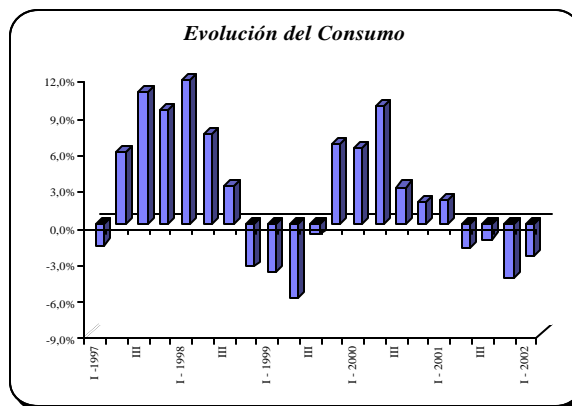
As we can see in Graph N° 2, the Chilean economy's production began to show signs of recuperation as of the fourth quarter of 1999, until reaching its highest level of growth (5%) in the second quarter of 2000. The final result is that the economy grew 4.4%. Nevertheless, from that point forward a notable deceleration began, which is reflected primarily in the behavior of internal demand, including investment and consumption. Additionally, this situation is reflected in the monthly activity indicator IMACEC.

Graph N° 3



Source: Central Bank of Chile.

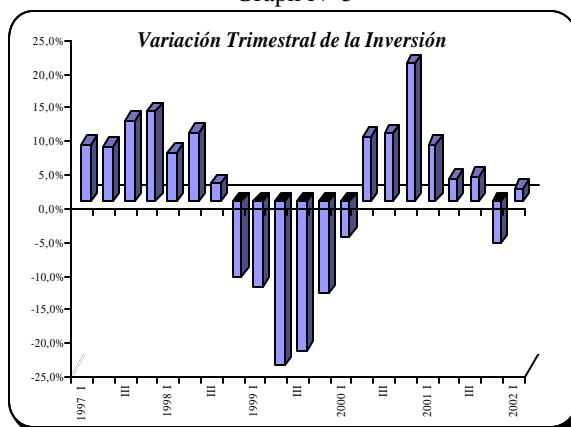
Graph N° 4



Source: Central Bank of Chile.

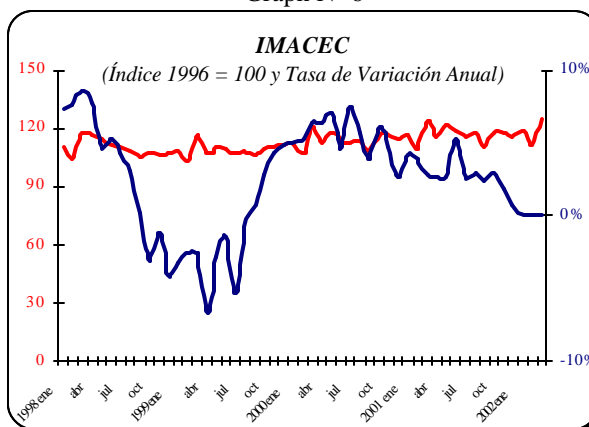
As with the output, internal demand underwent a brief recovery during 2000, reaching a 9.7% growth rate in the second quarter. Yet, following the path of output, internal demand began to show signs of deceleration in the second quarter of 2000, eventually even falling by the end of 2001 and the beginning of 2002.

Graph N° 5



Source: Central Bank of Chile.

Graph N° 6



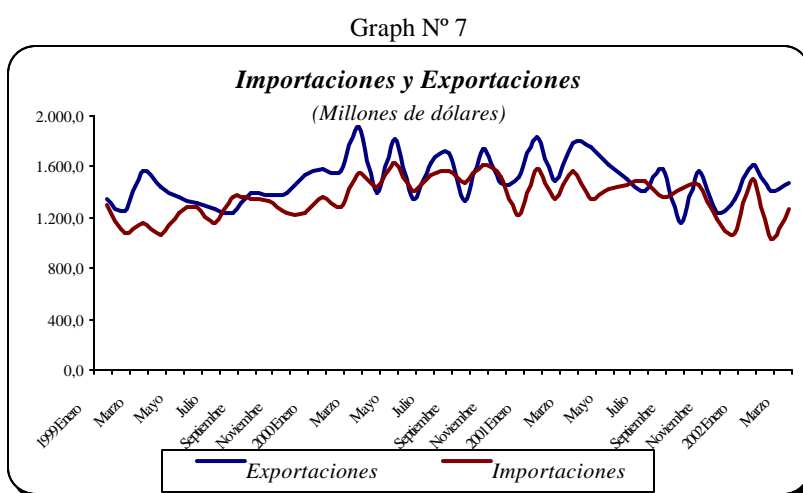
Source: Central Bank of Chile.

To find an explanation for this behavior, we can mention two aspects of the external performance that interact with each other: a recovery that appears at the beginning of 2001 that is based on a fragile expansion of exports in the context of the onset of an economic downturn in the United States plus the historical decrease in the price of copper.

The 5% growth rate achieved by the North American economy during 2000, which sustained the global economic situation until that point, creates a context that is favorable for the markets in which Chile acts, yet is extremely fragile due to the signs of recession in

the United States. Under these conditions, output growth in Chile reached 4.4%; nevertheless, this did not hasten similar behavior in other macroeconomic indicators. This is especially the case with investment and employment.²

In this context, the performance of the external sector during 2000 is the primary factor responsible for the short-lived recovery during that year. The fragility of this recovery can be explained by the low probability that these conditions would be maintained in the years to come. Also, the global economy is on the brink of a serious recession, which inevitably will have an impact on the Chilean economy. The situation in the USA is still subject to great uncertainty, despite the positive pace of internal activity recorded in the first quarter of this year.



Source: Central Bank of Chile.

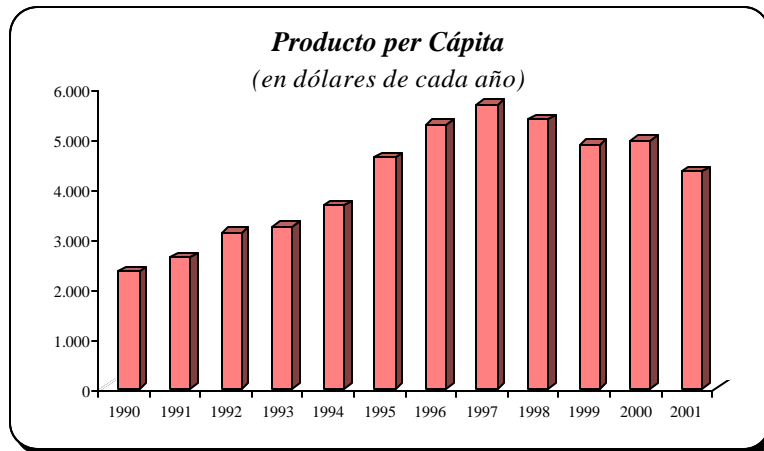
The current situation is one of dangerous economic deceleration. In the first quarter of the current year, 2002, a decrease in exports of 12.2 % was recorded relative to the same period in 2001. During the same period, imports fell 16.0%, which shows the seriousness of the contraction of internal demand. (See charts 3 and 4).

The long period of contraction and stagnation we have observed has had a profound impact on society. Clearly, the negative impact has not been distributed in a uniform manner, with workers and the poorest sectors of society suffering the greatest impact. In all,

² The variation in production in 2000 corresponds to a new series of national accounts recently opened. These originated in 1996 and changed the weight of different economic sectors. The previous series of accounts, based in 1986 carried a fluctuation of 5.4% for that year, which explains why the major economic contribution was by the export industry, according to the old categories of *insumo* - product.

per capita output in Chile reached US\$4,320 in 2001, which is below the 1995 level of US\$4,589.

Graph N° 8



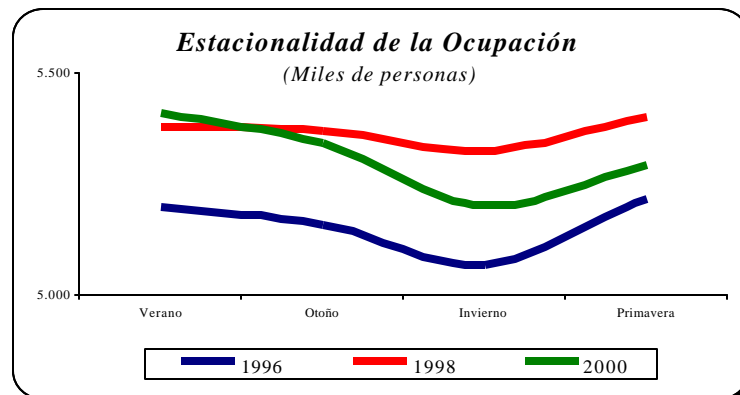
Source: Central Bank of Chile.

3.- *The Labor Market: Unemployment*

The effect of the economic contraction is seen most clearly in the labor market, where workers bear the major costs of the crisis. Both employment rates and real wages reflect the poor conditions of the market.

An analysis of the employment conditions in the Chilean economy requires that we pay attention to several structural situations. The first has to do with a marked stability in the employment rates, due to the character of agriculture and farming, where production is labor-intensive.

Graph N° 9



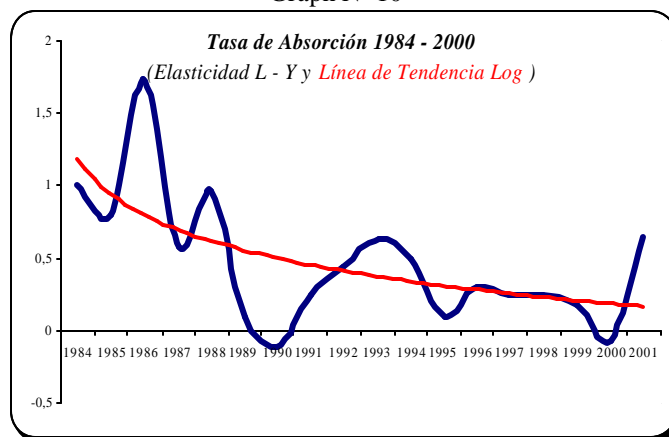
Source: Calculated with INE Data.

The demand for work in this sector is concentrated over the course of a year. During the summer, employment increases; in winter, employment falls substantially. The work force employed in this sector is typically precarious, thanks to low salaries as well as the transitory nature of their economic activities.

Graph N° 9 demonstrates the seasonal nature of work in this sector. (In 1998, the effect was less pronounced because of the overall economic crisis on agriculture and farming.) This characteristic leads to the highest rates of unemployment in Chile in the winter period.

The second structural condition is associated with a decline in the rate of absorption –how the economy converts economic growth into greater employment. The recent decline in the economy's absorptive capacity has contributed to rising unemployment.

Graph N° 10

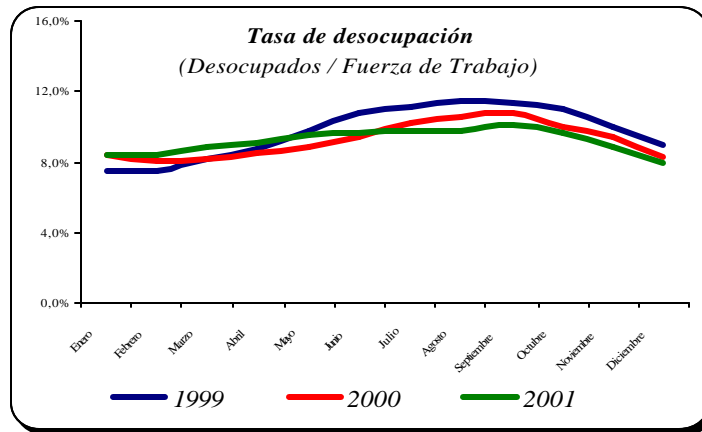


Source: Calculated with Central Bank of Chile INE.

In developed countries, the problem of the decline rate of absorption is due to technological innovation and accompanying improvements in productivity. However, in peripheral economies, the situation is different. In the Chilean case, the decline in absorption reflects the persistent displacement of the dynamic bases of economic growth by capital-intensive primary production activities. This dynamic is one of growth without increased generation of employment; the end result is growth with impoverishment.

The current situation of the labor market is based on these structural conditions and the deceleration and stagnation of the economy.

Graph N° 11



Source: Calculated with INE Data.

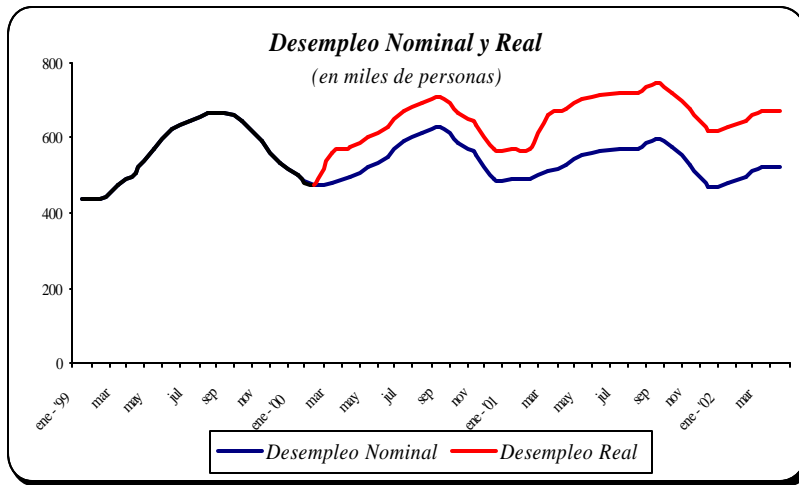
In 2001, we can observe unemployment rates that are slightly harsher relative to the traditional seasonal pattern. In Graph 11, we can also see that, in 1999, the rate of unemployment exceeded 10% for six consecutive months. The same happened in 2000, this time for four consecutive months. In 2001, unemployment topped 10% in only one month. While the data appear to demonstrate a tendency towards declining unemployment, under closer examination, this proves not to be the case.

Since 2000, the government has implemented programs to assist the unemployed. These programs involve the creation of emergency jobs, which are continually renewed, with local government. While these measures allow beneficiaries to obtain a minimum salary, they do not mean that the conditions of the underlying labor market have improved.

In 2000, an average of 80,000 such emergency jobs was created. This figure increased to 150,000 from 2001 to the present. Due to the unstable conditions we have discussed and the fact that the creation of these jobs does not depend on the actual performance of the labor market, holders of these jobs can reasonably be counted among the unemployed.

If we accept this definition, the conditions observed in Graph N° 11 change in an important way. The following Graph shows the trajectory of both measures –the official count and the adjusted count, which factors in the total number of people without stable employment.

Graph N° 12



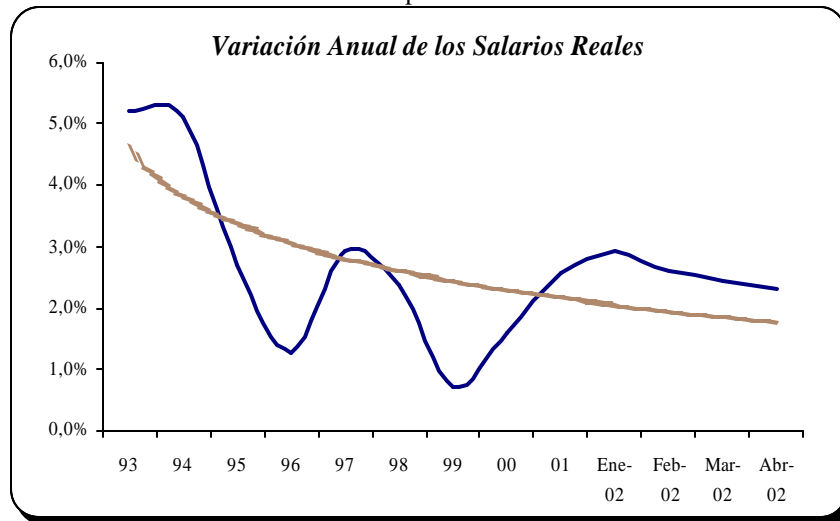
Source: Calculated with INE Data.

In this context, the actual average unemployment in 2001 would reach 11.5%, in contrast to the official average of 9.2%. In the same way, during the first quarter of 2002, the actual figure is 11.0% in contrast to the official figure of 8.5%.

4.- The Labor Market: Real salaries and the legal minimum salary.

The situation we have seen with respect to employment is mirrored in real wages. The decline in real wages, which we can see clearly in Graph N° 13, exacerbates the social problems that have worsened since the beginning of the crisis four years ago.

Graph N° 13

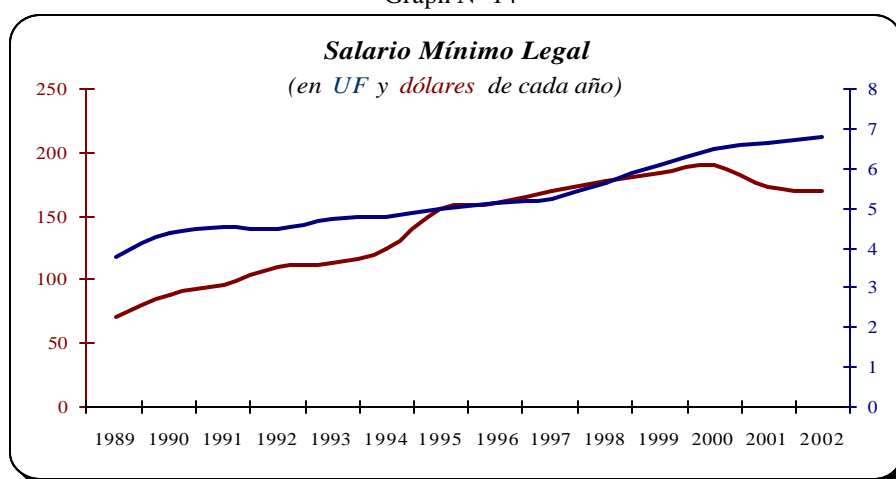


Source: Calculated with INE Data.

As we can see, in 2001, real wages experienced a slight recovery after having being almost stagnant in 1999. Real wages grew 1.5% in 2000 and 2.5% in 2001. By 2002, however, wages appeared to have stagnated. (The change in real wages shown above corresponds to the periods December-December, except in 2002, where the data refer to changes over the preceding 12-month period.)

In the 90's, Chile's legal minimum wage grew 55.8% in real terms, partly making up for the losses under the dictatorship of the previous decade. Currently, the minimum wage is \$111,200 (about US\$169.50 per month).

Graph N° 14



Source: Calculated with Central Bank of Chile data.

Note: The Unit of Hunger (UF) is a readjustable measurement that varies according to internal inflation.

Nevertheless, despite this important growth, the value of the minimum wage is still far below the minimum amount necessary to satisfy the basic needs of a working family.

The minimum wage is important for the entire Chilean economy. Close to 500,000 Chilean workers depend on it as their only source of income.³ When these workers' families are taken into account, over 2 million Chileans depend on the minimum wage.

Given the minimum wage's social importance, it should be set at a level that would permit the worker and his or her family to escape poverty by satisfying their basic needs. At its current level, the Chilean minimum wage falls short of lifting workers' families out of poverty.

³ INE, (1997) Income of Homes and People 1997, Supplementary Survey of Income. Santiago, Chile.

Chart N° 1

Características Socio Demográficas de la Población

Categorías	Media Nacional
Tamaño del Hogar (personas)	3,9
Ocupados por Hogar (personas)	1,4
Ingreso Autónomo ⁽¹⁾ (%)	92,6
Canasta de Necesidades Básicas ⁽²⁾	\$56.790

Source: Encuesta CASEN 2000, Mideplan.

(1) Se refiere al porcentaje del ingreso monetario total de los hogares que corresponde a ingreso autónomo independiente de las transferencias monetarias del Estado y las resultantes de las políticas sociales en las áreas de Educación y Salud. (2) En pesos de mayo de 2002.

Any effort to determine the appropriate level of the minimum wage should take into account the characteristics of the low-wage population. In this effort, we can turn to previous official statistics to determine the magnitude of the gap. Within these parameters, it is possible to calculate the level of the minimum wage necessary to satisfy basic needs. The first phase consists of multiplying the value of the Basket of Basic Needs per person, by the size of the family. The result corresponds to the Basic Needs Income per family. Taking into account that this total income is made up of the Own Income + Transfers, the second phase consists of extracting the proportion of transfers that the State provide,⁴ with which we arrive at the Own Income for Basic Needs. A third phase is to divide this last value by the number of people who work in the home. This last result is the amount of take-home pay that workers ought to receive in order to stay above the poverty line.

When we apply this process to the parameters presented above, it is possible to place a lower limit on salaries in Chile, with the aim of lifting workers out of poverty. From another point of view, this seems like an efficient instrument to assist the government in its efforts to eliminate poverty. What is clear, however, is that despite the efforts undertaken to address this imbalance, the gap between the minimum wage and a basic consumption basket remains large. This gap is the most important factor in explaining the high levels of poverty in Chile.

Chart N° 2

Cálculo del Salario Mínimo para cubrir Necesidades Básicas

Parámetros	Valores en pesos	Valores en US\$
Canasta de Necesidades Básicas por Persona	56.790	84,95
Personas por Hogar	3,9	3,9
Ocupados por Hogar	1,4	1,4

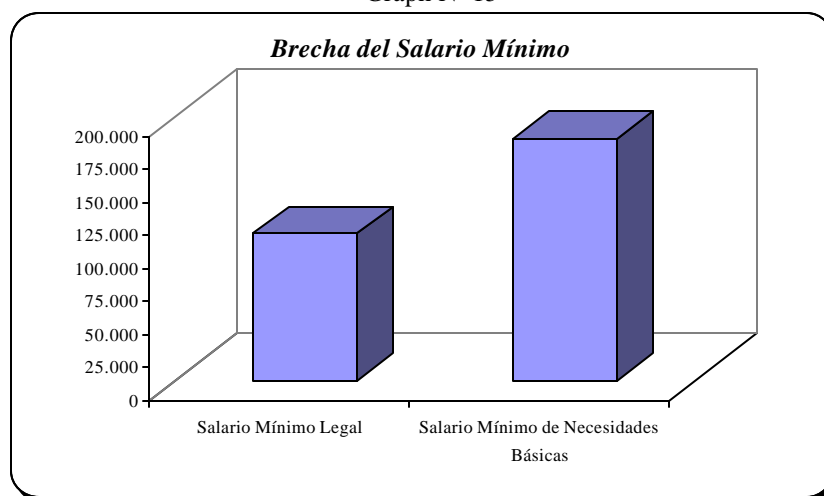
⁴ Para este caso se han contemplado en las transferencia al conjunto de subsidios monetarios entregados por el Estado: Asignación familiar, SUF, PASIS, SAP y Subsidio de cesantía, más las contribuciones estimadas en los rubros de Educación y Salud. Las contribuciones en los rubros Salud y Enseñanza las hemos incorporado, a pesar que en la estructura de Gasto de los Hogares, ambos rubros concentran un 11,4% del Gasto total, lo que implica que los aportes del Estado en ellos no permite satisfacer las necesidades que respecto a ellos tienen las familias. Ver, Encuesta de Presupuestos Familiares 1997-1998 INE.

In this case we have taken into consideration the transfers within the

Porcentaje de Ingreso Autónomo	92,6	92,6
Ingreso Familiar que cubre Necesidades Básicas	221.481	331,31
Ingreso Autónomo de Necesidades Básicas	205.091	306,79
Salario Mínimo de Necesidades Básicas	183.117	273,92

Chart No. 2 lays out the results of a simple analysis. A "Family Income that Covers Basic Needs" (line 5) is \$221,481 (about \$273). "Own Income Needed for Basic Needs" – after government transfers– however, is only \$205,091. Taking this last amount and the number of members per household, we can calculate the necessary level of the minimum wage. The final result corresponds to \$183,117 and represents the "Minimum Wage for Basic Needs" that in US dollars is equivalent to US\$273.92.

Graph N° 15



The existence of gap between the minimum wage and a basic basket of goods demonstrates that a significant proportion of workers in Chile find themselves receiving a wage that does not lift them out of poverty. The group of workers in these circumstances exceeds 500,000. As a result of the wage inequalities that exist in Chile today, nearly 50% of workers find themselves below the minimum necessary to cover basic needs.

The Chilean economy and labor markets are currently passing through an especially difficult period. The rest of 2002 is unlikely to be much improvement. On the contrary, everything indicates that the bleak picture that emerged in 2001 will continue. Estimates for the growth of output this year are only 2.5%. The slow growth reflects the both the recession in the North American economy and the collapse of the Argentine economy. The Argentine crisis –combined with the current situation in Brazil and Uruguay– in fact, call in to question the economic future of the region.

Another obstacle on the way to recovery is domestic. The open economic model applied in Chile shows signs of exhaustion. Unless major changes are made to the functioning of the economy, the tendency for unemployment – and all the conflicts and

difficulties it entails -- cannot be reversed. Nevertheless, the present economic policy gives no signs of changing course. To the contrary, currently policy embraces a strict neoclassical tradition where the best choice in politics is to do nothing –regardless of the impact on workers and other groups left behind.

Santiago de Chile, June 2002.