

Economy and Labor Market in Chile: From Stagnation to Uncertainty

Author: Manuel Razeto Barry*
Contributor: Andrei Chpakovski**

1. Background: The end of a decade of abundance.

The national economy has undergone a lengthy and sustained period of growth. In fact, the Gross Domestic Product grew by an average of 6.5% a year during the past decade. This growth was based primarily in the export sector, which grew by an annual average of 8.7% during the same period, invigorating the national economy.

Nevertheless, this growth halted abruptly and generated a strong recession during the fourth trimester of 1998 and the first trimesters of 1999. During this period, the GDP accumulated a decline of 9.1%.

The drastic fall of the national GDP is explained primarily by four economic factors. The weakness of the economy; the Asian crisis; the inadequacy of governmental monetary policies and automatic anticyclical mechanisms; and finally the drop in internal demand, which showed a 6.7% drop in household consumption.

The elements that account for the weakness of the national economy during the last phase of growth are primarily due to the significant commercial deficit, which had been dragging since 1996. In fact, the Current Account of the National Commercial Balance accumulated a deficit in 1998 that represented 6.3% of the GDP. This deficit was compensated for by a surplus in the capital account during the final phase of economic growth. This surplus was due to investments in primary sectors (especially copper mining), privatization of public enterprises, and the acquisition of private national enterprises (Enersis). This abundance of resources originating from abroad also stimulated a significant appreciation of the peso with respect to the dollar, further strengthening the commercial deficit.

The other element that accounts for the economic weakness has to do with the national economy's increasing difficulty in producing new jobs in the face of the growing GDP. In this sense, the rate of absorption of the labor force in relation to the growth of the GDP had declined dramatically.

* Subdirector of the Program for the Economy of Work (PET).

** Researcher with the Program for the Economy of Work.

In this context, the loss of “confidence” in developing economies associated with the so-called “Asian crisis” generated a significant decline in capital accounts, which in turn had a strong impact on the balance of payments. In fact, foreign investment fell by 500%. This phenomenon is exacerbated by a sharp fall in the price of copper, which further contributed to the deficit of the current account.

The State has attempted to deal with this situation through the elimination of the norms for containment and reserve of “launch” capital, with the aim of facilitating external investment. Yet this policy tends to make the capital markets even more flexible, not to attract fresh capital for the short term. Nevertheless, with this new state of affairs, in particular the elimination of the law which established a minimum permanence of capital in the country, the national economy has been exposed to external speculation, due to the volatility of these flows.

On the other hand, the Central Bank of Chile decided to confront the crisis by drastically increasing the interest rates, which reached their highest point in September of 1998 with a rate of 14% over inflation. These measures generated a strong contraction in the national economy, strongly affecting the micro-business sector and especially the small-business sector. Furthermore, it had an impact on consumption, due to an increase in indebtedness. All of this resulted in a strong decrease in internal demand.

This entire phenomenon also generated a significant increase in unemployment. This rise was taken advantage of by the business sector to reduce labor costs and destabilize working conditions. Also, many of the labor unions, which had negotiated from late 1998 to early 2000, were forced to freeze their salaries or even to give up benefits gained previously.

In examining this situation, we should also note the lack in Chile of mechanisms of social security with anticyclical effects (for example unemployment insurance). The nation lacks such mechanisms, which would allow for the support of consumption during periods of low economic activity.

The situation described above, together with the instability and contraction of the credit market due to the increase in risk rates and sluggishness of the financial system resulted in an even greater depression of internal demand.

2. 2000 – 2002: Stagnation or Uncertainty?

There has been much speculation about overcoming the economic crisis triggered in late 1998. In fact, during all of 2000 and 2001, pronouncements were made that during the upcoming semester, the national economy would recover and would follow a path of “normal” growth, similar to that of the past decade. Nevertheless, these predictions did not materialize.

In practice, the year 2000 was marked by a moderately significant growth of the economy, with a GDP growth of 4.4%. This growth is based primarily in the sector of **transables**, sustained by the growth in the North American economy, a slight increase in the price of copper and an increase in fiscal revenue due to the sale of public enterprises in order to sustain public spending. Nonetheless, this first stage was not accompanied by increases in employment nor internal demand, which pointed to the precariousness of the optimistic economic data.

The government strengthened its monetary policy as the primary tool for reviving the economy. Thus, even with the threat of inflation under control due to a reduction in internal demand, the government undertook a drastic path of lowering interest rates, which went from a high of 14% over inflation to the current nominal rate of 3%. If we consider that the inflation accumulated over the past twelve months is 3.0%, we can seriously assert that the current real interest rate of the Central Bank is practically negative. This fact is particularly significant because on the one hand it means a pressure based on a speculative “flight of dollars” while on the other hand – perhaps the most important lesson – it illustrates the impossibility of following this path laid out by government policies, considering the negligible impact of these kinds of policies on the economy.

In terms of fiscal policy, if in fact government spending increased in absolute terms, this increase tended to follow a rate of growth that was constant and not especially significant. Nonetheless, the fiscal revenues decreased, which generated an increase in the public deficit, which according to official data achieved an average of 1% of the GDP. Yet the Ministry of Housing, under pressure from international financial markets, was obliged to recognize that the official data about the fiscal deficit only took into account the operations of the Central Government, excluding public businesses, hospitals, municipalities, etc. Thus, it is estimated that the real fiscal deficit in the year 2002 reached levels close to 3% of the GDP. This deficit in the fiscal accounts demonstrate the impossibility of a policy of economic revival based solely on an increase in public spending. This is especially true in light of international experience, particularly that of Argentina and Ecuador, which show us that nation’s over-indebtedness results in a real lack of sovereignty and a process of subjugation to the dictates of the International Monetary Fund.

Similarly, in 2000 Chile recovered its export capacity with regard to our primary commercial partners, with the exception of Argentina. Nonetheless, in the year 2001, exports to Europe and Asia were down. Viewed in terms of economic sectors, the increase in 2000 was primarily due to the mining sector, based on copper, cellulose and chemical products. On the other hand, after this initial promising year, exports of minerals were reduced due to a decrease in copper prices. Thus, the behavior of

exports during this period achieved relative stability, with a slight decrease. This pattern does not allow for a solid, sustained shift in exports leading to economic recovery, nor does it indicate that exports will play an energizing role in economic growth, as they did in the mid-90's. Thus, the process of economic opening and the strengthening of business groups dedicated to this sector do not appear to be an effective mechanism for the necessary economic recovery. We have seen the intense vulnerability and dependency of the Chilean economy to international market cycles, due to its strong degree of openness.

Investment is also stagnant, maintaining a constant rate from 1999 to the present. Thus, the reduction in investment due to the crisis has not reverted to a pattern of growth. In 1997 the rate of investment was 27.7% and in 2001 it was 20.7%. This process does not offer hope for economic recovery through investment, since the economy has not reacted positively to lowered taxes offered over recent years, nor to permanent and sustained reductions in interest rates.

The rate of economic activity behaved in a similar manner during this period. Thus, even if there was a certain recuperation during 2000, this growth was not sustained during 2001 and what has transpired of 2002.

On the other hand, the State's foreign debt decreased throughout the previous decade. During the crisis of 1982, the State gradually took charge of private foreign debt and since 1987 the State began an accelerated program of paying off foreign debt. Nevertheless, during the decade of the 1990's, private foreign debt accelerated. This tendency was moderated due to the crisis, but it was not reversed.

Source: Central Bank of Chile

This situation keeps the Chilean economy in a situation of extreme weakness, especially because of the high levels of private foreign indebtedness, which have risen to levels never seen in national history: \$32.561 million dollars. Thus, private foreign debt has reached levels close to 58.33% of the GDP. In contrast, public debt is just 10.29 of the GDP. Thus, Chile finds itself in an even graver situation than it was in before the financial crisis of 1982; a rise in the exchange rate will create the impossibility of paying debts and the consequent "external debt crisis" could lead us to situations such as those in Brazil, Colombia or even Argentina.

Source: Superintendent of Banks of Chile.

* The Unidad de Fomento (UF) is one of the systems of readjustment authorized by the Central Bank of Chile, in support of that established by number 9 in article 35 of the Constitutional Law. The information regarding the methodology for calculations can be found in Chapter II B 3 of the Compendio de Normas Financieras.

** Income lower than 3 UF do not have access to bank credit.

With respect to the level of personal indebtedness, the economic crisis has affected different income groups differently. In fact, the middle and high-income sectors tend to compensate for the crisis through indebtedness, maintaining an anticyclic behavior in order to keep their income constant. Yet the lower income

sectors have confronted an absolute and permanent exclusion from the financial system throughout this period, at about 40% between 1997 (before the crisis) and 2001.

In this sense, the financial system has demonstrated adequate behavior for the middle and high-income sectors. Nevertheless, this system appears particularly inadequate with respect to the most vulnerable sectors, generating ever-higher levels of exclusion.

Internal demand underwent a recuperation in 2000. During the second trimester of this year, it reached a growth of 9.7%. Yet starting in that trimester it also began to show signs of slowing. Beginning in the last trimester of 2001 it records negative levels, which continue into mid-2002. Despite a slight recovery in the third trimester of this year, increased demand is not assured. In fact, the negative tendencies in the evolution of investment and imports; the establishment of "imported" inflation; and the instability of neighboring countries and trading partners do not add up to a favorable outlook for the national economy.

3. The impact on the labor market.

To a keen observer, the main effect of the economic crisis has been on labor conditions. Thus, we have witnessed a process of acute destabilization of labor. In this section, we will examine the quantitative aspects of the labor market; that is, the levels of employment and unemployment in our economy.

One of the primary effects of the economic crisis, which began in late 1998, has been its impact on employment. In fact, Chile maintained its level of average unemployment between 1990 and 1996 at 6.9%. Nonetheless, the rate of absorption sharply declined during this same period. In official data, unemployment reached levels close to 9% during 1999.

As we have already argued, the recovery seen in 2000, which improved the major macroeconomic indicators did not have a similar impact on employment levels. On the contrary, the level of unemployment during 2000 was around 8.3% annually, reaching 11.3% during the July-September trimester of that year.

The official data have recorded a slight decrease in the rate of unemployment from 2000 to the present. Yet this data should be analyzed with care, because it does not take into account the real impact of unemployment in Chile during this period.

First, it considers as employment the emergency plans implemented by the Government. These are not jobs generated by the economy and they are

characteristically temporary and short term -- generally around 3 months. These jobs are implemented during the winter months, which is the period of greatest unemployment.

If we add these temporary jobs to the unemployed population and we estimate the rate of unemployment, we see that the rate of unemployment in the economy during this year continues to rise slightly.

Source: Calculations based on data from INE and Ministry of Labor.

On the other hand, the most relevant and perhaps most difficult to measure effect is that on the shrinking labor force. In fact, the rate of unemployment is a percentage calculated over the labor force. Thus in order to understand the behavior of the rate of unemployment we must refer to the behavior of the two crucial elements – the labor force and the unemployed population.

During these years, the work force has behaved in a pro-cyclical way, following the rhythm of economic activity. Thus, when economic activity increases its pace, the work force increases in size and vice-versa; when economic activity wanes, the work force begins to diminish though a “migration” of the population from active to inactive. Unemployment, on the other hand, behaves in the opposite way, diminishing with increased economic activity and growing with slowing economic activity. If we analyze both of these patterns together, we can see that during periods of crisis, the rate of real unemployment tends to diminish due to the movement of people from the active to inactive sectors. In contrast, during periods of economic recovery unemployment has a very slow rate of diminishment due to the effect of incorporating the inactive population into the work force. Thus, the recorded tendency for unemployment to diminish is a product of the crisis itself; unemployed people, out of a feeling of desperation, do not look for work during the crisis, moving into the inactive population and thus creating a lower rate of unemployment.

Source: National Institute of Statistics of Chile. (INE)

Source: National Institute of Statistics of Chile. (INE)

This graph clearly shows a significant increase in the inactive population, much higher than the natural rate of population growth. The movement of people from unemployed to inactive generates this pattern, due to the fact that they stop seeking employment.

Similarly, a comparative examination of the employed population – that is, those who in fact occupy an employment position – shows a pattern which implies the inefficiency of the economy in generating jobs, less than the growth of the GDP. Clearly, rather than a diminishing of the rate of unemployment, what we see is a sedimentation of the lack of expectations for finding employment.

By way of Conclusion

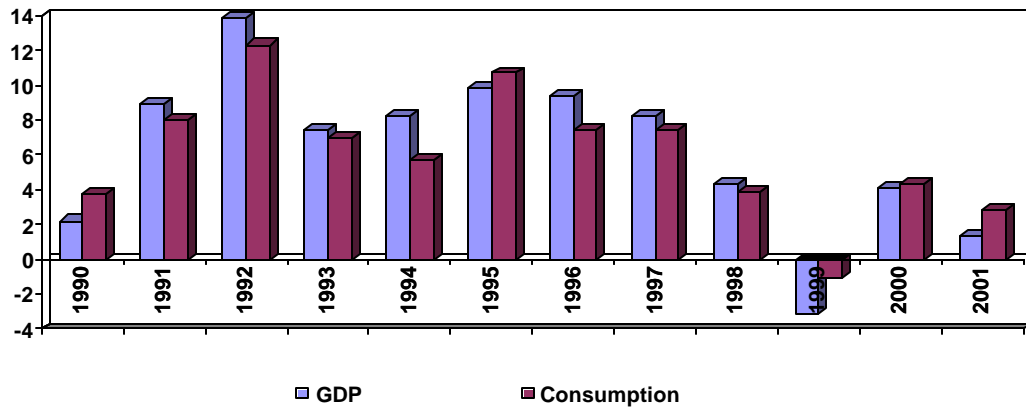
The official data, which optimistically shows Chile as an island of stability within the Latin American context, hides much of the reality. In fact the national economic situation has not reached the levels of uncertainty of neighboring Argentina, it is far from being a paradise of economic and financial stability. In fact, and as we have shown in this article, we can detect important weaknesses in our economy. This weakness is due primarily to the inefficiency of governmental measures to stimulate the economy; the high private external debt; and the inefficiency in raising the rates of domestic consumption and employment.

Within this context, we must point out the serious crisis of corruption, which has recently captured press attention and public opinion. Ministers and ex-Ministers have had to admit that they received inappropriate payments from the State, and some of them have been surprised to receive deposits in their banking accounts from businesses linked to private bidding. The outrage caused by the revelation that 5 Deputies of the Republic were linked directly to corrupt acts, as well as the unending string of exposes of irregularities at the regional level, community level, and in public businesses, etc. is not easily dismissed.

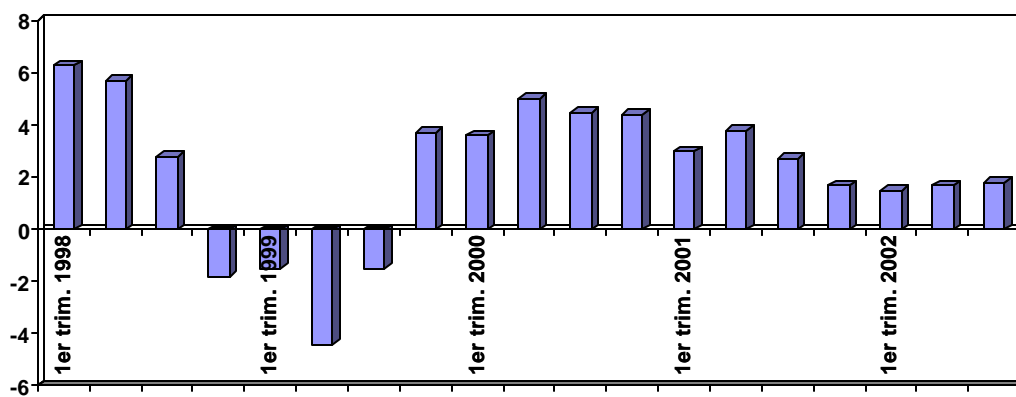
Given this context, speculating about the near future of the national economy is a challenge. Such speculation is difficult because of the instability of the international indicators; the weakness of our economy; and the lack of confidence and leadership in the government.

Thus, rather than attempt to project the economic future in this paper, we have taken this opportunity to illustrate the present situation of the economy and labor market in Chile, given that within weeks “all or nothing” can change in the sociopolitical landscape. New indictments are expected for corruption; the results of current charges against government officials are awaited from the courts; changes in Cabinet Ministers are underway; and positive or negative ramifications of trade agreements with the US and Europe are awaited, among other factors.

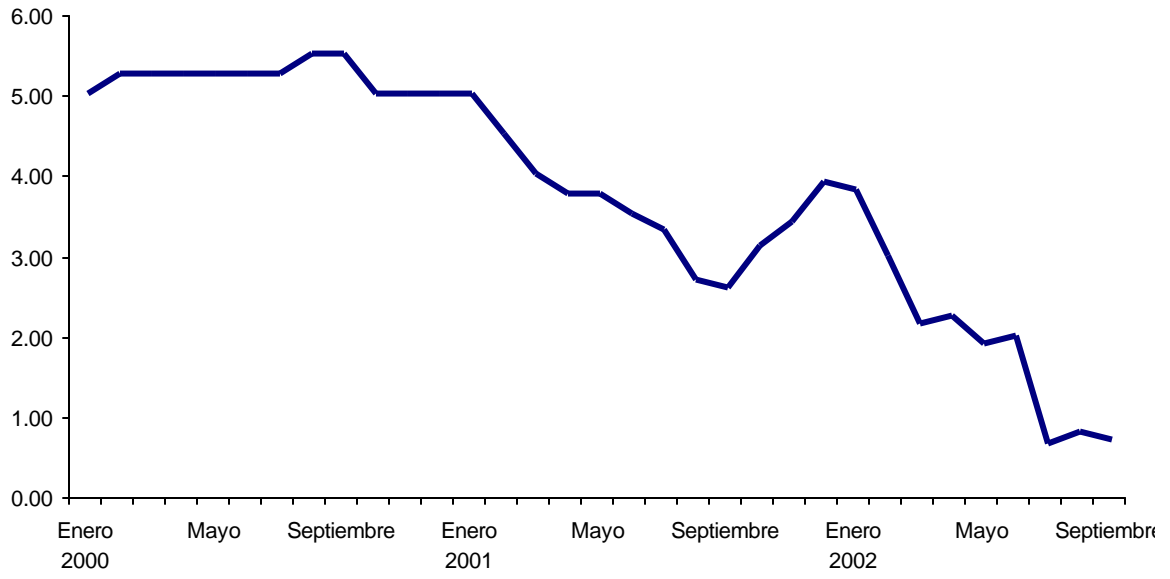
Evolution of GDP -- Percentages



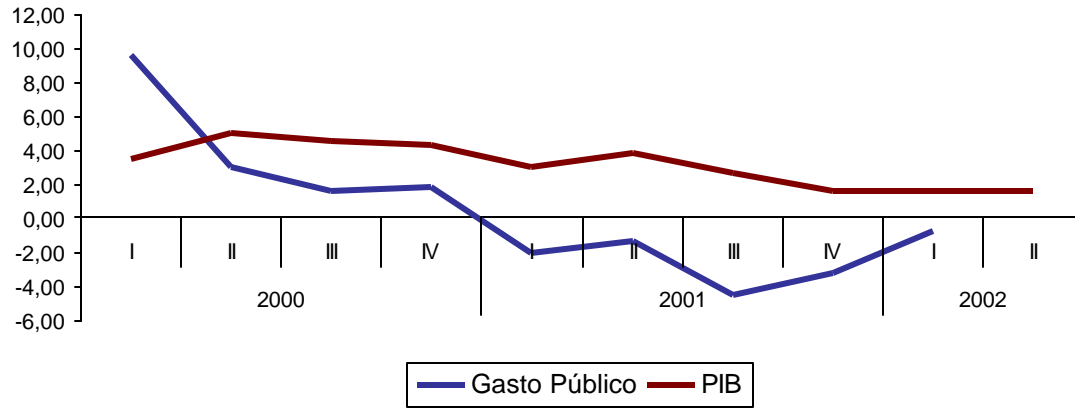
Evolución del PIB. Porcentajes



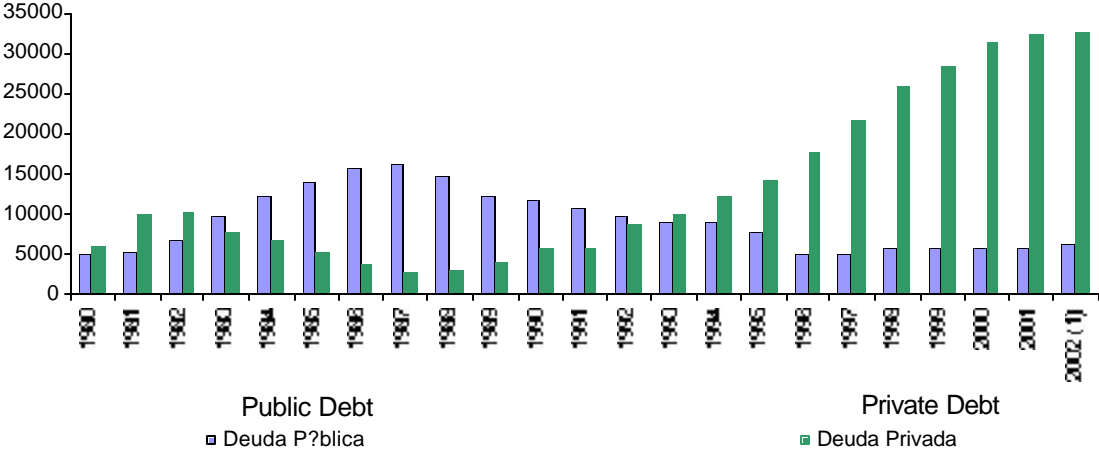
Real Interest Rate

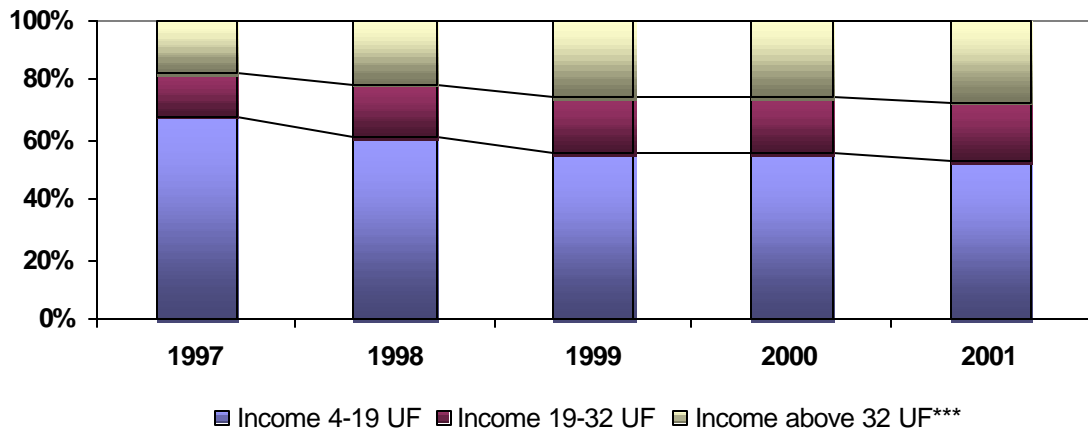


Evolución del gasto

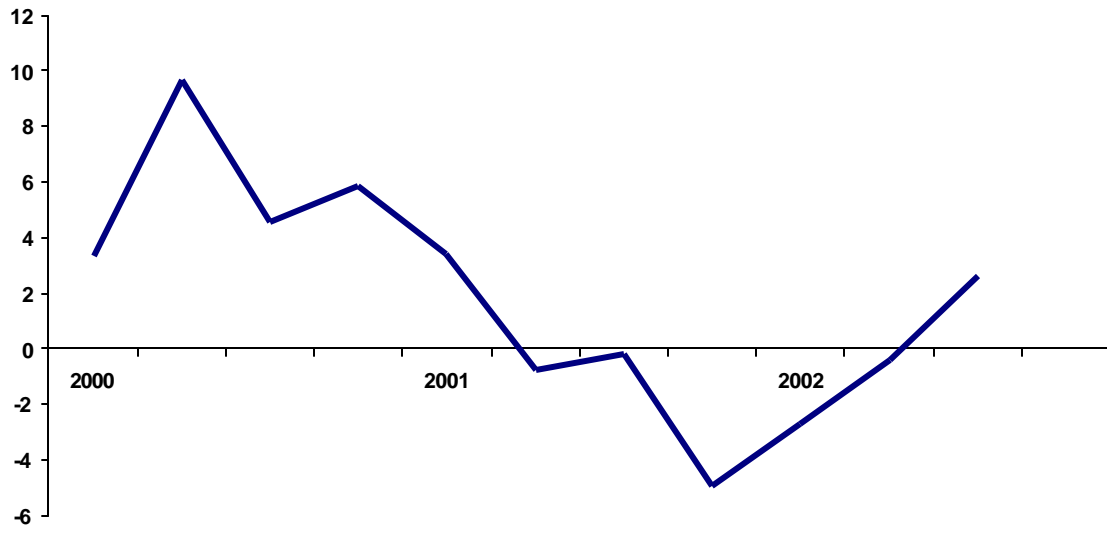


Public and Private Foreign Debt. Totals for Long and Short Term.

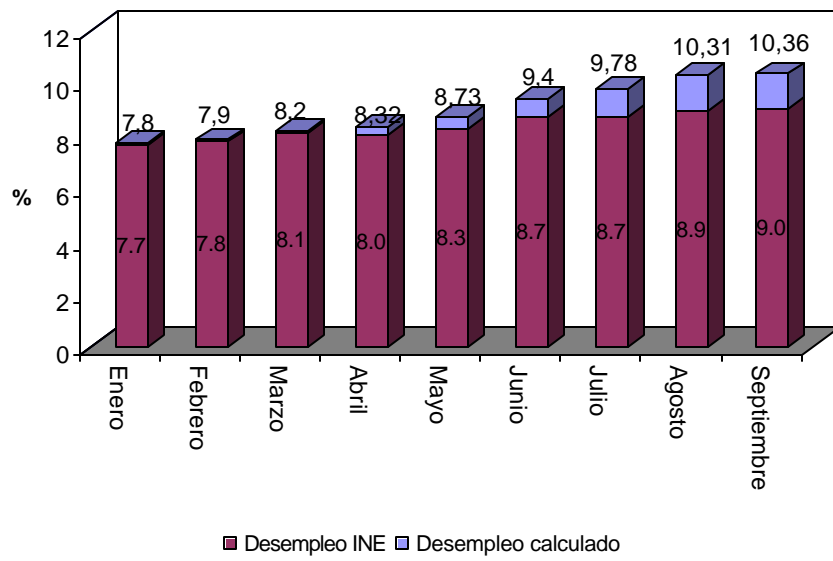




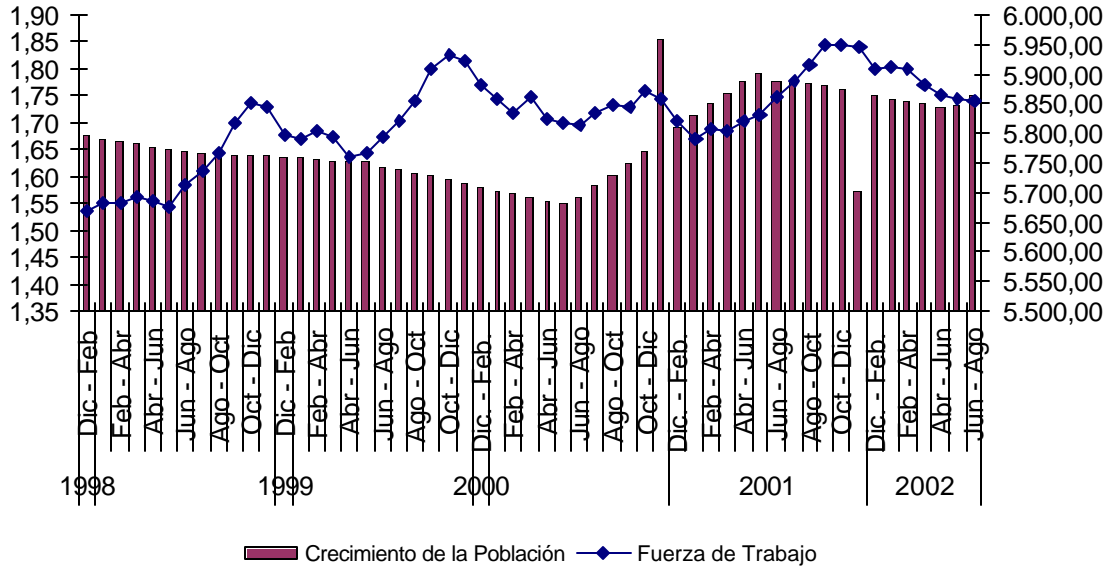
Evolución de la Demanda Interna



Desempleo. Comparación de las estadísticas con y sin participación del Estado en la creación del empleo año 2002. En porcentajes.



Comparación de la Fuerza de trabajo y la evolución de la Población



Comparison of Employed versus Inactive Populations

