

# 2009 Unemployment: No more employment-constraining proposals!

According to a recent survey conducted by the University of Chile, the rate of unemployment in the greater Santiago area stood at 12.8%. Nationwide, the National Institute of Statistics (INE, in its Spanish acronym) also showed an unemployment rise to 9.2%; which means that some 670,000 Chileans are currently unemployed and many fear losing their jobs in the short run.

Although the negative trend of these figures was to be expected -because the nation's economy is already in crisis- the magnitude of the deterioration was not anticipated by the experts. Since employment is crucial in the quality of life of Chilean workers and their families, the future scenario is not encouraging.

These elements are flagging us to take particularly good care with our upcoming policy decisions. This paper, on the other hand, seeks to provide elements to make us realize the fragility of the current situation while calling for prudence in the matter of labor legislation.

## A labor X-ray of the crises

A good exercise to understand the risk lurking behind the current situation is to review what happened during the Asian Crisis situation comparing its similarities to today's figures.

En the first place, according to quarterly growth figures, the Asian Crisis began in earnest during the third quarter of 1998<sup>1</sup> and economic activity dropped during 4 consecutive quarters<sup>2</sup>.

When measuring the quarterly product of the year 2008, one may observe that the current crisis also began during a third quarter (see Chart N°1). This coincidence -of both crises hitting the real economy during the same period of the year- somehow facilitates comparison. However, while the starting points of both crises are similar, insofar as the time of the year in which they occurred is concerned, they are quite different with respect to the prevailing figures in the job market.

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**Table N° 1: De-seasonalized product growth, with respect to the previous quarter**

Trimestre	Año		
	1998	1999	2008
I	-0,3%	-0,5%	1,6%
II	1,7%	-0,1%	1,5%
III	<b>-0,6%</b>	2,1%	<b>-0,8%</b>
IV	-2,9%	3,2%	-2,1%

Source: Central Bank.

In the quarter that preceded the Asian Crisis, the number of unemployed persons nationwide hovered around 300,000, and the rate of unemployment was 6.1%. Prior to this crisis, the unemployed amounted to 600,000 persons with a rate of unemployment of over 8%. During the last 10 years, we never recovered unemployment rates below the 7% mark.

Whatever is the explanation for this phenomenon, at this time there is a risk, since the figures appear to indicate certain historical similarities. For example, Chart N°1 shows us that the trend toward increased unemployment appears to be similar to the one occurred during the Asian Crisis. Since now the initial number of unemployed persons is higher, the situation will be of a greater severity if the effect is of the same magnitude in the labor market.

### Will history repeat itself?

Although the figures tend to show us a similar pattern of behavior, it is important to understand clearly that there are contextual differences, before inferring that history repeats itself.

In May 1998, during the government of Eduardo Frei Ruiz-Tagle, it was decided to negotiate the minimum wage for the years 1998, 1999 and 2000<sup>3</sup>. Probably, the thinking was

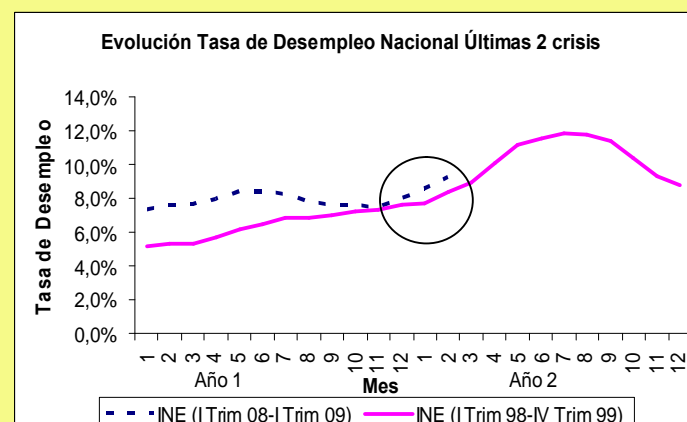
that our economy would be able to repeat the growth rates that had prevailed to date. But no consideration was made about the negative impact that such substantial pay raises could have in the event of a crisis.

This fact has been well documented. Several studies<sup>4</sup> have shown that the handling of the minimum wage policy indeed multiplied the unemployment effect of the Asian Crisis. Table N°2 shows the minimum wage values, the real variation regarding the previous year, and the rate of unemployment of the years 1998, 1999 and 2000.

In 2008, on the other hand, although neither was the second semester crisis anticipated, the expected rate of inflation was underestimated. As a consequence, the minimum wage remained virtually constant in real terms. Nevertheless, toward the end of 2008 and, particularly toward the beginning of this year, product projections deteriorated and the expected rate of inflation changed, which has contributed to seeing a subsequent upward trend in real salaries & wages. All this has negative effects on companies' demand for workers.

The minimum wage negotiations -to ap-

**Chart N° 1**



Source: Prepared in-house on the basis of the INE Survey.

**Table N°2: Real change of the minimum wage**

Año	Valor mensual (\$)	Variación real con año anterior	Tasa Desempleo
1998	76.708	5,9%	6,4%
1999	86.333	8,9%	10,1%
2000	96.042	7,1%	9,7%

Source: Prepared in-house on the basis of minimum wage laws. Inflation figures were taken from the INE.

ply during the second half of this year and the first half of the next- have not yet taken place. Hopefully, our authorities are mindful that giving in to minimum wage increase petitions – which will surely come up from those who are currently employed- will have negative effects on the employment of the more vulnerable workers and may also diminish the possibilities for the unemployed to find a job. Unfortunately, history teaches us that the negative effects of these resolutions take a long time in vanishing.

## Our labor legislation

The Asian Crisis, just like this one, visited us during a presidential elections year. On that occasion, the government submitted a number of labor proposals to Congress, such as reducing the workday and eliminating a number of causes for dismissal. Following their initial rejection, they were ultimately approved by Congress years afterwards.

Some may tend to think that these initiatives do not have major negative effects in the labor market. Probably, if analyzed separately, the effects of each measure are not great.

However, if we look at all the laws that have been approved on labor matters ever since the Asian Crisis, the conclusion is different. The sum total of such measures sowed an atmosphere of distrust which, according to certain studies<sup>5</sup>, was perceived by employers, dur-

ing the 1998-2001 period, as an increase in labor costs even before the laws were approved.

Following we submit different laws approved since then<sup>6</sup>.

- Law N° 19,759 was approved in 2001. It considers, among other aspects, reducing the number of working hours from 48 hours to 45 hours per week; it sets a maximum daily limit of 10 working hours; it reduces from 25 to 10 the number of workers required for companies, establishments, work sites or economic units to be obligated to design internal order, security & hygiene bylaws; and, it abolishes the lack of labor or technical skills as cause for dismissal.
- Law N° 20,047 was approved in 2005. This law establishes the paternal (male) post-natal leave, which authorizes each worker to take up to 5 working days of paid leave when having or adopting a child.
- Law N° 20,123 (better known as the “subcontracting law”) was approved in 2006. Among other aspects, this law forbids worker intermediation on any job site; it forbids disposing of workers of a related company; and, it establishes the joint liability of the subcontractor’s principal with respect to labor & social security obligations as well as with respect to legal & contractual indemnifications to be derived from the termination of a contractual relationship.
- Law N° 20.215 was approved in 2007. It imitated the workday enjoyed by commerce workers on pre Christmas days.
- Law N°20.281 (also known as the “continuous workweek”) was approved in 2008. It equaled base salaries to minimum salaries, granting those workers who are paid on a monthly basis and who receive either a base or a variable

salary the right to perceive commissions for non-worked days.

In sum, the new laws have tended toward a greater rigidity of the labor conditions, whether by fettering employment generation or by increasing labor costs without a productivity counterpart.

Although such rigidity may be seen as a positive attribute by those who presently hold jobs, it is damaging to those who are out of work because the hiring of new labor is made more expensive, thereby making it more difficult for the unemployed to find a source of work.

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Ever since, our labor legislative agenda has introduced significant rigidity components that attempt against the generation of employment.

It is to be desired that as we confront this new international crisis that is now hitting our economy, we may learn from the past, among other things, by appealing to the virtue of prudence on legislative matters, avoiding costly mistakes that may increase unemployment and prevent the generation of new jobs.

## Conclusion

Current unemployment figures, both at the national level as well as in the Great Santiago Area are high and the seasonality of our economy, as well as GDP shortfall projections for the months ahead are auguring that the country's unemployment situation will worsen.

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<sup>1</sup> Economic activity dropped during the first quarter of 1998; however, at that point the crisis had not yet unfolded, because economic activity picked up speed and recovered during the following quarter.

<sup>2</sup> When analyzing the de-seasonalized quarterly growth figures, we consider that the crisis started in earnest during the third quarter of 1998 because economic activity then dropped -as compared to the previous quarter- but continued to do so during 4 consecutive quarters.

<sup>3</sup> Law N°19,564 published in the Official Gazette of May 30, 1998.

<sup>4</sup> See Cowan K, Micco, A, Mizala, A, Pagés, C. and Romaguera, P. A diagnosis of unemployment in Chile ("Un diagnóstico del desempleo en Chile" (2003); an IDB document.

<sup>5</sup> Bergoing, R and Morandé, F. Growth, Employment & Labor taxes: Chile 1998-2001, ("Crecimiento, Empleo e Impuestos al trabajo: Chile 1998-2001" (2002), in Cuadernos de Economía V.39 , N° 117.

<sup>6</sup> See Costs & Benefits of our labor legislation – What can we do?, ("Costos y Beneficios de nuestra legislación laboral ¿Qué podemos hacer?", Ideas y Propuestas (Ideas & Proposals) N°28 Fundación Jaime Guzmán.