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International Employment Policies

**STRUCTURAL ADJUSTMENT AND THE LABOUR MARKET
(CHILE 1973-1992)**

by

Norberto E. Garcia

*Working Papers are preliminary material circulated
to stimulate discussion and critical comments*

December, 1993

International Labour Office Geneva

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PREFACE

A large and increasing number of developing countries are currently carrying out economic reform programmes, typically encompassing stabilization measures (aimed primarily at reducing current account deficits in the balance of payments and fiscal deficits) or structural adjustment (reforms in micro- and macro-economic policies to ensure more efficient use of resources), or a combination of both. These stabilization and structural adjustment measures in most cases have been introduced following recommendations of the IMF and the World Bank, respectively.

The implementation of reform programmes carries implicit and explicit effects on the levels and composition of employment as a consequence of changed levels of labour demand in the economy. Through an analysis of reform policies and measures introduced and an assessment of their positive and negative effects on employment and poverty levels it would be possible to identify ways of better incorporating employment concerns in the economic reform process and promoting employment-intensive growth consistent with the aims of the reform.

To assist governments in ensuring that employment considerations are fully taken into account while planning for or implementing economic reforms the Employment Strategies Branch has undertaken a review of selected country experiences of which this study on Chile² forms a part (the other studies cover Indonesia and Tanzania) to draw lessons from an analysis of how these countries have planned for and implemented reform programmes in terms of their effects on employment. More specifically these country studies cover two areas of investigation: (a) quantification of the implicit and explicit effects of the programme on employment, and (b) an evaluation of the performance of those bodies of government directly and indirectly responsible for employment considerations in government planning. Based on the results of the country studies a synthesis paper will be prepared which will suggest possibilities for a more analytical role for employment planners in the economic reform programme and identify specific interventions in policy formulation which could assist in mitigating the negative effects on employment and promote expansion of new productive employment consistent with the objectives of the reform programmes.

The present paper by Norberto Garcia reviews labour market developments in Chile during the period 1973-92. This was hardly a period when development planning was attempted and it began with the need to overcome the severe imbalances caused by the Allende regime. Chile's experience during the period encompassed a number of different economic and labour market policies so that lessons can be drawn from their interaction. Immediately after 1973 an aversion to any form of state intervention led to a complete reliance on market forces. After 1975 unemployment rose as tariff protection fell and wages were indexed to past inflation in a period of decelerating prices. The early 1980s saw the

debt crisis and an extent of deflationary overkill. However, further periods of euphoria and financial crisis followed in the mid to late 1980s before a degree of stability was achieved around 1990. Even this economic stability, and indeed success, failed to achieve a satisfactory integration of all parts of society into the world of work. For the future it is essential to improve the social safety net and to put increased stress on education and training.

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I. INTRODUCTION

A. Structural change and public policies (1973-1992)

Between 1973 and the present a deep transformation takes place in Chile, substantially modifying the growth pattern of the country. The Chilean economy becomes much more open and competitive and while the role of the State as regulator and producer is significantly diminished the function of the market and of private investment is enhanced.

The process proves successful in establishing the foundation for rapid and sustained growth, led by exports and import competing production. However, the transformation entailed high social costs during a prolonged number of years. Moreover, two decades after the changes were initiated more than one-third of households are still not incorporated to the dynamic of the new model - and excluded from its benefits - while at the opposite extreme the consumption levels of the richest 5 per cent surpass many of the standards set by countries more developed than Chile.

The fact that those negatively affected were fully conscious of the situation described helps to explain an apparent paradox, namely the existence of social inconformity and discontent in important segments of the population in spite of the notable economic success and swift growth verified in Chile.

The stabilization policies and reforms which brought about the transformation took place in a context of over-reaction against the excesses of state interventionism practised in the years prior to September 1973. In the following eight years the idea prevailed that the full liberalization of factor and product markets constituted the best approach for *any* kind of change, even if it was to be at the expense of severe social hardships and a large increase of the foreign debt, linked to greater access to external financing in 1975-81. The latter was reflected in a net transfer of external resources to Chile that averaged, annually, an equivalent of 3.0 per cent of GDP in 1975-81.

The deep financial and trade impact of the external crisis of 1982-83, which drove a considerable number of banks and enterprises to the brink of collapse, detonated a change in public policies. Interventionist public policies were implemented to face the crisis and to sustain the financial sector and numerous private enterprises by means of multiple transfer mechanisms.

The effort was backed and made feasible by access to external IMF financing and above all by successful negotiations with private banks. Between 1980 and 1984 Chile is one of the few countries of Latin America *receiving* a net transfer of resources from abroad amounting to an annual average equivalent of 2.5 per cent of GDP, whereas during the same period Latin America on the average *transferred* resources abroad for an equivalent of 2.0 per cent of GDP (ECLAC, 1991).

Between 1985 and 1989 public policies continue the financial reordering - though now with a greater degree of governmental supervision - implementing a more pragmatically conceived structural adjustment and stabilization process. During this period Chile's transfer of real resources abroad amounts to an annual average equivalent to 3.7 per cent of GDP. However, this took place at a time when the level of exports was already substantial, reducing the relative burden of the debt. A further significant lowering of the external debt is obtained through its conversion to domestic assets. Consecutive successful renegotiations with multilateral organisms and commercial banks likewise contribute to a rescheduling, thus clearing the external financial outlook.

In short, relying on the persistence of the export effort, having gained access to external financing thanks to the credibility vis-à-vis commercial banking secured in the period 1975-84, and adopting a more pragmatic economic policy from 1985 onwards, Chile manages to establish a sustained pace of economic growth which in 1985-89 exceeds 6 per cent annually.

The advent of democracy in 1990 redefines public policies in four aspects. In the first place, the goals associated with macro-economic equilibria are maintained - particularly price stabilization - though now with the additional incorporation of social objectives. In the second place, Congress approves a tax reform - the financial base to increase public expenditure - and a labour reform oriented towards strengthening labour stability, impeding arbitrariness, consolidating the functioning of the unions and establishing a social dialogue. In the third place, a significant effort is made to improve real remunerations, with emphasis on minimum wages and the income of the poorest sectors. The foregoing is implemented within a short space of time and without interfering with export led growth. In the fourth place, public policies are defined by the Government though within a context of social dialogue with entrepreneurs and workers and negotiations with the political opposition - all of which enhances their credibility. Thus, both public policies isolated from social actors and the blind faith in market adjustment are left in the past. Public policies recognize and support - with stable rules - a reallocation of resources based on the functioning of the markets but also intervene when the need arises, to avoid excesses and exert influence in areas where the market forces fail to be effective: (i) improvement of income distribution and alleviation of poverty conditions; (ii) setting a horizon towards the future; (iii) incorporation of externalities into private decision-making regarding the use of resources.

B. Changes in the labour market

The successive stages of stabilization policies and reforms combined with the shocks and the change in external conditions are the main determinants of the labour market performance. Indeed, the quantity-adjustment - through employment - which characterizes the major part of the period is explained by the peculiar interaction between economic reforms and stabilization policies during the period 1973-81, impinging on a less regulated labour market but that maintained wage indexation. Similarly, the impact of the adjustment to the external crisis of 1982-84 can in a large measure explain the behaviour of the labour market during that period. Finally, recovery of the employment situation in the period 1985-92 and of wages in 1988-92 is initially linked to the more pragmatic adjustment

policies enacted between 1985 and 1989 and later to the reorientation of public policies in the period 1990-92, that is, when democracy is being re-established.

During the period analysed three labour reforms took place: (i) the partial suspension of the prevalent institutional framework without substitution by a new normative system and the labour repression gave rise, between 1973 and 1979, to a "fierce" deregulation of the labour market; (ii) the definition of new institutional labour norms between 1979 and 1982 that remained in force until 1990 emphasized the adaptation of the labour market to the requirements of the adjustment; (iii) the labour reform of 1990 which retrieves a greater degree of labour stability, strengthens workers' organizations and encourages collective bargaining. Within the same historical period wage indexation to past inflation prevailed between 1975 and 1981; deindexation took place from 1982 onwards, followed by a gradual recovery of indexation in 1986-82¹. Hence, one of the issues is how the coexistence of deregulation with wage indexation influenced the labour market adjustment.

C. Object of the study

The objective of this study is to analyse the repercussions on the labour market of the policies of economic reform, adjustment and stabilization - including labour reforms - in 1973-92. Special attention is paid to identifying the causes of the main maladjustments of the labour market during the period mentioned. For this purpose, the analysis focuses on the interaction between the initial situation, the external shocks, the adjustment and stabilization efforts, and the reforms that took place during that span of time.

D. Content of the study

In Chapter II the economic and labour reforms carried out in the period 1973-89 are described. Chapter III analyses the interaction between the reforms and the stabilization policies and the arising repercussions. Chapter IV deals with the impact on the labour market in the period 1974-1989 of the policies and shocks outlined in Chapters II and III. Attention is focused on the causes of the rise in open unemployment, this being the principal adjustment feature of the labour market during that period, and the origins of the swift recovery of employment from 1985 onwards.

Chapter V explores some of the contributions of the labour market adjustment to restructuring, such as the evolution of the wage-productivity ratio and the increase in profitability and savings.

Chapter VI underlines the main changes - reforms and stabilization policies - introduced in the period 1990-92 when democracy was being re-established. The respective repercussions on the evolution of the labour market are likewise reviewed.

¹Inflationary behaviour shows a strong decline in the 1975-81 period, a shock-conditioned rise and subsequent deceleration between 1982 and 1989 and a gradual deceleration in the period 1990-1992.

Finally, in Chapter VII some of the main conclusions are highlighted, though various of these are contained in the respective individual chapters.

II. THE MAIN REFORMS

A. Introduction

Taking into account the orientation of public policies, four sub-periods can be distinguished within the period 1973-92. The first, from 1973 to 1981, is characterized by a series of transformations - such as liberalizing economic reforms, deregulations and privatization of enterprises - implemented simultaneously with a stabilization and adjustment programme. The second sub-period lasting from 1982 to 1984, is distinguished by successive attempts to control the serious impact of the 1982-1983 crisis. This not only implies relinquishing the principle of automatic adjustment and enacting successive adjustment and stabilization policies but also strong public interventions in the financial system - and elsewhere - to avoid its collapse and re-establish the possibilities of making it viable. The third subperiod 1985-89 stands out for a larger dose of pragmatism and coherence in the adjustment and stabilization policies as well as for a financial reordering process which includes the reprivatization of intervened banks and the privatization of great public enterprises. In the fourth subperiod 1990-92, corresponding to the restoration of the democratic process, it is feasible to harmonize macro-economic equilibria with a redistribution towards the poorest sectors. Particularly worth underlining is the stabilization effort *with* growth and the implementation of deliberate policies aimed at bettering the social situation.

The periodization outlined above is used in Chapters II, III, IV, V and VI, although in the present chapter it is preceded by a brief description of the initial situation. This preamble is essential if it is to be comprehended that the events following September 1973 go beyond a mere structural adjustment process.

B. The initial situation

It is worth keeping in mind that prior to the reforms the prevalent situation was characterized by large economic imbalances and social tensions accumulated during the attempted social transformation of the Allende Administration (Riveros, 1990; Larraín y Meller, 1991). Towards 1973, the fiscal deficit had soared to nearly 25 per cent of GDP. Money supply was expanding at a pace exceeding 350 per cent while consumer prices were growing at an annual rate of 600 per cent. Due to the swift inflationary acceleration, real wages had plummeted by 40 per cent in 1973, whereas the real exchange rate continued to be low in spite of the raise effected during that year. The deficit in the current account of the balance of payments had reached almost 300 million dollars in 1973, with a seriously negative impact on international reserves. The expansion of internal consumption, fuelled by the rapid income redistribution, was being accompanied by a decline in investment. In 1973 the gross investment coefficient had been reduced to 8 per cent of GDP. Moreover, a contraction of GDP was registered in 1973 for the second consecutive year. None the less, open unemployment stayed at a low rate of 4.8 per cent, due partly to the high level of activity developed in 1971 and partly to the considerable expansion of public employment.

In the social and political climate of 1971-73 the dynamic of the trade union movement reached an intensity never registered before. With the system of bargaining in

force, this dynamic generated wage pressures which became increasingly untenable (Riveros, 1990). In addition, the financial imbalances in the public sector augmented owing to the swift expansion of its control over private enterprises. By 1973 more than 250 private enterprises were state-run, having been intervened or placed under public sector control in the course of the 1971-1973 period. Added to the previously existing public enterprises, this represented close to 40 per cent of GDP in 1973, in contrast to the 14 per cent verified in 1965 (Hachette and Luders, 1987). The latter reveals the increasing loss of decision-making power of the private sector in the use of resources.

The situation outlined above would seem to suggest that the scope of economic imbalances, the excessive interventionism and the inconsistency of public policies facilitated - though it does not justify - an extreme approach to economic policy after September of 1973 (French-Davis, 1982).

C. Economic reforms

The objective of the Military Regime, which took over towards the end of 1973, was to constitute a free market economy based on the private sector and to enhance overall efficiency in the context of an open economy fully integrated with the rest of the world. This meant all but abandoning the import substitution strategy and spurring export growth. Although many of the reforms were oriented towards reallocating resources to tradeables, the main priorities were to stabilize the economy and to re-establish the capacity of the private sector to decide upon the use of resources through the free functioning of the markets. In this sense, the economic reforms implied deregulating and privatizing one of Latin America's economies most subject to state control and to curtail drastically the sway of the unions and other grass roots organizations so as to make the free market model feasible.

The strategy adopted represented an extreme case - even within liberalization strategies - owing to the amplitude of the role attributed to the market, the voluntary suppression of active public policies on various fronts and the change imposed on civilian society (Foxley, 1982, French-Davis, 1982). As became so clearly evident in the course of time, the recovery of a major role of the market could have been complemented with active public policies and greater social participation.

The main reforms included: (i) privatization of enterprises; (ii) reform and stimulation of foreign trade; (iii) fiscal reform; (iv) deregulation of product markets; (v) deregulation of domestic financial markets; (vi) external financial reform; (vii) deregulation of the labour market and privatization of social security.

1. Privatization of enterprises

As shown in Marcel (1989) the privatization of public enterprises, be they nationalized or intervened by the State, was of great magnitude. From controlling 500 enterprises in 1973, the State was reduced to managing 25 enterprises and one bank towards the end of the 1980s. The process comprised four stages. First came the rapid *reprivatisation* of 1974-75, consisting in the restitution of 257 enterprises and 3 700 land estates which had been intervened or turned over to state control. The second phase, between 1974 and 1978,

involved the sale of the enterprises that made up the so-called Social Property Sector constituted during the 1971-1973 period. The privatization implied sales of enterprises amounting to 540 million dollars (6 per cent of GDP), entailing a subsidy estimated at 30 per cent of the price and a down payment which on average fluctuated between 10 per cent and 20 per cent of the value of the acquisition. The sale of the enterprises coincided with a time of extremely high real interest rates in the domestic market with the upshot that only very few private conglomerates managed to acquire them, which in turn contributed to ownership concentration. The third phase corresponds to the reprivatisation of enterprises and banks pertaining to the so-called "odd sector" (*area rara*) which had emerged as a result of the external crisis of 1982-83 and its internal financial impact. During this stage enterprises for a total of US\$ 1 100 million (6 per cent of GDP) were sold with an implicit subsidy of approximately 50 per cent of the sales price. The fourth and last phase is set in motion between 1986 and 1989 when, in spite of the previous divestitures, it is esteemed that the economic dimension of the State continues to be disproportionate in size. During this period many traditional state-owned enterprises, including various public services, are put up for bidding, totalling a net amount of US\$ 3 600 million (18 per cent of GDP).

2. Foreign trade reform

The foreign trade reform (1974-79) included the homogenizing and lowering of the tariff system from ranges varying between 100 per cent and 220 per cent maximum to a flat 10 per cent, a task that was tackled between 1974 and 1977. Further eliminated were quotas, prohibitions and prior deposits for imports, since in 1973 almost two-thirds of all imports were subject to quantitative restrictions. In addition, the multiple exchange rate system was abandoned in favour of a unified exchange rate. As pointed out by Riveros (1986), though, the tariff reduction was initiated without clarifying its specific objective to the private sector, which created uncertainty in investment decisions.

3. Fiscal reform

The fiscal reform (1974-75) comprehended a tax reform and a reduction in public expenditures. Following (J. Yañez, 1992), the principal changes on the revenue side were: (i) the substitution of taxes on sales by a flat value-added tax (IVA) at an initial 20 per cent rate; (ii) the elimination of the wealth tax and the capital gains tax; (iii) reduction of taxes on profits of enterprises; (iv) the adoption of an adjustment in tax returns for currency devaluation or inflation; (v) the general simplification of the tax system, particularly with regard to taxes on personal income. The tax reform and price deceleration, allowed for the increase in tax revenues from 16 per cent of GDP in 1973 to 22 per cent in 1981. The decrease in public expenditures mainly depended on curtailments in public employment, which between 1973 and 1977 fell by 25 per cent, on wage cuts and on a strong diminution in public investment. The adjustment in the public sector was gradual but drastic: the fiscal deficit shrank from 24 per cent of GDP in 1973 to 10.5 per cent in 1974, to 2.6 per cent in 1975 and to 1 per cent in 1978. In the year 1979 a fiscal surplus of 1.7 per cent was obtained for the first time in many years.

4. Price deregulation

The deregulation of the goods markets signified relinquishing price controls or regulatory intervention that could affect prices. Likewise eliminated were barriers and minimum thresholds hindering access to specific markets. All this implied that within a period of two years the public sector ceased to exert an influence in the determination of more than 3 000 prices. Nevertheless, the way in which price deregulation was implemented, contributed to make more difficult the deceleration of inflation (Ramos, 1975).

5. Internal financial reform

Deregulation of domestic financial markets (1975-1977) included the privatization of the banking system and the shift from controlled interest rates to market-determined rates. The latter implied the elimination of quantitative credit controls and the liberalization of capital markets. Furthermore, special financing schemes for small entrepreneurs and peasants were reduced. The reserves required for commercial banks were lowered while the entry of foreign banks was facilitated. However, the procedures for regulating and supervising the credit portfolio and solvency of the banks were not in line with the liberalization measures (Held, 1990). This fact gave place first to a model of free-banking (1974-76) and afterwards to a model of uncontrolled banking (1977-81), that contributed decisively to the financial crisis of 1981-83. The accumulation of a high-risk portfolio was the result of the rapid growth of an uncontrolled banking system during the financial liberalization (Held, 1990).

6. External financial reform

The external financial opening (1977-82) allowed the private sector to borrow abroad. This covered the gradual liberalization of capital flows and the replacement of the State by the private sector as main borrower of foreign credits. Direct foreign investment had already been liberalized in 1975. Subsequently (1979), the existing quantitative limits for external indebtedness by banks were waived and a new ceiling of 20 times the capital and reserves was set. By 1982 the dissuasives and controls with respect to short-term flows had also been diminished. The progressive reductions of external indebtedness restrictions from 1978 onwards affected both stock and flow variables, and reached their total elimination in 1989 (Held, 1990).

D. The labour market institutional changes

The institutional changes in the labour market (1973-82) was a process that provoked serious repercussions.

The Labour Code, in force until 1973, authorized collective bargaining at the union level by branch of activity or at the confederate level, thus gradually giving rise to a more centralized model of bargaining in 1971-73. After September of 1973 collective bargaining was eliminated, the right to strike was suspended, and union activity prohibited, which automatically discarded the prevalent system of wage negotiation. Wage adjustments were now determined by governmental signals and recommendations as well as by market forces

atomized on the supply side. The Government established full indexation linked to past inflation, that became more rigid in the absence of collective bargaining². The repression to the trade unions - and labour - generated in practise a context within which neither workers nor Government were motivated to enforce the fulfilling of labour institutions, although they were legally prevailing. After 1973, it was only required an administrative authorization to justify collective dismissals - although compensations were still in force. Another important change involved the abandonment of mediation in labour conflicts and of the Labour Court system. Hence, in practise, labour stability was disrupted and the cost of dismissals reduced - since the reduced bargaining power of workers gave rise to frequent by-passing of legal regulations.

These changes granted private entrepreneurs great power in deciding upon their employment and wage policies (Riveros, 1990).

It is worth underscoring that, as pointed out by Riveros (1990), the collective bargaining institutional labour framework prevailing until September 1973 was suspended but not replaced. Together with labour repression, the previous fact affected in practise labour institutions in other areas. During the period 1973-79 there was a complete lack of norms or enforcement of laws regulating labour relations, collective bargaining, dismissals, the right to invoke strikes, labour conditions and union activity. This, coupled with the absence of any signals as to the coming modifications in the institutional norms and the wage indexation established by Government, generated uncertainty with respect to the future costs of hiring and dismissing labour, curbing in this manner employment creation.

Starting in 1979 the norms shaping the new labour institutional framework were introduced. New directives regarding the union movement and collective bargaining were decreed. The forming of more than one union per enterprise was encouraged, bargaining was allowed solely at enterprise level, not by branch of activity, and hiring for part time work was authorized. Joining the union became a voluntary action, the right to strike was abolished, in the public sector and limited to 60 days in the private one, and the Labour Courts which existed prior to 1973 were not restored. The law further established *full wage* indexation linked to past inflation as a basis for any bargaining activity.

As a result of the recession of 1982 full indexation was eliminated, as it proved a stumbling block for the enterprises in their efforts to adjust to this adverse conjuncture. Furthermore, compensations for dismissals were revised - establishing one month per working year with a maximum of five - for contracts signed after 1981. The dismissals were restricted to causes justified by the law, but including the unilateral right to dismiss a worker if the legal compensation was paid.

²Between the years 1973 and 1982 - a period during which inflation fell from 600 per cent to 10 per cent annually - a complete indexation to past inflation was implemented, based on recommendations from the Government to the private sector (1973-1979) and on legal directives (1979-1982). The effective incidence of this indexation has become a controversial issue. Besides, during the entire period a minimum wage was kept up, although its incidence was felt to a lesser degree due to wage indexation.

Also, between 1979 and 1982, a social security reform was implemented and significant changes in social policies were effected. In 1981 the system of social security funds was modified in so far as the greater part of it was privatized, with the introduction of a scheme of contribution and capitalization of benefits in replacement of the scheme of allotments³. At the same time, a private health system was established, based on users' quotations. In the same period the Government decentralizes education and public health at the local level besides putting into practice a social emergency housing plan for low income households. Simultaneously, the emergency employment programmes started in 1975 are enlarged and diversified at the national level. Similarly, steps are taken to target social spending on the poorest sectors.

³The decrease of non-wage labour costs was significant. The entrepreneurs' contribution to social security was slashed from 44 per cent of the total of remunerations in 1975 to 3 per cent in 1982.

III. THE INTERACTION BETWEEN REFORMS AND STABILIZATION POLICIES

A. The period 1973-81

In the Chilean experience the process of reforms was implemented *simultaneously* with stabilization policies, which led to serious repercussions.

The outstanding feature of the adjustment policies initiated in 1973 is the conviction that the free play of the markets would suffice to induce the reallocation of resources in an open economy (Cortázar, Foxley and Tokman, 1984). The public policies were to concentrate on achieving macro-economic equilibria and on correctly aligning key relative prices. Further yet, resource allocation towards tradeables and the modernization of the economy could also be reached by this route, provided the product and factor markets were deregulated and all state intervention in the use of resources eliminated. This extreme conviction was only abandoned a decade later when the impact of the 1982-83 crisis obliged the State to intervene on various levels with more pragmatic policies.

Given the high inflationary pace in 1973, the priority assigned to the stabilization of prices was determinant. Furthermore, considering that rampant inflation was not exactly conducive - due to the constant changes of relative prices - to sending clear and permanent signals to the private sector prompting investment decisions, price stabilization was also regarded as a crucial element in the reallocation of resources.

In the years 1975-76 a drastic stabilization effort is realized, headed by a sharp drop in the fiscal deficit and expenditure, which entailed a deep recession. It was during this period that the corrected unemployment rate soared first to 15 per cent and then to an average of 20 per cent⁴.

In 1976 and 1977 attempts are made to halt inflationary expectations by brusque revaluations of the peso. In 1978 a "table" is introduced which anticipates the expected evolution of the exchange rate so as to provide guidance for expectations or prospects and in 1979 a nominal fixed exchange rate is established to arrest inflation. The use of the exchange rate as a nominal anchor for price stabilization leads to an increasing erosion of the real exchange rate as of 1976, a process that becomes intensified after 1978 (Corbo, 1985; Edwards and Edwards, 1987). According to Meller (1991) it must be stressed that by 1979, when tariff reductions had finalized in a flat 10 per cent, there existed an exchange gap of 18 per cent with respect to the average real exchange rate of the years 1974-75. On top of this, between 1979 and 1981 was verified an *additional* real appreciation of the peso of around 26 per cent. Table 1 presents the evolution of the joint effect (real protection) of the average nominal tariff and the real exchange rate (Meller, 1991). As can be inferred from the third column of the table, in 1980 real protection had been reduced to less than half of that prevalent in 1975, owing to the combination of lowered tariffs and the *decline* of the real exchange rate. In other words, real protection which has a bearing on potential profitability

⁴Including open unemployed and those incorporated to the emergency employment programmes. Se Table 2 of Chapter IV.

of sectors exposed to external competitiveness, had fallen by 50 per cent in the space of five years, with the ensuing dissuasive effect on the production and the investment in tradeables, particularly in the imports competing lines - such as the industrial sector. The fall in real protection implied a sectorally differentiated shock, given the different sectoral sensitiveness to such an impact. Towards 1981 inflation was successfully cut down to 9.5 per cent, though at the expense of an increase in the deficit in the current account of the balance of payments equivalent to 125 per cent of exports and 15 per cent of GDP, which in due course required various years of intense effort - and social cost - to be corrected.

The external financial opening and the internal deregulation implemented in 1979-81, which made it possible for banks and enterprises to incur in indebtedness abroad, permitted financing the external deficit mentioned and thus facilitated the exchange lag. This contributed to an overvaluation of the peso and to the accumulation of serious macro-economic imbalances (Edwards and Edwards, 1987). It is noted that between 1976 and 1981 Chile obtained external financing equivalent to an annual average of 5 per cent of GDP.

The decline of the real exchange rate in the context of a price deceleration with full wage indexation, recommended by the Government to the private sector, accounts for the fact that average real wages rose by 54 per cent between 1975 and 1981, almost recovering their 1970 level.

In sum, the deterioration of the real exchange rate aimed at diminishing inflationary expectations, the internal financial deregulation and the opening of the capital account took place before the export drive was consolidated. Their impact is felt in the same years that trade opening is implemented, affecting the profitability of tradeables and generating important imbalances and an increased exposure on the eve of what was to be the greatest external recessionary crisis since the 1930s. It is in this period that a phase of deindustrialization is verified (Lagos and Tokman, 1982), since these policies particularly affected the pre-established industrial and new import competing sector, through the reduction of real protection.

This particular interaction between stabilization policies and reforms contributed to the enhancement and persistence of open unemployment in the period 1975-81, besides helping generate cumulative imbalances which subsequently enlarged the negative effect of the external crisis of 1982-83 on the labour market. From the latter perspective, the imbalances brought about by the interaction between reforms and stabilization measures in the years 1975-81 increased the internal impact of the external crisis of 1982-83. In this manner, they contributed to higher unemployment and lower real wages during the period of adjustment to the crisis⁵.

⁵In comparison to what the external crisis of 1982-82 would have induced in the absence of the accumulated imbalances.

B. The period 1982-84

The external shock of 1982-84 implied a serious impact on the Chilean economy. To begin with, the increase in the international interest rate had a direct bearing on the foreign debt, which between 1979 and 1983 had risen from 40 per cent to 100 per cent of exports. Towards 1983 debt service in interest payments alone amounted to an equivalent of 10 per cent of GDP. The deterioration of the terms of trade was likewise very acute - 26 per cent in 1981-82. Both factors - financial and trade - caused crippling restrictions of foreign exchange which were met by successive and chaotic adjustment attempts.

As pointed out by Meller (1991b), during 1981 and the beginning of 1982 no measures were taken to reduce the increasing deficit in the current account of the balance of payments. The prevailing idea was automatic adjustment, based on a monetary approach to the balance of payments⁶, whereby it was expected that the rise in the real interest rate would adjust the external deficit. In practice, the *real* interest rate soared in the second half of 1981 and the first half of 1982 until almost reaching 48 per cent per annum. The effect of this on an over-indebted economy was devastating. Domestic expenditure fell by nearly 20 per cent, imports shrank to 50 per cent and GDP registered a cumulated decline of 15 per cent in the 1982-83 biennium. Unemployment, including those occupied in emergency programmes, climbed to 30 per cent of the EAP. In spite of the spectacular rise in the real interest rate, the inflow of foreign exchange instead of augmenting actually *decreased*. This only confirmed the scant sensitiveness of external credit and capital flows to the raised interest rate, given the crisis environment prevailing throughout Latin America.

The Government continued rejecting a real devaluation, partly because it wished to preserve financial and wage indexation and partly because its prestige was tied to the fixed dollar rate. When devaluation was finally adopted in June of 1982, the measure precipitates a crisis of confidence in the game rules.

Between June and September of 1982 four different exchange systems were in force, including two maxi devaluations. In spite of the efforts of the government in the midst of this crisis of confidence, the successive devaluations only created expectations of further devaluations, exerting a strong pressure on the foreign exchange market. As time went by, the atmosphere of apprehension provoked by the recession gave rise to demands for government intervention (Meller, 1991b), inasmuch as neither the automatic adjustment nor the sizable real devaluations seemed to have had the slightest effect. The Central Bank adopted an expansive monetary policy with the result that towards the end of 1982 a drop of 25 per cent in monetary supply (M-1) is registered. It thus becomes evident that whatever the exchange rate system, it is not feasible to regulate money supply, much less use it for reactivating purposes, without controlling capital flows. In these circumstances, capital flight becomes accelerated. By the end of 1982, after the Central Bank has lost one-third of its

⁶According to this approach, in a small and open economy with a fixed nominal exchange rate and without monetary sterilisation policies, money supply would be *endogenous*, expanding (contracting) in relation to the inflow (outflow) of foreign exchange. If the inflow of exchange is insufficient to finance the deficit on the current account, money supply will shrink and the interest rate rise, which will correct the external deficit.

reserves, exchange control and restrictions for capital flows are introduced. Thus begins a phase of increasing state intervention in resource allocation.

Between 1982 and the beginning of 1985 a succession of stabilization and adjustment endeavours of distinct character are embarked upon. The common denominator of these attempts is the jettisoning of the non-interventionist dogma - the guiding principle of public policies during the period 1973-81. In fact, between 1982 and 1984 the State intervenes radically on a diversity of fronts in order to avoid a general collapse. The interventions manifest themselves both in successive macro-economic policies and in significant changes in many of the areas subjected to reforms in the years 1973-81. Thus, the measures enacted consist in the periodic devaluation of the exchange rate along with exchange controls, the administrative regulation of the interest rate, control of capital flows, the raising of tariffs to an average of 25 per cent together with the imposition of temporary surcharges modifying low and flat tariffs.

Among the more intensive interventions, it is worth singling out the efforts to avoid the collapse of the financial system, the fixing of a preferential dollar rate for payment of the foreign debt and the guarantees backing private external debts.

Liberalization of the domestic financial market in the mid-seventies - within a framework of exchange stability and external financial opening - had led to an over-indebtedness of the enterprises and a credit allocation that favoured enterprises "related" to each bank (Arellano, 1983)⁷. Financial liberalization had also contributed to relax the limits and collateral for personal credits. The overvaluation of private assets generated by the boom and the exchange rate stability reigning from 1978 to 1981 enhanced the value of the collaterals. By 1982, half of the *domestic* credit was expressed in foreign currency. In this context, high real interest rates plus a maxi devaluation combined with a profound recession created a situation of insolvency for thousands of enterprises, a state of affairs that was bound to spread rapidly to financial institutions.

The Government intervenes heavily, with the Central Bank and the Ministry of Finance as last resort bailers-out. Increased regulation and control of the financial market are reintroduced. Between 1982 and 1984 14 banks and eight finance companies are intervened and an ample plan is implemented to provide assistance to faltering firms and banks. Among the measures adopted, the Central Bank came to the rescue of the private banks by purchasing their bad loans; trade and consumer debts as well as mortgages were rescheduled and subsidised; and a subsidised exchange rate or "preferential dollar" was instituted for payments of the external debt. It is estimated that the fiscal cost and the foreign exchange losses assumed by the Government amounted to 9 000 million dollars⁸ (Eyzaguirre and Larrañaga, 1990), which, paradoxically, represented an extreme example of public intervention. The enormous fiscal cost of refloating the financial system doubtlessly contributes to its better subsequent functioning. Yet the magnitude of the

⁷Towards 1982 close to 30 per cent of credit portfolios were channelled to enterprises linked to the respective banks.

⁸Around one-third of GDP of a given year during that period.

resources swallowed by this process impede an expansion of the social expenditure so necessary to mitigate high unemployment, low wages and increasing poverty arising from the harsh adjustment to the crisis.

It is worth bearing in mind that during the 1982-84 period agreements are subscribed with the IMF jointly with successive rescheduling of the private external debt with commercial banks. Nevertheless, the Government is obliged to provide guarantees for this private debt in order to obtain the renegotiations⁹. One consequence of this was that the foreign public debt grew to the extent of tripling between 1981 and 1985.

As of 1983 Chile subscribes three adjustment programmes with multilateral organisms: In 1982-84 an IMF loan for US\$ 795 million; in 1985-87 another IMF loan for US\$ 821 million; and in 1985-88, through the World Bank, a SAL loan in three instalments for US\$ 750 million. The first agreement with the IMF emphasized the priorities of reducing the foreign debt and the enhancement of domestic saving to finance recovery but also supported rescheduling of the debt with commercial banks. The seal of approval of the IMF proved a crucial element in convincing foreign creditors. Furthermore, the stand-by agreement of 1983 provided macro-economic coherence where chaos had reigned in 1982. But it also proved conducive to prolonging the recession and the unemployment problem owing to its insistence on the fiscal and monetary positions to decrease the external deficit. Towards the end of 1984, in spite of having fulfilled the majority of the fiscal and monetary goals, the deficit in the current account continued to be nearly US\$ 800 million higher than accorded with the IMF (Meller, 1991b).

It must be underlined that the important flow of external credits received by Chile from 1981 to 1984 was decisive in upholding the adjustment process in the period of the greatest disequilibria (Frenkel, Damill and Fanelli, 1992). This explains why the net transfer of resources abroad in this period does not affect Chile with the same intensity as the rest of the indebted countries of the region. Thus, in the years 1980-84 a net transfer of external resources *towards* Chile was effected - with the creditors' approval - amounting to an annual average equivalent of 2 per cent of GDP¹⁰. Meanwhile, during the same period Latin America as a whole was transferring net resources abroad for an average of 2 per cent of

⁹In January 1983 the position of the government was that private debtors and creditor banks should come to a satisfactory solution *without* governmental intervention. The international banking community responded by suspending all types of credit, including short-term credits for foreign trade. The government then agreed to be guarantor of the private debt of the financial sector, though not of the non-financial private sector. Thus, more than 86 per cent of external indebtedness became public or was guaranteed by the state (Meller 1991b).

¹⁰This average includes years with a positive net balance (1980, 1981 and 1984) and years with a negative net balance (1982 and 1983).

GDP¹¹. It is only as of 1985 that Chile begins to seriously raise the net transfers abroad, though it does so *after* having attained an export growth which, compared with the rest of Latin American countries, lightens the burden of the effort.

The successive adjustment policies of 1982-83, lacking in co-ordination and at times inconsistent, produced an overkill. As pointed out by Meller (1990), real domestic expenditure in 1982-83 drops by 30 per cent with respect to 1981. And in 1984-85 it *continued* to be 20 per cent lower than in 1981, to say nothing of domestic investment which had plummeted by 50 per cent. More disturbing yet was the decline in the production of tradeables which in spite of the maxi real devaluation of 1982 was still 5 per cent lower in 1983 than it had been in 1981. Even by 1985 production in tradeables had still not caught up with the 1981 level (Meller, 1990). All of which suggests that the recessionary overadjustment enacted in 1982-84 was excessively prolonged, non-selective and costly, resulting in an overkill.

In 1984 a new economic programme backed by expansive fiscal and monetary policies *with* the use of reserves, accounts for a recovery of 6 per cent of GDP, curbing recessionary expectations. However, the design was not feasible for medium-term effectiveness. A redeeming element of the successive policies applied in the 1982-84 period is that despite their being contradictory among themselves they all contributed to raising the real exchange rate - in fact, by almost 50 percent between 1981 and 1984. Considering a time lag of more than two years for the expansive effect of real devaluation to be felt in external accounts and domestic activity, it must be concluded that this devaluation, together with those effected subsequently in the lapse 1985-88 decisively contributed to the recovery period of 1985-89.

C. The period 1985-89

At the outset of 1985 a new adjustment programme is initiated, more pragmatic in character than the policies applied between 1974 and 1981 and more consistent than those implemented in 1982-84. Aided by the improvement of external conditions, the new programme first contributes to a swift recovery and subsequently to the accomplishment of rapid and sustained economic growth.

With respect to external conditions a pronounced improvement of the terms of trade is verified while access to external financing remains open. Between 1985 and 1987 Chile agrees to a structural adjustment programme, receiving three loans from the World Bank for this purpose, which paves the way for negotiations with foreign private banks. From 1983 to 1989 six renegotiations take place with creditor banks which permits avoiding building up arrears during the structural adjustment (Butelman, 1990). This banished the domestic uncertainty which tends to arise from conflictive or fruitless negotiations and furthermore generated a new external financial space, appropriately occupied by the adjustment policies.

¹¹Taking into account the *entire* decade of the eighties, Latin America transfers resources for an annual average equivalent to 2.5 per cent of GDP while Chile does so for an average annual amount equivalent to 0.6 per cent of GDP (ECLAC, 1991).

Adjustment policies in the period under discussion continued to raise the real exchange rate which increases by 22 per cent in 1985, by 11 per cent in 1986 and by 10 per cent in the 1987-88 biennium. As a result, the real exchange rate more than doubled between 1981 and 1989 (see table 1), which prompted a robust growth in tradeables, especially those destined for export. As can be gathered from figure 1, a close correlation can be established between the real exchange rate and the export coefficient with respect to GDP. Nominal tariff - that had been increased to 25 per cent after the external crisis - was reduced to an average of 15 per cent. In the years 1986-89 real protection recovered from the decline registered until 1981 and again reached the 1974 level, though now with a greater relative incidence of the exchange rate, which was conducive to stimulating exports.

A second feature of the period in question refers to the conversion of the foreign debt into investment or acquisition of internal assets, a process that quickly reduced the debt stock. Between 1985 and halfway through 1990 this mechanism permitted reducing the foreign debt by close to 10 000 million dollars on an eligible amount of 14 000 million.

A third priority area of the adjustment policies of the period was concerned with fiscal income and expenditures. The approach to this problem consisted in reducing the deficit incurred owing to the expansive policies of 1984. The increase in the copper price, which has an impact on public income, and a severe discipline in public expenditure combined in decreasing the deficit until turning it into a surplus at the beginning of 1987.

It must be pointed out here that the diminution in expenditure focused on *current* outlays. Public investment exhibits a *significant growth* between 1983 and 1989. This constituted an important advance, inasmuch as it helped maintaining domestic demand and contributed to economic growth due to its complementariness with private investment.

As for fiscal income, the rise in the real exchange rate and in the price of copper entailed increased tax collection and enhanced non-tax revenues. The higher tax collection proceeded from segments connected with foreign trade, such as taxes on profits from copper sales, the 20 per cent value-added tax (IVA) on imports, existing tariffs and taxes on fuel. Hence, the sensitiveness of tax revenues to changes in the external sector proved to be one of the relevant factors of the scenario (Larrañaga and Marshall, 1990). The hike in the copper price proved decisive in attaining an improvement in fiscal accounts. The trends outlined allowed a reduction of direct taxes with an incentive for reinvesting profits and a decline in the aliquot of the value-added tax (IVA) to the benefit of the private sector.

During this period the State reprivatises the banks intervened in 1982-84, through the sale of shares and, as mentioned before, also privatises an important group of traditional and strategic state-owned enterprises. New regulations for the banking system and new responsibilities for the Superintendence of the Banking System are also introduced - contributing to increase creditability and to the reduction in the interest rate.

The increment in fiscal revenues in the manner described above, added to the stringency in current fiscal expenditure, produced a gradual recovery of public accounts, which liberated resources towards the private sector.

This performance of the public sector contributed to strengthening the financial position of the private one. The transfer of income and assets by means of tax rebates, transfers and subsidies through the financial system accounted for the recovery of private savings and the gradual re-establishment of financial soundness. As mentioned before, the public sector in various ways transferred to the private sector part of the profits obtained from copper sales, due to the improved price conditions and the fiscal effects of real devaluation (Frenkel, Damill and Fanelli, 1992). Furthermore, it transferred to the private sector part of the increment in the internal and external public debt incurred in order to finance the rescheduling of the private debt, including the acquisition of the uncollected loans of the banking system. From this perspective, the adjustment was characterized by a sound financial public sector, with access to external financing, which in various manners helped solving the problems of a private sector over-indebted in dollars and with rationed credit availabilities (Frenkel, Damill and Fanelli, 1992).

Consequently, even though the improvement in the terms of trade and the access to foreign credit contributed to the recovery, it remains no less certain that the public policies adopted were crucial in: (i) obtaining a greater diversification of exportable and import competing production; and (ii) reverse the sluggish tendencies of investment and savings and reorient their destination. It was largely thanks to the financial support mentioned that the private sector managed to neutralize the impact of the 1982-83 crisis and take advantage of the more rewarding profitability of tradeables brought about by the change in relative prices.

The foregoing suggests that, contrary to common belief, the adjustment policies embarked upon in the period 1985-89 implied a pragmatic approach with diverse and prolonged state interventions to shore up the private sector and to continue the reallocation of resources towards tradeables.

D. Macro-economic performance

After the deep recession of 1975, in which GDP contracts by 13 per cent, the economy recovers and exhibits an average economic growth per annum of 7.1 per cent between the years 1975 and 1981. Standing out is the rapid expansion of exports, averaging an annual rate of 12 per cent between 1973 and 1982, which implies a rise in the export coefficient from 11 per cent in 1973 to 20 per cent in 1981. Imports, though, evidence an even swifter growth, causing the import coefficient to climb to 33 per cent in 1981. Nevertheless, the gross investment coefficient remains at low levels (15 per cent of GDP) for the better part of the period 1974-81, reacting only in 1979-81 when it augments to an average of 25 per cent owing to the effects of both the real appreciation of the peso with respect to imports of equipment and the construction boom.

As mentioned previously, the external shock of 1981-82, intensified by the imbalances accumulated prior to it, causes GDP to contract by 15 per cent in the biennium 1982-83. In 1984 the policy of reflation of domestic demand induces a growth rate of more than 6 per cent.

From 1985 onwards, after an initial year of severe adjustment with GDP growth of 2.5 per cent, a rapid and sustained recovery can be verified. Between 1985 and 1989 GDP

grows at a annual rate exceeding 7 per cent, a rate that becomes particularly accelerated in 1988-89 due to the domestic expansion verified on the eve of the democratic elections. Exports, whose growth had not been checked by the 1981-82 shocks, not only continued rising at an annual pace of 10 per cent but also speeded up diversification of goods and foreign markets. Towards the end of this period the export coefficient reaches 32 per cent of GDP. In contrast with the 1974-81 period, imports between 1984 and 1989 are kept below exports, with the result of a significantly favourable trade balance. Gross investment evinces a slow but sustained recovery from 9 per cent of GDP registered in 1983 to 15 per cent in 1986 and 22 per cent in 1989.

The strategy proves successful in achieving a greater dynamism and diversification in the field of exportables and as of 1984 the same can be said of import-competing production. Export growth is intensive in natural resources proceeding from ambits such as agriculture, agroindustries, fishing and mining. This growth is based on the expansion, diversification and modernization of activities in tradeables and of the supporting economic infrastructure - communications, banking, transport and services - but no less on the sustained effort to amplify and diversify foreign markets.

Yet the effort to update the social infrastructure - education, health and housing - is less determined despite the fact that an improvement in this direction must be considered a crucial element for sustaining productivity gains in the long run.

Lagging behind too is the participation of the middle and low income groups in the fruits of modernization and growth. Hence, the structural change is accompanied by an increase of social inequity.

Table 1

CHILE: NOMINAL TARIFF AND REAL EXCHANGE RATE, 1973-90

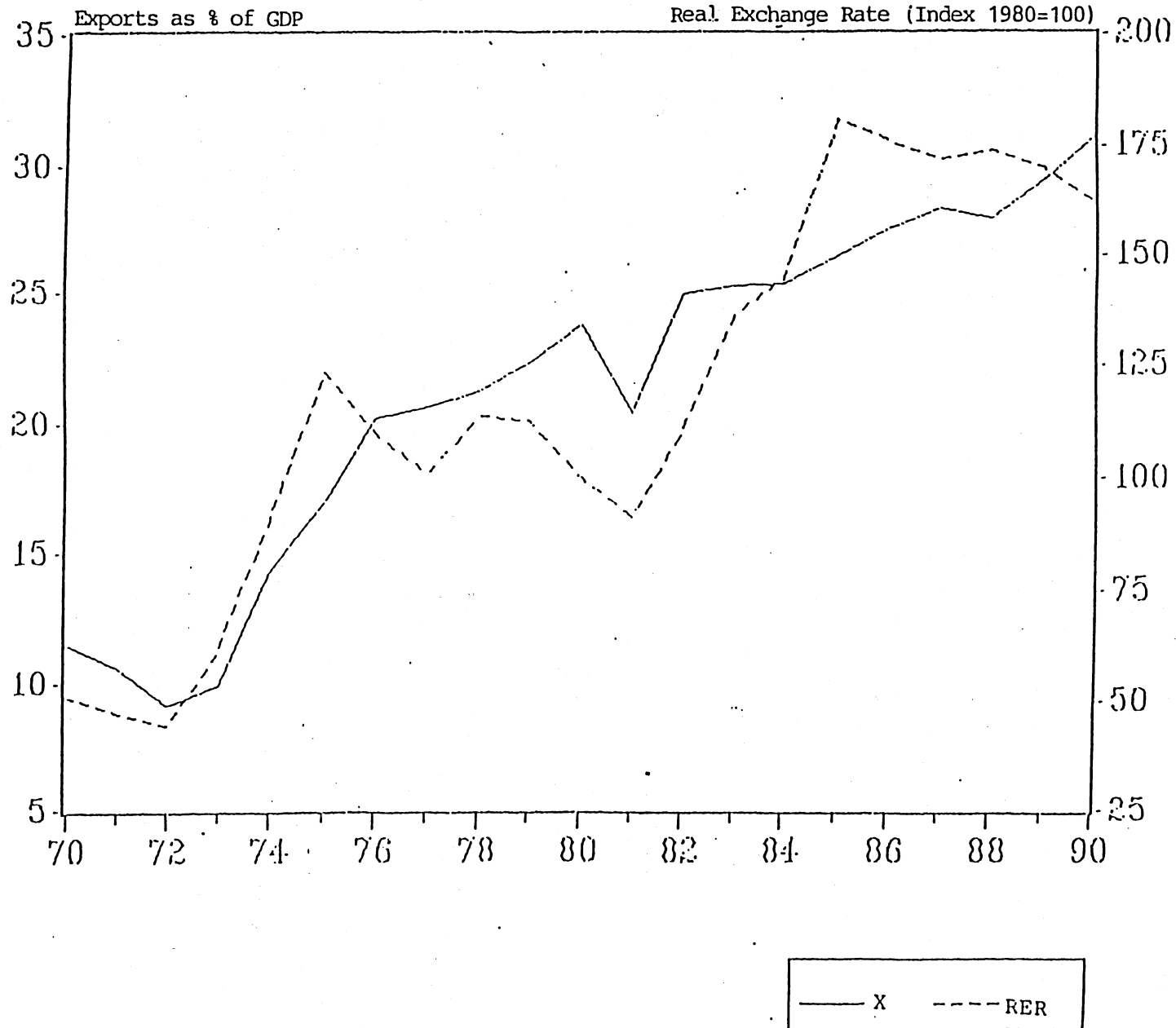
Year	Average nominal tariff (%) (1)	Real exchange rate a/ (\$/US\$ of 1990) (2)	Indicator of real protection level b/ (1990=100) (3)=[1+(1)]x(2)
1973	105	201.5 c/	117.8
1974	75	199.8	99.7
1975	49	273.8	116.4
1976	36	221.5	85.9
1977	22	184.7	64.3
1978	15	205.2	67.3
1979	11	200.5	63.5
1980	10	175.0	54.9
1981	10	148.8	46.7
1982	10	172.6	54.2
1983	18	207.2	69.7
1984	25	218.0	77.7
1985	26	264.9	95.2
1986	20	294.6	100.8
1987	20	305.1	104.4
1988	15	324.5	106.4
1989	15	313.6	102.9
1990	15	304.9	100.0

Fuente: Meller, P. (1991) based on information of the Central Bank of Chile.

- a/ For real exchange rate read: Real nominal official exchange rate deflated by consumer price index and inflated by external inflation index.
- b/ The level of real protection is: the real exchange rate multiplied by 1 plus the nominal tariff.
- c/ The average between the official and unofficial or parallel exchange rate has been used for this calculation.

Figure 1

CHILE: EXPORT COEFFICIENT AND REAL EXCHANGE RATE 1970-90



IV. EFFECTS ON THE LABOUR MARKET (1974-89)

A. The period 1973-81

1. Introduction

This section is dedicated to analysing the impact of reform and stabilisation policies on the labour market during the period 1973-81. In particular, attention focuses on: (i) the increase of unemployment and its duration, along with the diminishing job opportunities; (ii) the reasons explaining this phenomenon, considering that, as shown earlier, a significant economic growth was registered between 1975 and 1981; (iii) the adjustment of employment and incomes in the informal sector; (iv) the behaviour of part-time employment; (v) the evolution of hiring and dismissal rates; (vi) the absorption in emergency employment programmes; (vii) the abrupt decline of the union movement; and (viii) the sharp drop in real wages in the 1973-75 triennium and its subsequent recovery between 1975 and 1981.

2. Increase of open unemployment and its causes

The adjustment, stabilisation and reform policies struck the labour market with a dramatic impact. Particularly affected was the open unemployment rate which soared from 4.8 per cent in 1973 to 9.2 per cent in 1974, then to 15.6 per cent in 1975 and finally to 20.6 per cent in 1976, with those occupied in emergency employment being included in the percentages¹². From that point onwards the open unemployment rate decreases but so gradually that in 1981 it still exceeded 15 per cent. The average duration of unemployment also jumps from six months in 1973 to one year in the period 1975-79 (Riveros y Diaz, 1987).

The rise in the unemployment rate added to its average duration lead to a marked lessening of the probabilities of finding work within a reasonable space of time (Haindl, 1985). As can be gathered from table 8, the probability of finding a job within six months was estimated at 74 per cent for Greater Santiago towards the end of the sixties. This probability descended to 52 per cent in the quadriennium 1975-78.

What, then, are the whys and wherefores of this drastic rise in unemployment and its protracted duration?

A hypothesis open for consideration is the concurrence of diverse internal shocks caused by the interaction of stabilisation and reform policies in the period 1973-81. Distinct measures and signals of both sets of policies combine to cause a sharp increase in the dismissal rates on the one hand and a check - though not a fall - in the rate of hiring labour on the other. In this scenario, the following points could be highlighted:

¹²The figures indicated correspond to data from the employment and unemployment survey of the University of Chile, adjusted for coverage of emergency employment programmes. The INE data follow a similar trend in 1972-76 though they differ in levels. See table 2.

a) After two successive years of contracting (1972 and 1973) GDP remains practically stagnant in 1974 to drop by 13 per cent in 1975, owing to the abrupt recession induced by the stabilisation policies applied. This to a large extent explains the rise in unemployment in the years 1974-76.

b) The notable reduction of public employment also contributes to augmenting open unemployment. Various estimates suggest that the curtailments in public employment between 1973 and 1977 amounted to an equivalent of between 3 per cent and 6 per cent of the labour force - see Riveros (1990); Paredes (1987); and Cortés and Sjaastad (1982).

c) The partial suspension of the prevalent institutional labour norms, at a time when competition with the exterior as well as among domestic enterprises was growing rapidly, helped favouring adjustment by way of unemployment, since dismissals had been facilitated and the uncertainty generated¹³ also affected the hiring of manpower.

d) Trade liberalisation had a twofold effect. On the one hand, fear of external competition drove enterprises to adjust by rationalising their tasks, which resulted in further unemployment. To this must be added the impact provoked by the closure of enterprises. On the other hand, given that liberalisation of trade was not accompanied by sufficient information for the private sector regarding the specific objectives, investment decisions in tradeables were not prompted at the required pace. In other words, hiring of labour would have proceeded at a more satisfactory rate, had the climate for investment decisions been more propitious.

e) The trade reform and reduction in the real exchange rate implemented after the recessive adjustment, implied a sectorally differentiated shock (Sapelli, 1990). Some sectors contract or disappear altogether, other stay afloat or expand. This is reflected in the asynchronism existing between the composition of labour demand and labour supply: the new profile of labour demand was different from the one prevailing among those that were dismissed.

In Sapelli (1990) the following is underlined: (i) the sectors that suffered a comparatively *lesser degree* of decline in the period 1973-81 were precisely the ones that subsequently grew most, which points to a change in the sectoral mix of production; (ii) following this line of thought, the variation coefficient of the sectoral employment growth rates rises between 1973 and 1981 and diminishes in the years that follow, as can be gathered from table 3; (iii) unemployment particularly intensifies in the higher age groups and among those with better education, suggesting marked changes in sectoral demands for human capital; (iv) the loss of specific human capital entails a difficult and costly process of replacement which takes *time* during which unemployment increases and is prolonged by the resulting mismatching. It must be added that these frictions were enhanced by erroneous signals proceeding from such diverse factors as the absence of an adequate institutionalised

¹³As mentioned in the previous chapter, the existing institutional labour norms were partially suspended in 1973 but were not replaced until 1979-82. During this interregnum the new institutional norms were an unknown factor.

labour framework, the appreciation of the real exchange rate and the scant information regarding the specific objectives of the trade reform for the private sector.

f) The decision to use the exchange rate as a guide to reduce inflationary expectations, added to the internal financial deregulation and the anticipated opening of the capital account, provoked an appreciation of the real exchange rate, which, as shown in the previous chapter, seriously reduces real protection and the rate of return for tradeables. The fall in the real protection contributed to the sectorially differentiated shocks and hence, to the increase of open unemployment originated in the mismatching. This affects investment decisions in the corresponding sectors, slows down the adjustment and curbs employment growth. It seems obvious, therefore, that the signals from the applied economic policies were not consistent with the functioning of an open economy.

g) The erosion of the real exchange rate created a space that was occupied by an increase in real wages far exceeding that occurring in productivity. After contracting by 40 per cent in 1973 and 15 per cent in the biennium 1974-75, as can be seen in table 4, average real wages *grow* between 1975 and 1981 at an annual average rate of 6 per cent. The application of full indexation to *past* inflation in a period of notable inflationary deceleration explains why the room left by the descent of the real exchange rate was occupied by the increment in wages. As was to be expected, the rise in wages is more pronounced in tradeables. However, this raises the unitary labour costs in the initial period of liberalised trade, discouraging in this manner additional hiring of manpower in these sectors¹⁴ besides acting as a dissuasive factor in engaging in relatively labour intensive activities.

3. Adjustment in the informal sector

During the period 1973-81, no tendency can be detected pointing to a significant increase of informal activities in urban employment (table 3). This is consistent with the circumstance that internal shocks tend to provoke an adjustment by way of open unemployment and with the absorption of secondary labour in emergency programmes. In table 4 it can be noted that real average informal income was abruptly reduced in the 1973-75 triennium, as were real wages. From 1976 onwards, these incomes are assumed to have experienced an average growth approaching that of real wages. (See García, 1992).

4. Adjustment through work hours and part-time work

The figures analysed previously in this text measure open unemployment by number of persons, to which should be added the decrease in the average number of hours worked. From table 5 and figure 2 it can be gathered that this average dropped from nearly 49 weekly hours in 1970 to 45.6 hours in 1977. The 1970 average is only recovered by 1980-81. Similarly, in the period 1974-76 the percentage of those working more than 35 hours per week notably diminishes. This can be explained in part by the weighted increase of those

¹⁴This is particularly the case when the increased unitary labour costs in tradeables are compounded by the uncertainty caused by the lack of labour legislation with respect to the hiring of labour.

occupied in part-time jobs. Thus, with respect to previous years, the share of those working less than 35 hours per week in Greater Santiago's employment, rises by nearly 2 percentage points in the 1974-76 interval.

5. Emergency employment programmes

One of the reasons why informal employment did not grow at a faster pace during the critical period is to be found in the implementation of emergency programmes creating direct employment. As can be seen in tables 2 and 6, these programmes accounted for 1.9 per cent of the EAP in 1975, growing to almost 6 per cent in the period 1976-77, to subsequently decline gradually until settling at 4.8 per cent in 1981. Hence, between 1975 and 1981 the number of persons incorporated in these programmes represented a highly significant percentage of EAP.

Despite the meagre pay involved, the programmes helped improving the situation of the most affected households, inasmuch as the average income of these at that time was very low.

After the shock of 1981-82, the emergency employment programmes absorbed increasing percentages of the EAP, ranging from 8 per cent in 1982, to 15 per cent in 1983 and 12 per cent in 1984. Between 1985 and 1988 this share in EAP gradually decreases until reaching zero.

The fiscal cost of the subsidies backing these employment programmes ran to US\$ 200 million in 1982 and US\$ 300 million in 1983, that is 1 per cent and 1.5 per cent of GDP respectively. From 1984 onwards, with the decline in purchasing power brought about by massive real devaluations, the fiscal cost descended to less than US\$ 100 million, equivalent to 0.5 per cent of GDP.

From the point of view of remunerations, the outstanding feature of these emergency programmes was the extremely low pay they signified. Thus, in the 1982-83 crisis the so-called *PEM*, which absorbed an average of 300 000 persons per year, paid a monthly remuneration equivalent to US\$ 30 per individual. The *POJH*, reserved for heads of household, received 150 000 persons per year in the same biennium with an average monthly income of US\$ 60 per individual. It is worth keeping in mind that during that period the minimum wage in Chile amounted to an equivalent of US\$ 100 per month.

As observed by Meller (1991b), during the most critical years more than half of the unemployed did not receive any subsidy whatsoever; a third of them were earning less than 30 per cent of the minimum wage while a fifth were receiving 60 per cent of this minimum. The sharpest contrast emerges upon verifying that during the harshest years 500 000 unemployed received 1.2 per cent of GDP while during that same period 2 500 debtors with external banks or firms obtained, in addition to their regular incomes, 3 per cent of GDP by way of subsidies such as a preferential dollar and a rescheduling of their debts.

6. Hiring and dismissal rates and structural changes

As can be gathered from Haindl (1985) - see table 7 - the period 1974-81 is characterised by a rise in the hiring rates and a relatively higher increase in the dismissal rates. This phenomenon, conducive to a smaller net increment of employment, gives rise to the hypothesis of unemployment generated by mismatching between sectoral demand and supply (Sapelli, 1990), caused by the structural change occurring between 1974 and 1979. (As will be seen further on, a different situation prevailed in the 1980-82 period when the recessionary adjustment hits all sectors, resulting in a fall in the hiring rate and a rise in the dismissal rate). The assumption of mismatching owing to structural change tends to be ratified by the change occurring in the sectoral mix of employment. As shown in table 3B., the share of agriculture, industry and mining in total employment falls from 45.3 per cent in 1973 to 37.5 per cent in 1981 whereas trade, services and construction evidenced an increased participation. This trend reveals a nil growth of employment in tradeables which in turn reflects the slow reallocation of resources towards these sectors.

7. Decline of the union movement

Unionism reached its peak in 1972 when 30 per cent of the employed were affiliated, as shown in table 9. As of September 1973, the labour deregulation policies and the suspension of trade union activity going hand in hand with social repression and the change in the occupational structure, caused a strong decline of the union movement and its sway. Towards 1982-83, when the new labour legislation permitting collective bargaining at the enterprise level had already been introduced, the rate of workers belonging to unions was only 12.5 per cent of occupied labour. Doubtlessly, this undermined the bargaining power of the unions during the years of economic transformation in Chile.

8. The behaviour of wages

As can be inferred from table 4, the rapid inflationary acceleration of 1973 reduces the real average wage by 40 per cent - wage index INE (National Institute of Statistics) - compared to the peak reached in 1971-72.

In 1974 and 1975, owing to the recession, average real wages continue to shrink until they reach 50 per cent of the 1972 level.

As mentioned before, between 1975 and 1981, average real wages recover at a very fast pace¹⁵ despite the persistence of high unemployment rates. As shown in table 4, towards 1981 the levels of 1970 had almost been restored. In Cortázar (1983) it is suggested that an explanation of this recuperation can be found in the full wage indexation to past inflation the government recommended to the private sector in a context of inflationary deceleration. In Riveros (1990) it is sustained that in the period 1973-79 it is the functioning of a segmented labour market, with a protected formal sector, that accounts for the rising trend. In Sapelli (1990) this point of view is complemented by adding that the effect of expanding sectors and wage rigidity in contracting ones also contributed to this upward

¹⁵Averaging 6 per cent annually which *exceeds* productivity growth.

tendency. Still, Riveros himself (1990) holds that as of 1979, when full wage indexation is incorporated into the Labour Law, the unmistakable effect of this measure on the growth of wages in the years 1979-82 cannot be ignored. Moreover, Cortazar's hypotheses seems more accurate, considering that the labour market segmentation was present both during periods of wage indexation and non wage indexation in 1975-92, and wage formation was more sensitive to the changes in wage indexation than to segmentation.

In this perspective, in a period of an eroding real exchange rate and a constant nominal rate, full wage indexation implies a lesser degree of adaptability of enterprises to changes occurring in their internal and external ambits. Indexation, together with the exchange regime, provoked a strong decline of the relative price of tradeable goods with respect to wages (Corbo, 1985). This in turn contributed to slowing down the reallocation of resources towards tradeables besides curbing employment generation in these sectors.

Finally, it is worth bearing in mind these facts: (i) the average increase in wages in the formal sector is associated with a high variance - intensified wage dispersion by sectors, educational level, age and type of occupation; (ii) in the informal sector the rise in incomes is slower - which only heightens the already existing differentials with respect to the formal sector - and besides it also implies considerable dispersion. Both these factors exert an influence on income inequalities.

B. The crisis of 1982-1983

The domestic impact of the great external shock of 1982-83 is heightened by the accumulated imbalances of the period 1976-81 and by the recessionary over-adjustment which even affects the production of tradeables in a negative way between 1982 and 1984.

The upshot is an abrupt and serious deterioration of the labour market which superimposes itself on the unresolved problems arisen between 1973 and 1981. The worsening of the situation extends to the increase of unemployment and part-time employment, the proliferation of informal activities, the decrease of real wages and of informal incomes and the generalised ousting of manpower from diverse sectors.

Open unemployment soars to a historic record of 30 per cent in 1983, with 12 per cent of the economically active population incorporated in emergency employment programmes. Additionally, the unemployment situation turns out to be of protracted duration. As a result, the probability to find a job within a period of six months declines from 64 per cent in 1980-81 to 43 per cent in the 1982-83 period (see table 8). Unemployment affects more the low income families. More than 50 per cent of unemployed belongs to families of the lowest 20 per cent income brackets (Meller *et.al.*, 1992).

A decline from 49 hours in 1980-81 to 47 in 1983 is further registered in the average of weekly work hours in Greater Santiago while, to make matters worse, part-time work is on the rise. Thus, the proportion of the employed working between 35 and 48 hours per week drops from 52 per cent in 1981 to 44 per cent 1984 whereas an increase is observed in the contingent working less than 35 hours per week.

The share of informal employment in non-agricultural EAP rises from 26 per cent in 1981 to 29 per cent in 1984. The average real income of informals contracts at a faster pace than that of average real wages¹⁶.

Real wages further succumb to the deindexation decreed in 1982 and the inflationary acceleration of 1982-83. By 1984 wage indices showed a real fall of 11 per cent with respect to the year 1982.

In *all* sectors of activity a significant *ousting* of labour can be observed, as shown in table 3A. The variation coefficient of sectoral employment growth rates is *less* than that verified during the period 1973-81 which would suggest an across the board impact and not a sectorally differentiated (Sapelli, 1990).

In the period 1982-88 real devaluation is implemented as a systematic policy, with special emphasis on the years 1983 and 1985. In the context of a segmented market and with a protected formal sector, the devaluation needed to significantly raise the real exchange rate is associated with inflationary acceleration and a widening gap between formal wages and informal income (Riveros, 1990). This, according to the author mentioned, is supposed to have contributed to increasing open unemployment, to hampering labour mobility and to negatively affecting income distribution. Empirical evidence confirms that the formal-wage/informal-income ratio rises considerably in the years 1982-84, even though the increase in the real exchange rate does not require a pronounced inflationary acceleration, possibly owing to the deindexation decreed in 1982. This begs the question of just how protected formal employment really was. The same evidence is compatible with yet another type of adjustment. If total informal income is influenced - on the demand side - by the formal payroll, as empirical evidence suggests (García, 1992), then a severe contraction in the latter will lead to a decline in the former. Taking into account the rapid expansion of informal employment, this decline will speed up the downturn in *average* informal income. In reality this seems to have been one of the striking features of the 1982-84 adjustment, as can be deduced from table 4.

C. The period of recovery 1984-1989

Following the macro-economic performance, led by the rapid expansion and diversification of exports and an average economic growth of approximately 6 per cent annually, the labour market experiences a swiftly-paced recovery in the period 1984-89.

Between 1984 and 1989 *private* formal employment expands at the high rate of 8 per cent per year while public employment remains practically constant, save for the reductions associated with the privatisation of enterprises. Informal employment, on the other hand, grows at an annual rate of 2 to 3 per cent, which is tantamount to a drop in its share in non-agricultural EAP from 29 per cent in 1984 to 24 per cent in 1989.

¹⁶ Measured by the income of selfemployed workers with less than eight years of school attendance. See table 4.

Owing to these trends, the open unemployment corrected rate (University of Chile data plus emergency programmes), sinks from 30 per cent in 1983 to 10 per cent in 1989. Towards 1988 the emergency employment programmes are abolished. Duration of unemployment also diminishes appreciably.

The foregoing developments lead to better job opportunities so that the probability of finding an occupation within six months jumps from 43 per cent in 1982 to 76 per cent in 1989, the latter being similar to figures registered between 1965 and 1970.

Part-time employment also decreases, in so far as the proportion of those working *less* than 35 hours *declines* from 17.5 per cent in 1984 to 10.9 per cent in 1989.

It is noteworthy that employment growth does not arise from the expansion of low productivity occupations, since, as mentioned, the share of informal employment in EAP *declines* in the years 1984-89. Moreover, the evidence contained in table 10, based on information from AChS¹⁷, suggests that the increment in private formal employment takes place in medium and large enterprises of 50 or more occupied and this applies to all sectors of activity except construction, as shown in table 10. Similarly, as indicated in table 11, the share of employment in manufacture enterprises occupying 50 or more workers grows from 70 per cent in 1984 to 80.6 per cent in 1989 whereas it decreases from 30 per cent to 19.4 per cent in enterprises with 10 to 49 workers.

The recovery of wages and other labour incomes occurs a good deal after the improvement of the employment situation. All wage indicators point to 1988 as the beginning of the recovery, save for industrial wages which started bettering in 1987. Once initiated though the process proceeds at a fast pace. In particular, the gradual decompression of an excessive labour supply in informal activities added to an active minimum wage policy contribute to a rapid restoration of the average informal income, though only as of the year 1988¹⁸. Hence, the recovery of average informal incomes is slower than that of wages.

On the other hand, the recuperation of private sector wages is influenced by: (i) the positive evolution of the labour market; (ii) the active minimum wage policy implemented in 1988-89; and (iii) the institutional changes in wage bargaining registered in the period 1983-89, after deindexation in 1982. Among these the changes in the terms and the period of the readjustment stand out.

Between 1983 and 1991, average readjustability with respect to the consumer price index (CPI) rose from 82 per cent to 100 per cent of past CPI while the proportion of collective instruments with a period of readjustment of six months or less increased from

¹⁷AChS: Asociación Chilena de Seguridad

¹⁸The readjustment of minimum wages has a bearing on the average informal income since in Chile it constitutes a referent to the nominal readjustments of informal incomes. See the respective empirical testing in García (1992).

47.3 per cent to 68 per cent¹⁹. The trends to shorten the readjustment period and to raise readjustability with respect to past CPI was not limited to collective bargaining but gradually extended to individual negotiations. (García, 1992).

The two trends mentioned are linked to two sets of facts: (i) the gradual broadening of bargaining power in the period 1983-91 and the increasing proportion of the labour force partaking in this process; and (ii) the rise of the rate of inflation from 9.5 per cent per annum in 1981 to rates fluctuating between 23 per cent and 26 per cent in the years 1983-85. Even though inflation decelerates between 1985 and 1989, the two trends mentioned persist throughout this subperiod.

As can be seen, therefore, after deindexation in 1982 a slow process of reconstitution of indexation to past inflation can be observed as far as the period and terms of readjustment are concerned.

¹⁹Statistics from the Department of Labour, the Ministry of Labour and Social Security.

Table 2

EMPLOYMENT AND UNEMPLOYMENT

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
1. Population																					
(thousands of persons)																					
(a) 12 years or more	6 455.6	6 636.3	6 815.4	6 992.5	7 164.2	7 339.1	7 515.0	7 691.2	7 866.7	8 047.1	8 207.4	8 389.7	8 527.0	8 681.9	8 808.6	9 096.0	9 307.6	9 502.7	9 710.2	9 922.2	10 181.0
(b) Total labour force	2 932.2	2 978.8	3 000.8	3 039.0	3 066.8	3 152.9	3 216.4	3 259.7	3 370.1	3 400.7	3 539.8	3 607.3	3 729.5	3 797.1	3 937.1	4 071.8	4 160.3	4 288.3	4 455.0	4 620.6	4 815.8
(c) Participation rate	45.4	44.9	46.8	43.5	42.8	43.0	42.8	42.4	42.8	43.2	43.1	43.8	43.7	43.7	44.3	44.8	44.7	45.1	45.9	46.6	47.3
2. Employment																					
(thousands of persons)																					
(a) Total employment (UE)	2 766.1	2 865.6	2 907.8	2 875.1	2 704.7	2 727.3	2 705.0	2 796.8	2 891.5	3 000.4	3 122.1	3 207.3	3 291.5	3 391.2	3 485.1	3 420.3	3 582.0	3 748.0	3 911.5	4 163.2	4 399.9
(b) Total employment (IIE)		2 880.5	2 901.8	n.a.	n.a.		2 777.3	2 820.5	2 901.3	3 003.3	3 257.1	3 270.9	3 294.1	3 215.8	3 349.4	3 537.4	3 875.7	4 010.8	4 110.8	4 426.8	4 459.1
(c) Emergency Employment Programme							71.5	172.0	187.6	165.8	133.9	191.0	175.6	226.8	502.7	336.3	324.3	233.5	148.5	46.2	..
3. Unemployment (percentages)																					
(a) Castañeda (UE)	5.7	3.8	3.1	4.8	9.2	13.5	15.9	14.2	14.2	13.8	11.8	10.9	20.4	18.6	19.1	16.0	13.9	12.6	12.2	10.1	9.2
(b) Adjusted (a)	5.7	..	..	..	..	15.5	20.6	19.2	18.0	17.2	16.5	15.1	25.7	30.1	22.9	20.9	18.0	15.2	13.1	10.1	9.2
(c) IIE		3.3	3.3	n.a.	n.a.		12.7	11.8	14.2	13.6	10.4	11.3	19.6	14.6	13.9	12.0	8.8	7.9	6.3	5.3	5.7
(d) Adjusted (c)		..	..	..	..		17.4	16.9	17.9	17.0	15.0	15.5	25.0	26.2	21.4	19.0	13.6	10.9	7.2	5.3	5.7
4. Formal employment as % of non-agricultural employment																					
(a) Private		67.0	68.0				67.0				64.0	65.2	61.4	62.8	62.0	65.8	66.1	67.9	67.1	67.8	68.5
(b) Public											52.0	54.4	48.6	51.1	51.5	55.9	56.9	59.6	59.7	60.9	61.3
5. Informal employment as % of non-agricultural employment																					
		26.0	24.0				26.0				27.7	26.4	29.1	27.6	29.0	24.4	24.6	23.3	23.9	24.1	23.6
6. Domestic service as % of non-agricultural employment																					
		7.0	8.0				7.0				8.3	8.5	9.4	9.5	9.0	9.8	9.3	8.8	9.0	8.1	8.1

Source: Riveros (1990) and official data for 1, 2 y 3. Data from FREALC for 4, 5 y 6 FREALC.

1(a) 1970-83 from Castañeda (1983), 1984 projected based on University of Chile surveys.

1(b) 1970-83 from Castañeda (1983), 1984 estimated with growth rate (March-May) based on University of Chile surveys.

2(a) Economic and social Indicators 1990.

3(a) Data from Castañeda using the IIE (National Institute of Statistics) unemployment rates adjusted by participation rate; 1984-1990 based on University of Chile surveys

3(b) Corresponds to 2(a) adjusted by emergency employment programmes in period 1975-1988.

U Adjusted = (U) + (EEP*0.80)/(LF + (EEP*0.05)).

where LF : total labour force

U : unadjusted unemployment rate

EEP : number of members.

Table 3A. EMPLOYMENT GROWTH BY BRANCH OF ACTIVITY
(annual variation in percentages)

Year	Agriculture	Minining	Industry	Construction	Trade	Transega a/	Others/EP	Totals/EEP	Tradeables b/	Non-tradeables b/
1970	-	-	-	-	-	-	-	-	-	-
1971	0.9	1.0	2.5	6.2	2.7	5.8	4.6	3.2	1.6	4.4
1972	0.3	5.0	8.3	-10.7	0.7	-1.3	0.2	1.0	3.9	-1.2
1973	-3.2	15.2	2.0	-14.3	-2.0	-0.1	-2.8	-1.8	0.3	-4.0
1974	1.7	-3.9	-2.5	10.3	-2.9	-4.4	0.9	-0.1	-0.6	1.0
1975	-6.9	-1.8	-8.9	-22.9	-3.0	-11.6	-7.0	-8.0	-7.4	-8.0
1976	1.4	-1.2	-3.0	-16.0	9.9	-11.2	2.5	0.1	-0.7	2.5
1977	4.7	-3.5	1.1	7.5	10.4	12.6	6.2	5.6	2.6	7.4
1978	3.5	-1.2	1.9	13.8	9.4	-0.4	9.9	6.0	2.5	10.1
1979	-1.6	-5.0	-0.6	10.3	9.8	6.7	1.8	2.3	-1.4	4.8
1980	2.1	-1.5	0.6	13.3	6.5	0.4	4.1	3.5	1.3	5.6
1981	0.3	-0.3	-1.7	27.3	9.5	4.5	6.3	5.1	-0.5	9.3
1982	-7.7	-13.6	-18.6	-38.5	-11.4	-6.1	-8.1	-12.1	-12.5	-12.6
1983	0.7	7.9	-4.2	-18.9	-2.2	-6.2	-3.1	-3.0	-0.6	-4.1
1984	7.9	13.4	14.6	29.5	9.6	6.3	21.8	14.7	10.7	18.5
1985	2.0	34.9	8.6	13.5	1.3	3.0	9.4	6.9	6.8	7.4
1986	2.3	-0.5	15.8	8.1	8.2	15.9	9.7	8.8	7.2	9.2
1987	7.5	8.7	7.7	16.7	8.9	-2.5	10.0	8.5	7.7	10.2
1988	5.2	13.6	10.9	17.1	3.5	8.0	2.8	5.8	8.2	4.1
1989	-3.3	-3.4	3.3	1.2	7.6	13.1	5.5	3.8	-0.5	5.7
1990	2.3	12.5	3.9	-3.4	8.9	8.9	4.9	5.0	3.8	5.2

Source: Proper compilation based on Jadresic (1986) covering period 1970-83; period 1984-90 based on Employment and Unemployment Survey, University of Chile.

a/ Transport, electricity, gas and water.

b/ Tradeables: Agriculture, mining, industry. Non-tradeables: rest of sectors, excluding transport, electricity, gas and water (transega).

Table 3B. EMPLOYMENT MIX BY BRANCH OF ACTIVITY
(participation percentages with respect to total)

Year	Agriculture	Mining	Industry	Construction	Trade	Transega a/	Others/EP	Totals/EEP	Tradeables b/	Non-tradeables b/
1970	22.9	2.8	18.0	6.7	12.1	7.7	29.8	100.0	43.8	48.6
1971	22.4	2.8	17.9	6.9	12.0	7.8	30.2	100.0	43.0	49.1
1972	22.3	2.9	19.2	6.1	12.0	7.7	30.0	100.0	44.3	48.0
1973	21.9	3.4	19.9	5.3	12.0	7.8	29.7	100.0	45.3	46.9
1974	22.3	3.2	19.5	5.9	11.6	7.5	30.0	100.0	45.0	47.5
1975	22.6	3.5	19.3	4.9	12.3	7.2	30.3	100.0	45.3	47.5
1976	22.9	3.4	18.7	4.1	13.5	6.4	31.0	100.0	45.0	48.6
1977	22.7	3.1	17.9	4.2	14.1	6.8	31.2	100.0	43.7	49.5
1978	22.2	2.9	17.2	4.5	14.5	6.4	32.3	100.0	42.2	51.4
1979	21.3	2.7	16.7	4.9	15.6	6.7	32.2	100.0	40.7	52.6
1980	21.0	2.6	16.2	5.3	16.0	6.5	32.4	100.0	39.8	53.7
1981	20.1	2.4	15.2	6.5	16.7	6.4	32.7	100.0	37.7	55.9
1982	21.1	2.4	14.1	4.5	16.8	6.9	34.2	100.0	37.5	55.6
1983	21.9	2.7	13.9	3.8	17.0	6.6	34.2	100.0	38.4	54.9
1984	20.6	2.6	13.9	4.3	16.2	6.1	36.3	100.0	37.1	56.8
1985	19.6	3.3	14.1	4.5	15.4	5.9	37.1	100.0	37.1	57.0
1986	18.5	3.0	15.0	4.5	15.3	6.3	37.4	100.0	36.5	57.2
1987	18.3	3.0	14.9	4.8	15.3	5.7	37.9	100.0	36.2	58.1
1988	18.2	3.3	15.6	5.3	15.0	5.8	36.8	100.0	37.0	57.2
1989	16.9	3.0	15.5	5.2	15.5	6.3	37.5	100.0	35.5	58.2
1990	16.5	3.3	15.3	4.8	16.1	6.5	37.4	100.0	35.1	58.4

Source: Proper compilation based on Jadresic (1986) covering period 1970-83; period 1984-90 based on Employment and Unemployment Survey, University of Chile.

a/ Transport, electricity, gas and water.

b/ Tradeables: Agriculture, mining, industry. Non-tradeables: rest of sectors, excluding transport, electricity, gas and water (transega).

Table 4. REAL WAGES 1970-91 a/

Years	National Institute of Statistic				University of Chile	
	Minimum wage (1)	Index of remuneration (2)	Wage of manufacturing sector (3)	Relative wage small/large (4)	Informal income (5)	Formal wage (6)
1970	81.0	109.7	97.1	-	124.1	144.0
1971	106.8	134.1	106.6	-	133.7	182.9
1972	101.7	119.0	101.2	-	138.4	157.7
1973	46.2	73.1	68.4	-	99.0	94.3
1974	90.6	70.2	62.2	-	94.5	78.4
1975	105.1	62.5	58.3	0.51	77.3	66.7
1976	100.1	78.9	78.6	0.49	77.0	77.7
1977	84.6	79.9	78.6	0.48	80.3	89.5
1978	97.4	85.0	87.4	0.49	82.4	97.6
1979	98.3	92.0	94.2	0.51	102.6	103.3
1980	100.0	100.0	100.0	0.47	100.0	100.0
1981	111.0	108.3	115.5	0.47	120.4	117.7
1982	122.2	108.6	110.7	0.47	126.6	133.3
1983	93.2	97.0	102.9	0.45	80.9	95.2
1984	82.1	97.1	99.0	0.45	77.8	89.8
1985	74.3	93.0	97.1	0.44	75.6	74.4
1986	73.8	95.0	101.9	0.43	64.4	66.6
1987	66.9	93.1	103.2	0.46	63.1	65.2
1988	74.2	98.6	109.8	0.46	66.8	62.3
1989	82.5	100.5	113.4	0.49	80.0	71.1
1990	88.1	102.5	115.5	0.50	81.6	78.8
1991	96.3	107.5	123.3	0.51	-	-

Source: (1), (2) y (3) INE, deflated by adjusted consumer price index Cortázar-Marshall.
 (4) Compilation of data based on INE Manufacturing Survey; large: 50 or more occupied; small: 10 to 49 employed.
 (5) Average income of own account workers with less than 8 years of school attendance, based on University of Chile survey.
 (6) Salaries and wages of employees and workers with less than 8 years of school attendance, based on University of Chile survey.

a/ Columns (1), (2), (3), (5) and (6), covering period 1970-88, Riveros (1990). Remaining years, data compiled for this study. Column (4), period 1970-87, Paredes (1987). Remaining years, data compiled for this study.

Table 5. COMPOSITION IN PERCENTAGES OF THE EMPLOYED
 ACCORDING TO WEEKLY WORK HOURS, 1970-90
 (Greater Santiago)

Year/hours	1-10	11-20	21-34	35-48	49 or more	Average (hours)
1970	1.5	3.6	7.8	53.0	34.0	48.7
1971	1.6	3.0	7.6	57.8	19.8	48.4
1972	1.5	3.4	7.1	58.4	29.6	47.4
Dec. 1973	2.3	3.4	6.3	56.8	31.0	46.0
1974	3.5	4.5	7.4	57.2	26.3	45.6
1975	2.8	3.5	5.6	56.4	31.1	47.4
1976	1.9	4.7	6.8	53.2	32.3	46.6
1977	1.9	4.3	6.6	56.4	30.7	46.7
1978	1.5	3.6	5.8	56.3	32.9	47.4
1979	2.2	3.5	7.5	49.7	36.9	48.4
1980	0.9	2.7	6.3	53.3	36.7	49.1
1981	1.4	3.3	6.3	51.9	37.0	48.9
1982	1.5	4.3	8.2	49.1	36.8	48.1
1983	1.6	5.6	8.9	48.5	35.2	47.2
1984	2.2	4.6	10.6	43.9	38.6	47.8
1985	1.7	3.5	9.2	47.8	37.3	47.7
1986	1.5	4.8	9.9	43.5	39.8	48.2
1987	1.6	4.5	8.4	46.7	38.7	48.4
1988	1.9	4.4	7.3	45.4	40.8	48.9
1989	1.7	3.1	6.1	49.8	39.2	49.3
1990	1.6	3.4	5.8	47.8	41.3	49.6

Source: Employment and Unemployment Survey, University of Chile, for Greater Santiago, issued yearly in June.

Table 6. EMERGENCY EMPLOYMENT PROGRAMMES
1975-1988
(annual averages, thousands of persons)

Year	PEM	POJH	Total EEP
1975	72 700	-	72 700
1976	171 988	-	171 988
1977	187 650	-	187 650
1978	145 792	-	145 792
1979	133 923	-	133 923
1980	190 673	-	190 673
1981	175 607	-	175 607
1982	226 799	81 200	307 999
1983	341 578	161 228	502 806
1984	167 559	168 697	336 256
1985	134 299	190 023	324 322
1986	81 033	140 357	221 390
1987	35 702	88 359	124 061
1988	8 960	24 926	33 886

Source: Proper compilation of data based on the Monthly Bulletin of the Central Bank.

Table 7. GREATER SANTIAGO: HIRING AND DISMISSAL RATES,
1965-90
(as percentages of employment)

Year	Rate of net increment of EAP	Hired	Dismissed, retired and pensioned	Net increment employment
1965	6.2	19.7	13.5	6.2
1966	5.5	19.0	14.3	4.7
1967	2.7	17.6	16.0	1.6
1968	4.5	19.3	13.7	5.6
1969	4.6	18.0	13.4	4.6
1974	2.9	21.0	21.1	-0.1
1975	3.0	19.4	26.6	-7.2
1976	1.7	35.2	27.1	8.1
1977	3.1	23.7	20.1	3.6
1978	5.6	25.5	21.8	3.7
1979	2.5	34.2	29.2	5.0
1980	6.0	31.4	23.0	8.4
1981	4.8	22.9	21.3	1.6
1982	1.6	27.8	35.3	-7.5
1983	2.9	32.3	28.4	3.9
1984	1.8	35.0	27.7	7.3
1985	5.5	32.1	24.0	8.1
1986	1.5	35.2	29.9	5.3
1987	3.1	28.5	25.3	3.1
1988	2.7	32.9	28.3	4.7
1989	5.3	29.2	24.0	5.2
1990	3.0	34.0	31.1	2.9

Source: Until 1983 based on figures by Haindl (1985). For subsequent years the methodology developed by the author mentioned is used, with data based on the University of Chile survey.

Table 8. GREATER SANTIAGO: PROBABILITY OF FINDING EMPLOYMENT
AND EXPECTED TIME OF UNEMPLOYMENT,
1965-1990

Year	Unemployment Greater Santiago (rate %)	Probability (%) of finding employment in:				Expected time of unemployment (months)
		1 month	3 months	6 months	12 months	
1965	5.5	23.6	55.5	80.1	96.0	3.2
1966	5.3	23.6	55.5	80.2	96.1	3.2
1967	6.1	20.2	49.2	74.2	93.3	4.0
1968	6.0	21.3	51.2	76.2	94.3	3.7
1969	6.2	20.1	48.9	73.9	93.2	4.0
1974	9.7	14.3	38.2	61.9	85.5	5.7
1975	16.1	9.6	26.2	45.5	70.3	9.4
1976	16.8	12.3	33.8	56.1	80.8	6.8
1977	13.2	11.8	31.3	52.3	77.8	7.5
1978	14.0	12.0	31.8	53.5	78.3	7.4
1979	13.5	15.3	40.3	64.3	87.3	5.3
1980	11.8	16.7	42.2	66.6	88.9	5.0
1981	11.1	14.4	37.3	60.7	84.6	5.9
1982	22.1	8.9	24.5	43.0	67.5	10.2
1983	22.2	9.0	24.7	43.3	67.3	10.1
1984	19.3	10.8	29.1	49.7	74.7	3.2
1985	16.3	12.2	32.3	54.2	79.0	7.2
1986	13.5	16.6	42.0	66.3	88.7	5.0
1987	12.2	15.2	39.0	62.3	86.2	5.6
1988	10.9	19.4	47.6	72.6	92.5	4.2
1989	9.1	21.2	51.1	76.1	94.3	3.7
1990	9.6	23.0	54.4	79.2	95.7	3.3

Source: Until 1983 based on figures by Haindl (1985). For subsequent years the methodology developed by the author mentioned was used, based on data from the University of Chile survey.

Table 9. UNION MOVEMENT, CHILE 1960-90

Year	Union members	Employment	Rate (%)
1960	272 966	2 317.2	11.8
1966	369 507	2 798.5	13.2
1970	627 664	2 719.9	23.1
1972	855 404	2 836.0	30.2
1980	386 910	3 035.6	12.7
1981	395 951	3 190.6	12.4
1982	347 470	2 803.1	12.4
1983	320 903	2 720.3	11.8
1984	343 329	3 120.8	11.0
1985	360 963	3 336.3	10.8
1986	386 987	3 630.8	10.7
1987	422 302	3 939.2	10.7
1988	446 194	4 169.5	10.7
1989	507 616	4 328.0	11.7
1990	577 493	4 542.9	12.7

Source: Department of Labour (1980-1990), Union Statistics of the University of Chile for the period 1960-1972. Employment figures from Jadresic (1986) and University of Chile. Data for period 1960-1972 based on Castañeda (1983).

Table 10. EMPLOYMENT GROWTH BY SECTOR AND SIZE OF ENTERPRISES, 1986-90
(average annual growth rates in percentages)

Size	Size of firms by number of employed								Aggregate
	Less than 5	5 to 9	10 to 19	20 to 24	25 to 49	50 to 99	100 to 499	500 or more	
Agriculture	-2.2	-0.5	1.3	0.3	2.3	4.0	4.3	11.4	3.8
Mining	-14.9	-4.4	-8.4	7.0	1.4	-5.4	2.2	11.5	2.7
Industry	-2.1	0.5	1.8	3.7	5.3	5.4	6.1	4.9	5.1
Construction	-6.0	-0.4	-1.0	4.4	1.0	-2.9	0.8	-3.3	0.0
Electricity, gas and water	3.2	-9.4	1.7	-4.1	3.2	8.7	1.8	7.1	5.0
Trade	-0.2	0.4	3.1	5.2	5.2	8.0	10.1	10.1	7.0
Transport	2.9	3.5	3.7	3.0	4.7	10.5	-1.3	2.6	3.5
Finance	1.7	3.8	4.9	8.2	1.9	7.1	10.0	9.3	8.2
Services	-1.2	0.0	1.9	2.9	4.2	4.4	5.5	8.6	6.0

Source: Based on data from Chilean Association of Security (AChS).

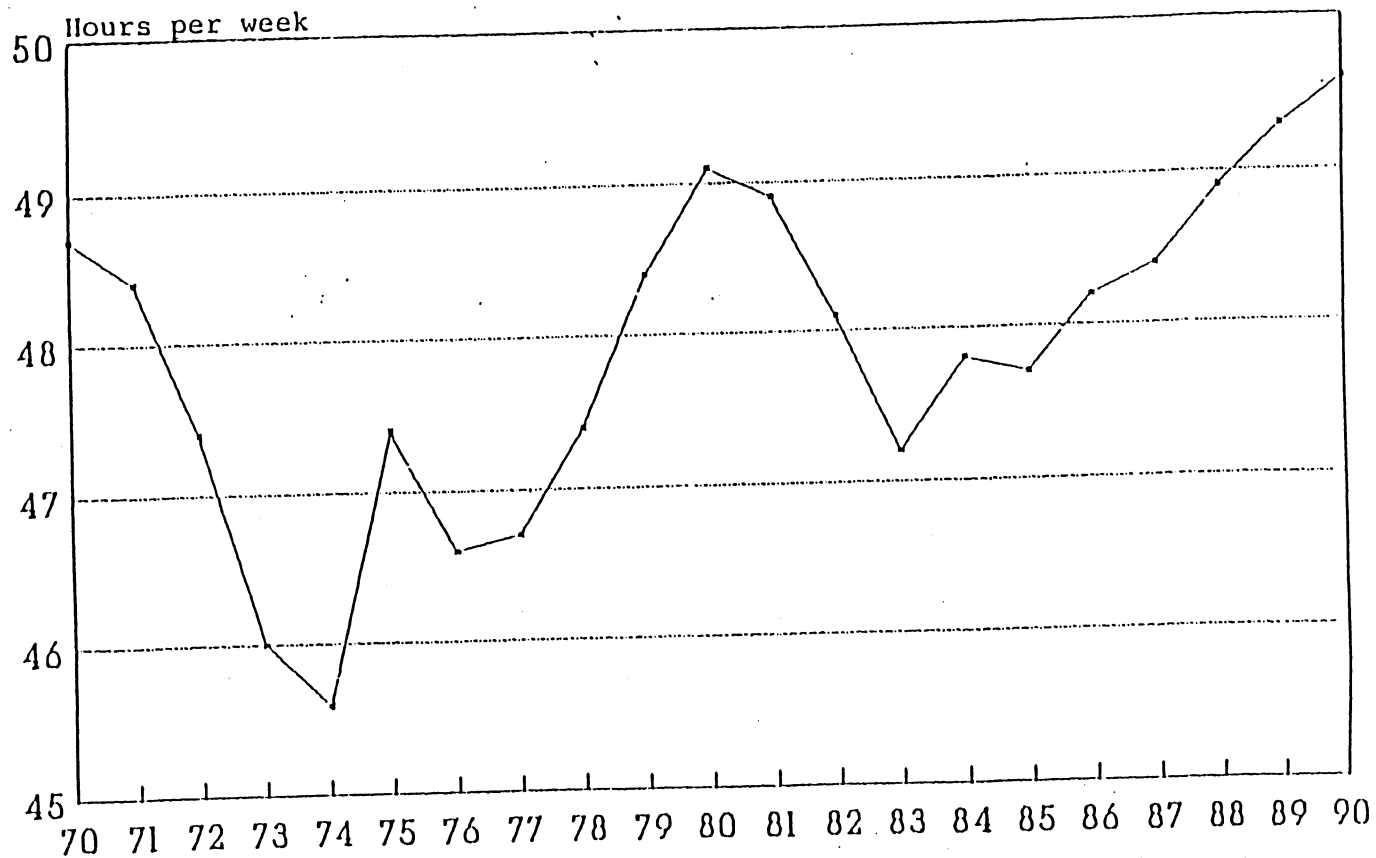
Table 11. EMPLOYMENT BY SIZE IN MANUFACTURING INDUSTRY

Year	10-49 workers		50 or more workers		Aggregate
	Index	Participation percentages	Index	Participation percentages	
1979	100.0	29.2	100.0	70.8	100.0
1980	90.9	28.4	94.6	71.6	93.5
1981	84.4	28.4	87.8	71.6	86.8
1982	77.9	31.7	69.5	68.3	80.6
1983	73.7	30.5	69.2	69.5	78.9
1984	79.0	29.7	77.1	70.3	87.0
1985	77.8	27.5	84.7	72.5	92.5
1986	74.9	24.7	94.5	75.3	99.4
1987	80.4	23.1	110.4	76.9	113.8
1988	78.4	21.2	120.4	78.8	121.1
1989	78.1	19.4	133.7	80.6	131.5

Source: Data based on the Annual Survey of Manufacturing Industry, INE.

Figure 2

GREATER SANTIAGO: AVERAGE WORK HOURS,
1970-1990



Includes unemployed who perform occasional work
and unemployed and temporarily inactive persons
working some hours.

V. ADJUSTMENT OF THE LABOUR MARKET: MAIN IMPLICATIONS

A. Social cost and the labour market

The structural change of the Chilean economy involved a high and protracted social cost. During a stretch of 14 years (1975-1988) adjusted open unemployment more than *tripled* the unemployment rate of 1970 which can be considered a normal year for pre-adjustment and pre-Allende Administration times. In the period 1975-1988 open unemployment rates averaged 19.6 per year, including around 6 percentage points corresponding to emergency employment programmes - to which the increase in underemployment ought to be added.

With regard to average real wages, the remuneration index reveals that 1981 was the *only year* in the period 1973-89 in which average real wages recovered the 1970 level. Sectoral behaviour indicates that during this period only industry registers recoveries of any significance. In 1980-82 and subsequently between 1986 and 1989 real wages in manufacture match and even exceed the 1970 levels.

As far as the average informal income is concerned, the 1970 levels are only recuperated by 1981-82. They fell from 1982 onwards. In 1989 the respective index was still considerably below the 1970 level.

Between 1986 and 1989 wage dispersion augments, as is manifest in the comportment of the individual occupational category indices. Thus, the growth in real remunerations of administrators and managers averages 7 per cent per year and that of specialised workers between 2.6 per cent and 3.8 per cent which is considerably above the overall average of 2.1 per cent. Non-specialised workers, administrative personnel, salesmen and personal service labourers, meanwhile, tended to earn around the overall average or below it. It should be added that in the period 1986-89 the real minimum wage grew at an average pace of 3.8 per cent per year in spite of which the gap between the average wage and the minimum wage remained pronounced, owing to the initial lagging behind of the latter.

A further point is that between 1986 and 1989 growth of real remunerations was *less* than that of per capita income which reveals the higher increment of non-labour income as opposed to income from work.

It is nor surprising, therefore, that the available indicators suggest a strong increase in the spread of poverty up to 1987, followed by a slow decline between 1987 and 1989 (ECLAC, 1991 and Infante, 1990). Towards 1990 poverty still affected 39 per cent of households.

Between the years 1973 and 1987 a worsening of the functional and personal income distribution can also be observed. Thus, during that period the share in income of the poorest 40 per cent is significantly below the 1968-70 average (Riveros, 1990). For another matter, the Gini coefficient evinces a worsening in 1974-76, a slight improvement in 1977-78, a new deterioration in 1979-81 and then a drastic negative impact in 1982-84. It

is only from 1984 onwards that the Gini coefficient begins to reflect a more steady improvement in the distribution of family income²⁰.

In sum, the social costs were exceedingly high and above all of *prolonged* duration. This implied depriving a substantial percentage of the population of the minimum prerequisites for decent living conditions. The social cost was particularly accentuated for households whose income mainly depended on remuneration from work and pensions, in contrast to incomes derived from the ownership of assets. In this sense, the major part of the burden of the social cost during the period fell on the workers.

The scaling down of public expenditure with its impact on social spending is another determinant feature of the social cost verified in the period 1973-89. From table 12 it can be gathered that per capita social spending, in constant dollars, exhibits pronounced variations throughout the period both in terms of the amounts involved and in regard to the destination of the resources. Particularly reduced was the per capita outlay in behalf of health, housing and education. Meanwhile per capita social spending increases in the areas of social assistance²¹, social security²² and regional development²³.

In general terms, access to health, housing and education is narrowed down but the targeting of social expenditure on the poorest groups prevents the situation from becoming unmanageable in the period 1982-89.

B. Adjustment of the labour market, savings formation and profits

Part of the social cost incurred in the 1974-89 period through the labour market adjustment was linked to the new needs for domestic savings formation and profitability that emerged from the trade and financial liberalisation and adjustment policies.

A process demanding an increase in the coefficient of the external trade balance with respect to GDP requires, if it is to be financed, an increment in the domestic savings

²⁰ See Riveros (1990) for an analysis of the Gini coefficient in the period 1960-87.

²¹Including fiscal contributions to emergency employment programmes, subsidised additional hiring of labour, support of nurseries, kindergartens, lunch programmes, scholarships and other assistive expenditures.

²²Including fiscal contributions to Social Security Funds for disbursement of retirement benefits, pensions and unemployment compensation and to Social Security Funds for public personnel.

²³Resources allocated to regions for health, extreme poverty, housing and education.

coefficient with respect to GDP²⁴. This increase will assume the character of "forced savings" (Kaldor, 1956) if its attainment involves a decline in the share of wages in GDP. Similarly, the process of boosting investment decisions in a newly open economy which has been subject to multiple regulations usually calls for increased rates of return, if only on account of the higher risk rate caused by the change. This applies particularly to investments in tradeables.

The relevance of an adjustment by way of forced saving in Latin American countries was highlighted by Frenkel and Rozenwurcel (1989). In García (1991b) an analysis of this aspect of structural adjustment in various Latin American experiences can be looked up. When trade and financial liberalisation coincide with a pronounced hike in international real interest rates and an appreciable foreign debt stock, the required increase in the coefficient of the external trade balance - and by implication in the savings coefficient - is bound to be higher still unless additional external financing is obtained to pay the augmented interest. Similarly, the rise of international real interest rates will have to be matched by an increase in the internal rate of profit so that the latter can compete with the former.

The experience of Chile between the years 1973 and 1989 acknowledges the successive impacts of the phenomena mentioned above in various subperiods. In table 13 the relevant empirical evidence is presented. For further elucidation, in the four bottom rows of table 13 the *increments* in the coefficients used in the analysis are indicated.

Between 1970 and 1975 a fall of nearly five points in the share of wages in GDP is registered, mainly concentrated in the period 1973-75. This sharp drop is accompanied by a decline in the saving coefficient and is not explained by it. But it does generate considerable room for a potential improvement in the macro-economic rate of profit. Hence, the commencement of the adjustment and the liberalisation of the economy occur in the context of a preceding distributive deterioration.

From 1975 to 1980 the decline of real protection owing to liberalisation with a drop in the real exchange rate - exerting pressures on profitability - is not wholly transmitted to the share of wages in GDP because it had already contracted prior to these developments. Thus, the share of wages in GDP further decreases in 1975-80 by close to 1 per cent. The savings coefficient rises by 5.7 percentage points in order to finance an increase of 6.9

²⁴Let s be the savings coefficient; i the investment coefficient; $(x-m)$ the coefficient of the external trade balance; sp the saved profits coefficient; P total profits; Y GDP; and W total wages. Thus, it can be defined :

$$(1) s = i + (x-m)$$

$$(2) s = sp P/Y$$

$$(3) P/Y = 1 - W/Y$$

From (1), (2), (3) we obtain:

$$(4) i + (x-m) = sp (1-W/Y)$$

From (4) it can be inferred that an increase in $(x-m)$ is likely to require a descent in W/Y .

percentage points of the investment coefficient - and not the coefficient of the trade balance, which declines in the period 1975-80.

The hike in the external interest rate in the 1980s and the increase in the trade balance required by the adjustment as of 1981 give rise to the process described at the beginning of this section. In the 1980-82 interval an increment of 8.2 percentage points is registered in the coefficient of the trade balance, accompanied by an increase of 3.5 points in the coefficient of interest paid - with respect to GDP. However, during the same period the investment coefficient drops 11 percentage points, liberating resources to finance the increment in the trade balance and forestalling the necessity of raising the domestic saving coefficient. What is more, the saving coefficient descends which accounts for the rise of 2.4 per cent of the share of wages in GDP.

In the triennium 1983-85, featuring massive real devaluations and their impact on the external trade balance, the coefficient of the latter increases by 10.2 points. This requires a rise of 7.5 percentage points in the saving coefficient which in turn demands a drop of 7 percentage points in the share of wages in GDP. Indeed, towards 1985 this share in GDP falls to 33 per cent, the lowest level in recent history.

In the period 1985-89 the cumulative net rise of the trade balance coefficient is quite low: 0.4 per cent. Yet the saving coefficient augments 6.6 per cent to cover the 6.7 per cent increment in the investment coefficient. The decrease of net payments of interest of 3.5 percentage points with respect to GDP, the considerable widening of profit margins registered previously and the employment effect of investment and growth recovery help explain why during this period the rise in the saving coefficient occurs side by side with an improvement in the share of wages in GDP.

Hence, the years in which a linkage between an increase in the trade balance and a rise in "forced saving" takes place are clearly confined to the period 1980-85 in which the exceedingly severe adjustment to the external shocks of 1981-82 is applied. In consequence, it is safe to assume that part of the adjustment of the labour market carried out during that quinquennium significantly contributed to generating the savings required for the external adjustment.

With respect to the enhancement of average macro-economic profitability it is worth bearing in mind that between the situation prior to the reforms and the year 1985 the share of wages in GDP plunged from 44 per cent to 33 per cent. Parallel to this fall, a rise in the share of profits, dividends, interest and revenues from 32.4 per cent to 42.2 per cent was registered (see table 13). If it can be assumed that the share of profits behaved in a correlative manner with the aggregate mentioned, then it can be concluded that the rise contributed notably to the average macro-economic rate of profit²⁵. To cite an example, assuming that the capital/output ratio descended from 2.9 to around 2.4 in the period 1975-85, the average macro-economic rate of profit is estimated to have risen from 11 per cent to 17.5 per cent in 1985. Of the 6.5 incremental percentage points 4 points are

²⁵In the period 1974-85 interest payments remitted abroad increase at a faster pace but real domestic profits are also on the rise.

cent to 17.5 per cent in 1985. Of the 6.5 incremental percentage points 4 points are supposedly explained by the distributive change and the remaining 2.5 points by the increase in capital efficiency. Furthermore, the adjustment of the labour market contributed - above all in the period 1980-85 - to the increase of net internal profitability which in turn led to the reallocation of resources in the context of high external interest rates. The improvement in profitability in tradeables with respect to the macro-economic rate of profit was *additional* to the figures mentioned.

The experience of Chile in the period 1973-89 therefore reveals that the increase in profitability to redirect investment not only relied on the change in relative prices of tradeable/non-tradeable goods and services but also on a drastic fall in the functional distribution which raised the average rate of profit.

The foregoing leads to conclude that the *distribution* of the costs of an adjustment process can only be confronted with more selective public policies applied in a socially and politically receptive environment. Both the selective policies and the proper socio-political climate were absent during the successive adjustments implemented in Chile during the 1973-1989 period.

Lacking in selectivity, the instruments entailing a global macro-economic incidence merely contributed to transferring the main burden of the adjustment to the workers.

One option; theoretically speaking, consists in charging the enterprises with the costs of adjustment. Yet had this materialised, it would have signified a drop in the average macro-economic rate of profit at a time when macro-economic policies aspired to attain an increase of profitability in tradeables to induce the reorientation of resources. Such an increase would therefore have been virtually incompatible with a non-selective shifting of the adjustment costs to enterprises. At the opposite extreme, the second option, was to let the load of the social cost fall on the workers. An intermediate option would have implied distributing the adjustment costs between the two. However, this would have required a degree of selectivity in public policies as well as a level of negotiation and social consensus inexistent in Chile at that time.

C. Productivity and employment growth

In an open economy productivity growth, particularly in tradeables, generates conditions for the improvement of competitiveness and the enhancement of savings-investment. The latter facilitates the subsequent growth in production and employment. Consequently, in an open economy undergoing a process of productive modernisation, productivity gains in the *present* are bound to boost - allowing for a certain time lag - employment growth in the *future*.

A complementary aspect is that competitiveness can be enhanced by raising the real exchange rate, which tends to be reflected in a drop in the wage/productivity ratio, especially in tradeable sectors.

The *two* factors mentioned exert an influence over the efforts displayed in Chile in the period 1973-89, aimed at encouraging profitability, investment and production in tradeables and supporting sectors. Hence, these factors contribute to the creation of "future" employment during the period 1984-89.

Productivity gains and higher profitability in tradeables lead to future employment growth in these sectors as well as in *the remaining* ones, inasmuch as the greater availabilities of foreign exchange and savings make it possible to attain higher growth rates in the economy as a whole.

1. Productivity growth in the period 1973-1990

In the experience of Chile the increase in productivity registered in tradeables between 1975 and 1983 doubtlessly contributed to the subsequent employment growth in the years 1984-90. Given that the model developed in Chile focused on comparative advantages already acquired²⁶, growth in productivity occurred in natural resources intensive sectors and supportive activities.

As shown in table 14, annual productivity growth averaged 4.6 per cent in the agricultural and fishing sectors, 7 per cent in mining, 2.5 per cent in industry and 4.7 in transport and electricity. (During the same period productivity in non-tradeable *declines*, with the exception of construction which grows at 3.9 per cent per year). During the period 1985-90 a downward trend in productivity prevails in *all* sectors, excluding agriculture and transport where productivity grows 2 per cent and 1 per cent per annum respectively.

If the sectors are grouped to provide proxies of productivity in tradeables and non-tradeables (see table 15), it becomes evident that the former grow a significant 3 per cent between 1973 and 1983 but stop to do so in subsequent years while the latter remain stagnant during the 1973-83 period and then actually decline in the following years.

Figure 3 allows a clearer identification of what has occurred, since it reflects the evolution of tradeable and non-tradeable productivity at constant prices. Productivity in tradeables, which in 1970-73 was lower than that of non-tradeables, begins to grow more rapidly in the period 1973-83 until outdistancing non-tradeables in 1982-83 to remain in the leadership position from then onwards. This trend was greatly influenced by developments in the agricultural and fishing sectors.

With respect to productivity by size of enterprise, the only information available proceeds from the Annual Survey of the Manufacturing Industry (see table 16 and figure 4). The figure mentioned indicates that in the segment of large enterprises (50 or more workers) productivity is estimated to have increased at an annual pace of 4.2 per cent between 1976 and 1985 in order to decline slightly in the period 1985-89. In small enterprises (10 to 49 workers) productivity falls in the period 1975-79 but then recovers, although very gradually,

²⁶As opposed to acquirable advantages.

between 1982 and 1986²⁷. It is only in the years 1986-89 that a meaningful increase in productivity of more than 12 per cent can be observed in this segment owing to direct or indirect linkage to growing tradeables. Appropriate information is not available for micro-enterprises (less than ten employed) though it is to be assumed that part of these followed the behaviour of small enterprises.

Using the method of total factor productivity (Agacino, Rivas, y Román, 1992), it can be concluded that in the period 1976-81 productivity in large manufacturing enterprises grew at a pace of nearly 4 per cent per year while a decline of 1 per cent annually was observed between 1984 and 1988. In other words, a similar conclusion as the one arrived at in the preceding paragraph.

2. Evolution of the wage/productivity ratio

Available information (see table 17) suggests that throughout the period 1973-90 the wage/productivity ratio was considerably below that of the 1970-72 lapse of time in all sectors for which it was possible to compatibilise the required data, that is industry, mining, agriculture, construction and the aggregate. This could be a partial explanation of the enhanced profitability, especially in primary sectors. In industry and mining the ratio plunges sharply in 1973-75, then recovers partially only to fall again in the period 1982-86 and subsequently regain recovery between 1986 and 1990. In construction and agriculture an abrupt drop is likewise registered in 1973-75, followed by a recuperation until the year 1982. However, from then onwards until 1989 the wage/productivity ratio systematically and significantly descends in both sectors.

The foregoing leads to two relevant conclusions:

a) The rapid employment growth between 1984 and 1990 takes place after nearly ten years of steady productivity gains in tradeables with the ensuing impact on profitability, competitiveness and savings formation.

b) The incidence on profitability, competitiveness and savings was enhanced because during the better part of the period all sectors functioned with a wage/productivity ratio below that prevalent prior to the structural adjustment. In particular, during most of the period of swift employment growth (1984-90) this ratio stayed at a level which allowed room for profitability in all of the sectors analysed.

These conclusions suggest that the lagging behind of real wages with respect to productivity generated conditions - through profitability, savings-investment and availability of foreign exchange - which in part account for the expansion of the product and of employment in the period 1984-90.

²⁷It is likely that small enterprises have been harder hit than large ones by the lessening of real protection occurring in 1975-82 and by the disappearance or reconversion of the most affected branches of manufacture.

D. The impact on the labour market and the social actors

1. Economic policy decisions and employment

Upon embarking on the drastic stabilisation measures of 1974-75, government circles expected a negative impact on employment in view of the intensity of the recession provoked. Proof of this is that the National Training and Employment Service of the Ministry of Labour (SENCE) organized a programme of direct emergency employment creation in 1974 to be put into practice in the following year.

What the Government did not anticipate was the protracted duration of high open unemployment, which overrode any positive expected results from the mixture of policies applied.

One of the consequences of the authoritarian character of the Government was that erroneous economic policies could be perpetuated since they did not provoke any political cost - a scenario that changed towards the end of the 1980s, before the return of democracy. However, the very authoritarian nature of the regime can explain too why many drastic measures with positive repercussions in the long run could be adopted in spite of the political and social opposition they inspired.

In the innermost recesses of the Government various strategic alternatives were discussed but the one that prevailed was based on a spontaneous adjustment of the markets as a remedy to overcome the initial accumulated imbalances, chiefly because this option coincided with the political objectives of the Military Regime to strengthen the private sector in decisions affecting the use of resources.

It should be underscored that the policies applied in the period 1973-81 spring from the concepts of national technicians steeped in the economic philosophy of the Chicago School. During this period the influence of measures proposed by the International Monetary Fund and the World Bank is relatively negligible because the extreme domestic orthodoxy goes far beyond anything these entities had in mind. Traces of IMF ascendancy can be detected as late as 1981. Subsequently, with the adoption of a more pragmatic model in 1985, the influence of the World Bank can be felt through the programmes of structural adjustment.

The National Planning Bureau (ODEPLAN) had the responsibility for employment. However, within a policy approach such as the one prevailing in 1973-89, the emphasis of ODEPLAN was on studies and proposals towards the flexibilization of the labour market. The basic idea was that labour institutions considered as an obstacle to a free labour market - imperfections - should be replaced by norms that enhance competitiveness and reduce labour costs, in order to accelerate employment creation. Thus, several proposals were developed that were finally integrated in the new labour regulations of 1979-81. ODEPLAN worked also in the design of the employment emergency programmes implemented in 1974-87 by the Ministry of Labour and the Ministry of Internal Affairs - since the execution was decentralized at the regional and local level. The emergency programmes were carefully design to avoid interference with the labour market adjustment. The programmes had great incidence although the emergency was extended to 14 years. The expertise attained during

this process proved also useful for the design and execution of social expenditure targeting on poverty groups. ODEPLAN was also in charge of: (i) monitoring the employment - and social - evolution, and (ii) producing studies on specific employment issues. Although the main approach was that a more flexible and competitive labour market would create more employment, the protracted duration of very high unemployment forced the authorities to increase attention and resources first on emergency employment programmes and then on social expenditure towards the extreme poor households.

Hence, there was no employment policies in the regular meaning of these words. This issue had a strong expression in the fact that little was done on employment and human resources policies in a country where the mismatching, during structural adjustment, proved to be one of the main causes of unemployment. The faith on free market adjustment prevailed over approaches that would have implied a government intervention in the labour market.

In general, the evolution of the employment situation was followed very closely by the National Planning Bureau (ODEPLAN) and above all by diverse NGO's²⁸. One aspect worth highlighting is that none of the public or private institutions foresaw the extent and protracted nature of unemployment which in hard practice persisted throughout the period 1974-84. This miscalculation arose because nobody could anticipate that the effects of the stabilisation and reform policies introduced in 1973-74 would be compounded by the impact of the harshest external crisis to hit Chile since the 1930s. Paradoxically, the intense employment growth verified in the years 1984-90 was also not foreseen in its magnitude. On the whole, the studies realised by public institutions and private NGOs expected a lower degree of elasticity in the response of employment during the period mentioned. Hence, private and/or public projections underestimated not only the intensity and duration of unemployment in the period 1974-84 but also the subsequent swift absorption between 1984 and 1990.

As outlined in preceding pages, the main governmental measures implemented to offset negative effects consist in direct programmes of temporary employment and later, in the eighties, in an increased targeting of social expenditure on the poorest groups.

During certain subperiods, a subsidy for the hiring of labour - which proved to be quite ineffective - was also instituted as well as a minor fiscal stimulus for re-training, which enterprises availed themselves of for their technicians and executives.

There existed no explicit measures oriented towards the re-training of labour, a policy that might have reduced the protracted period of social costs and hardships. On the other hand, in the private sector an intense promotion was accorded to the retraining of executives and technicians in such areas as business administration, foreign trade, information science, etc.

²⁸In this respect, numerous studies of CIEPLAN in the period 1976-87 should be mentioned.

In this perspective, rather than resorting to compensatory policies, the major emphasis was focused on an absolute flexibilisation of the labour market, which was achieved albeit with many errors and a high social cost.

2. Social actors and the impact on employment

From the outset the economic policies initiated in 1973-74 provoke strong reactions from such different quarters as trade unions, certain highly affected entrepreneurial sectors, *all* political parties of the center and the left and, finally, the Catholic Church. All agreed in calling attention to the injustice of the exceedingly high social cost. Nevertheless, given the authoritarian character of the Military Regime and the political chasm that divided the country into two, these reactions did not succeed in bringing about a significant change of course. They merely furthered the implementation of emergency programmes undertaken by NGO's, consisting in infant and child nutrition, lunch programmes, maternal care and others. Among these initiatives the activities carried out by distinct institutions of the Catholic Church deserve special mention²⁹.

The entrepreneurial leadership adopts a more opposing position in 1982-83 when the severity of the external crisis and the accumulated imbalances spill over into the contingent economic policy and threaten the propagation of financial bankruptcy. It can be affirmed, therefore, that the external crisis of 1982-83 was a keynote factor in bringing about a change in economic policies towards a more pragmatic design.

²⁹It is interesting to observe that the Military Regime explicitly recognises the high social cost of the transformation but it does so in 1988-89, emphasising that the social cost that permitted applying the new development model had already been suffered and been paid for.

Table 12. PER CÁPITA SOCIAL EXPENDITURE
(US dollars of 1976)

Year	Health a/	Social assistance b/	Housing c/	Social security d/	Education e/	Regional development f/	Others g/	Total
1970	18.8	3.4	10.1	28.1	43.5	0.8	-	104.7
1971	25.8	6.1	20.3	49.0	58.1	2.5	-	161.8
1972	30.0	3.1	17.7	45.9	62.6	2.2	-	161.5
1973	28.3	5.3	22.5	26.3	44.7	1.9	-	129.0
1974	21.6	5.1	20.2	24.2	44.6	3.2	-	118.9
1975	15.4	10.2	8.1	24.6	33.0	3.4	-	94.7
1976	12.8	14.3	7.1	21.3	32.9	5.4	-	93.8
1977	14.5	12.8	7.6	28.1	39.6	4.6	-	107.2
1978	14.9	16.0	5.8	29.4	39.4	4.4	-	109.9
1979	13.9	10.3	6.2	31.7	40.5	4.1	-	106.7
1980	17.7	18.0	6.9	37.3	42.3	4.1	-	126.3
1981	18.4	34.3	6.5	49.3	50.1	4.3	-	162.9
1982	17.4	42.2	2.3	57.2	51.2	2.1	-	172.4
1983	13.9	46.3	4.4	53.8	42.6	1.5	-	162.5
1984	13.5	41.0	6.7	67.5	43.0	1.2	-	172.9
1985	11.9	37.4	7.5	69.8	41.6	0.6	-	168.8
1986	10.9	29.9	7.5	78.3	40.7	1.8	-	169.1
1987	10.6	23.8	8.6	73.7	37.0	2.8	-	156.5
1988	10.9	19.1	12.1	76.9	34.4	3.2	-	156.6
1989	10.5	15.2	8.0	73.1	33.4	2.6	-	142.8
1990 h/	10.4	13.6	7.4	72.9	31.9	2.2	-	138.4
1990 i/	12.2	15.6	11.6	79.3	35.4	2.2	-	156.3
1990 j/	13.6	15.6	14.1	79.3	37.2	2.4	1.8	164.0

Source: PET (1991), "Economy and Labour in Chile, Annual Report".

- a/ Fiscal contributions to institutions of the Ministry of Health: SNS (National Health Service), Soc. Constructora de Establecimientos Hospitalarios (Construction Corp. of Hospitals) Consejo Nacional para la Alimentación y Nutrición (National Food and Nutritional Council), and Fondo Nacional de Salud (National Health Fund).
- b/ Fiscal contributions to the institutions of the Ministry of Labour (excluding Social Security Funds): PEM (Emergency Employment Programme), Allocation of Additional Hiring of Labour, National Council of Nurseries and Kindergartens, National Board of Educational Aid and Fellowships, National Service for Minors, National Emergency Bureau; and contributions from Fire Brigade Corps.
- c/ Fiscal contributions to institutions of the Ministry of Housing and Urbanisation.
- d/ Fiscal contributions to Social Security Funds for retirement benefits, pensions, unemployment allowances, indemnifications and to the Social Security Fund of Public Employees.
- e/ Fiscal contributions to institutions of the Ministry of Education: private and state primary, secondary and higher education, CONICYT, Construction Corporation of Educational Establishments, and National Television Committee.
- f/ Resources allocated to regions and basically destined for health, extreme poverty, housing and education.
- g/ Includes FOSIS, Institute of Youth, returnees and support of peasantry.
- h/ Budget Law.
- i/ Includes Tax Reform.
- j/ Includes international contributions and additional funds from FNDR (National Fund for Regional Development) up to July, 1990.

Table 13. CHILE: CHANGES IN THE SHARE OF WAGES IN GDP, EXTERNAL ADJUSTMENT AND SAVING

	1970	1975	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
1. GDP at market prices	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1.1. Remuneration of wages earners	43.7	39.0	38.1	40.0	42.4	38.0	36.0	33.0	35.0	35.6	38.1	37.1
1.2. Exploitation surplus	39.0	32.4	40.2	36.5	33.1	37.4	39.0	42.2				
1.3. Fixed capital consumption	7.8	14.7	9.6	9.3	10.8	11.2	11.7	12.0	65.0	64.4	61.9	62.9
1.4. Indirect net taxes of subsidies	9.5	13.9	12.1	14.2	13.7	13.4	13.3	12.8				
1.5. Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2. Net remuneration of factors paid to the rest of the world as % of GDP	2.4	3.9	3.4	4.4	7.9	8.6	10.1	11.2	11.2	9.0	8.7	7.7
3. Gross saving coefficient with respect to GDP	17.1	11.1	16.8	11.8	9.0	12.5	12.5	16.5	18.4	21.0	24.2	23.1
4. Coefficient of trade balance with respect to GDP	0.7	-2.0	-4.2	-10.2	-2.0	2.7	-1.1	2.8	3.8	4.1	7.2	3.2
5. Gross investment coefficient a/	6.4	13.1	21.0	22.0	11.0	9.8	13.6	13.7	14.6	16.9	17.0	20.3
6. Incremental points in gross saving coefficient		-6.0	5.7	-5.0	-2.8	3.5	0.0	4.0	1.9	2.6	3.2	-1.1
6.1 Incremental points in coefficient of trade balance		(-2.7)	(-2.2)	(-6.0)	(8.2)	(4.7)	(1.6)	(3.9)	(1.0)	(0.3)	(3.1)	(-4.0)
7. Incremental points in net remuneration coefficient of factors abroad		1.5	-0.5	1.0	3.5	0.7	1.5	0.9	0.0	-2.2	-0.3	-1.0
8. Incremental points in the share of remunerations		-4.7	-0.9	1.9	2.4	-2.0	-2.0	-3.0	2.0	0.5	2.5	-1.0

Source: H. García (1991b) based on data from ECLAC (1989 and 1990), and estimates from PREALC and Infante (1991).

a/ Includes variation of stocks.

Table 14. AVERAGE SECTORAL PRODUCTIVITY
(1970=100)

Year	Agriculture	Mining	Industry	Construction	Trade	Transega	Others	Aggregate
1970	100.0	100.0	100.0	100.0	100.0	100.0 a/	100.0 b/	100.0 c/
1971	98.0	104.9	110.8	94.3	112.8	102.6	102.4	105.5
1972	89.5	96.2	104.6	84.9	116.3	105.2	101.2	103.2
1973	83.2	81.5	94.6	88.1	111.1	102.9	101.5	99.3
1974	103.8	103.7	94.6	100.8	91.9	110.1	102.1	100.4
1975	116.4	93.7	77.4	96.7	78.5	116.4	104.9	95.0
1976	113.0	106.4	84.6	96.1	73.2	137.6	107.3	98.3
1977	119.3	113.4	90.8	88.6	82.8	133.5	109.0	102.3
1978	111.0	116.5	97.3	84.2	90.8	144.6	106.3	104.4
1979	119.8	129.3	105.6	94.5	91.9	146.9	111.1	110.5
1980	121.8	138.1	111.5	103.4	96.9	160.0	112.5	115.0
1981	126.0	149.1	116.3	98.3	95.0	155.9	113.2	115.7
1982	134.9	182.4	113.0	122.3	87.3	151.9	104.3	112.9
1983	130.5	165.8	121.5	129.1	88.2	162.4	107.5	115.6
1984	130.1	152.8	115.5	101.9	83.1	162.5	93.0	107.1
1985	134.7	115.7	109.1	105.6	77.1	165.5	85.1	102.6
1986	143.3	118.0	101.1	110.0	79.7	153.6	81.2	99.7
1987	137.6	108.5	99.1	104.3	78.6	170.4	78.1	97.1
1988	138.0	99.6	97.1	94.5	83.4	174.9	80.4	98.5
1989	149.5	111.8	103.4	105.1	88.4	172.4	82.9	104.4
1990	150.9	98.6	99.6	111.6	83.2	171.5	80.5	101.6

Source: Employment data based on Jadresic (1986) and Employment Survey University of Chile for 1984-90. Special employment programmes are excluded. GDP data based on Monthly Bulletin, Central Bank, several issues.

a/ Corresponds to the sum of "transport and communications" and "electricity, gas and water" sectors in the case of production statistics. Employment statistics based on University of Chile data on "transport, storage, communications and public utilities".

b/ In the production statistics the item "others" includes financial sector, real estate or home ownership, education, health, other services, public administration, banking imputations and taxes on imports. Under employment such items as "governmental and financial services", "personal and household services" and "communal and social services" are added. Special employment programmes are excluded.

c/ To verify differences between sectors, it can be stated that productivity in 1970 in thousands of \$ of 1977 as follows:

	Agric.	Mining	Indust.	Const.	Trade	Transega	Others	Aggregate
1990	36.8	241.8	142.6	116.1	142.3	89.1	103.7	104.1

Table 15. AVERAGE PRODUCTIVITY OF TRADEABLES OPPOSITE
NON-TRADEABLES, 1970-1990

Year	Index tradeables	Index non-tradeables a/
1970	100.0	100.0
1971	107.5	104.3
1972	102.6	103.6
1973	94.9	102.9
1974	101.8	98.6
1975	91.6	95.5
1976	97.1	95.0
1977	102.0	98.7
1978	104.0	99.6
1979	112.9	103.7
1980	117.5	107.2
1981	122.7	105.4
1982	124.5	100.2
1983	126.0	102.7
1984	122.9	91.1
1985	117.9	86.6
1986	117.4	83.0
1987	113.1	80.4
1988	111.8	82.7
1989	121.8	86.8
1990	118.1	84.2

Source: Drawn from data base of table 13.

a/ Excluding "Transega", i.e. transport, communications, electricity, gas and water.

Notas

Tradeables: Agriculture, mining and industry.

Non-tradeables: Construction, trade, others.

Table 16. INDUSTRIAL PRODUCTIVITY BY SIZE OF ENTERPRISE a/
(index for large enterprises 1975=100)

Year	Aggregate	Enterprises	
		Small a/	Large b/
1975	61.1	42.2	100.0
1976	52.9	39.6	86.0
1977	45.1	31.6	73.7
1978	46.7	27.5	77.5
1979	46.8	27.8	81.1
1980	53.0	32.4	90.8
1981	55.6	35.3	93.8
1982	60.7	34.9	107.2
1983	64.9	35.7	115.8
1984	68.1	38.2	120.4
1985	69.6	36.7	124.2
1986	62.5	34.0	109.4
1987	63.1	40.8	105.3
1988	71.8	44.7	120.6
1989	73.9	48.7	122.3

Source: Compiled for this study on basis of figures from INE (National Institute of Statistics) and Annual Survey of Manufacturing Industry.

a/ Corresponds to enterprises with 10 to 49 workers.

b/ Corresponds to enterprises with 50 or more workers.

Notes: Value added per worker occupied in industry deflated by implicit deflator of private consumption (National Accounts, Central Bank).

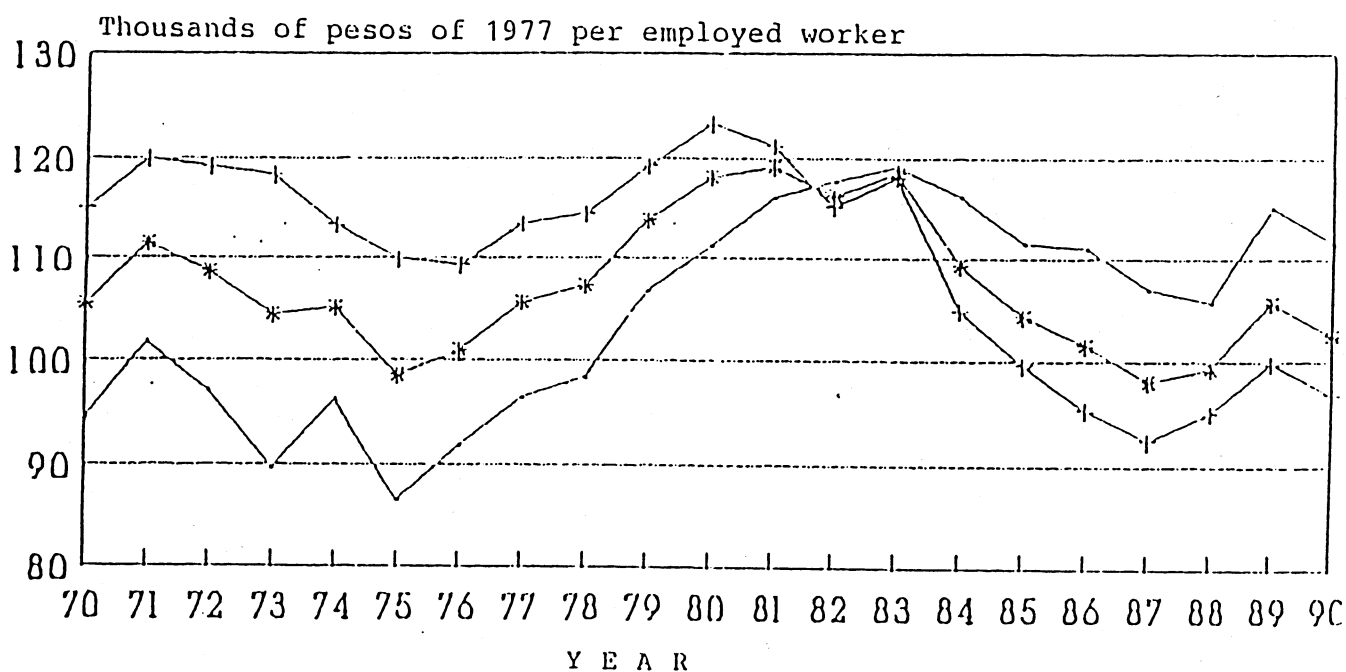
Table 17. REAL WAGE/PRODUCTIVITY RATIO
(index 1970=100)

Year	Aggregate	Industry	Mininig	Construction	Agriculture a/ b/
1970	100	100	100	100	-
1971	124	117	128	149	-
1972	116	126	105	208	-
1973	63	78	69	125	-
1974	61	73	49	83	100
1975	59	76	56	83	76
1976	70	92	64	86	83
1977	72	91	62	101	100
1978	73	91	59	108	115
1979	69	84	53	94	102
1980	74	92	53	97	96
1981	86	102	54	115	92
1982	86	99	40	86	89
1983	75	83	42	61	67
1984	82	87	46	67	59
1985	82	87	60	54	60
1986	86	97	61	48	50
1987	88	100	66	50	47
1988	92	108	75	60	55
1989	89	104	67	58	60
1990	93	111	78	58	-

Source: Wage data based on INE (National Institute of Statistics) and Table 2. See a/.

- a/ The evolution of agricultural wages is based on Palma (1991). It corresponds to the income from work of wage earners employed in the forestry-fishery-agriculture sectors deflated by the implicit deflator of private consumption.
- b/ 1974=100 owing to lack of information for previous years.

Figure 3
 AVERAGE PRODUCTIVITY 1970-1990
 TRADEABLES OPPOSITE NON-TRADEABLES*



Mean Product Y/L

— Tradeable

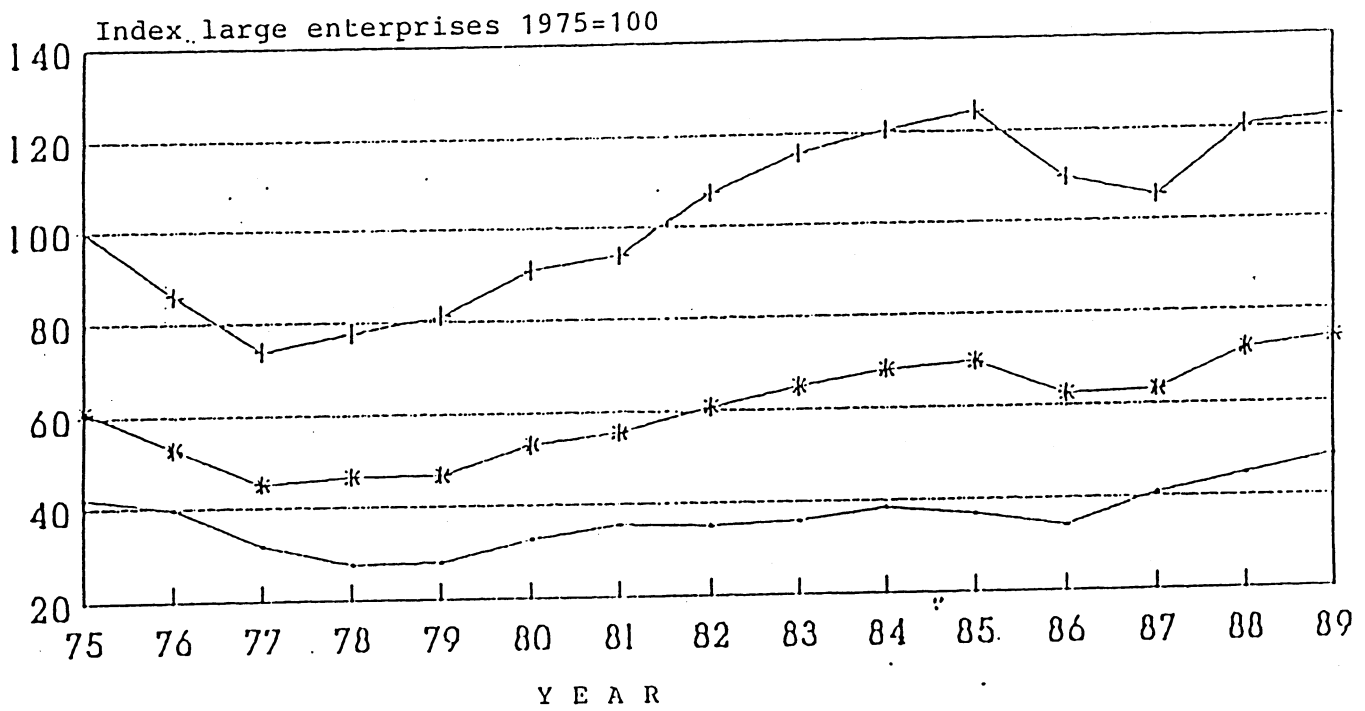
-|- Non-tradeable*

-*- Aggregate*

* Excludes public utilities, transport, electricity, gas and water.

Figure 4

INDUSTRIAL PRODUCTIVITY 1975-1989
BY SIZE OF ENTERPRISE



— Small enterprises

— Large enterprises

—*— Aggregate enterprises

VI. TOWARDS A MORE EQUITABLE GROWTH (1990-1992)

A. Continuity and change

The new democratic Administration, that takes office in March of 1990, proceeds to implement a set of policies which while ensuring the continuity of the new model of growth introduce a social and economic component of a greater equity. Continuity is embodied in the decision to maintain the macro-economic equilibria required by the growth strategy. Equity is sought with a variety of measures: (i) the priority given to diminishing poverty through employment, wages and social spending; (ii) the tax reform of 1990, needed to finance the increase in social expenditure of the next years; (iv) the increment in targeted social spending; (iv) the labour reform of 1990; (v) the new attitude towards social negotiation; (vi) the concerted readjustment of the minimum wage; and (vii) the priority attached to employment.

B. Stabilisation and growth

The objectives of fiscal, monetary, price and balance of payments equilibria are upheld in the period 1990-92. In 1990, in particular, the Government applies a monetary adjustment to control the over-expansion registered in the pre-election term and in addition implements a tax reform³⁰ to finance the heightened social expenditure from 1991 onwards. Continuing the initiatives launched in 1988, the authorities foment an active though now *concerted* minimum wage policy. As of 1991, the surplus of foreign exchange and the subsequent pressure on the exchange rate and on money supply are among the principal problems to be confronted. Despite the efforts of public policies, a drop in the real exchange rate³¹ is beginning to become apparent. To avoid further pressures on the money supply the placement of drafts and bonds in the money market is facilitated, which in turn has an incidence on the interest rate³². The fall of the real exchange rate and the increase in productivity create room for a significant rise in real wages.

In spite of the three effects mentioned, i.e. real rise in wages and interest rate and descent of the real exchange rate, growth of exports reaches record figures³³, the gradual

³⁰The main modifications of the tax reform consisted in: (i) higher direct taxes on individuals and enterprises and (ii) an increase in the value added tax (IVA).

³¹Relative to the U.S. dollar. However, since half of the Chilean exports are effected to European countries and Japan it must be emphasised that the lag is less noticeable in relation to other relevant currencies.

³² The decline of the U.S. interest rate during this period is one of the factors affecting the situation through inflow of foreign capital or return of domestic capital.

³³In 1990-92 exports at constant prices grow at a rate of 11 per cent per year, with an increasing tendency towards diversification of products and markets.

deceleration of prices proves successful³⁴ and after the internal adjustment of 1990 the economy steadies at an average growth rate of close to 8 per cent per year³⁵. As a result employment grows at a fast pace with the unemployment rate shrinking to 4.6 per cent, the lowest level of the last decades in spite of the increase in the participation rate. The rise in real wages³⁶ can be explained by the conjuncture of: (i) a more tight labour market with less under-utilisation; (ii) inflationary deceleration; (iii) a greater incidence of institutional variables on the labour market³⁷; and (iv) the foreign exchange rate lag and productivity growth.

C. Strengthening of social dialogue

The Government convoked labour and entrepreneurial representatives to analyse diverse projects of the new administration. Specially emphasised were the reinforcement of dialogue and social negotiation in such core issues as: (i) the new labour reform; (ii) the successive increases of the minimum wages and family allowances; (iii) professional training and programmes of labour training for youth; and (iv) the signing of a series of framework agreements between representatives of workers, entrepreneurs and the Government. The first of these framework agreements, underwritten in April of 1990, propounds a common vision in behalf of the development of the country and the pledge to favour concerted solutions.

Simultaneously, the number of unionised workers and of trade unions grows by approximately 40 per cent in the 1990-92 triennium. An additional characteristic of the renewed social dialogue is that despite the easing of restrictions labour conflicts remains at a very low level - 1.2 work hours a year per economically active person. This average is less than half of that registered in Chile during the decade of the sixties and less than that recorded in the United States, Italy, Spain, the United Kingdom and Canada in 1990-91 (SECC, 1992).

³⁴Consumer prices rise from an annual average of 16 per cent in the 1988-89 biennium to 26 per cent in 1990 whereas in 1991 and 1992 this percentage is reduced to 18 per cent and 13 per cent respectively.

³⁵GDP, which had grown at a pace of 7.7 per cent in 1986-89, plunges to 2.1 per cent of growth in 1990 owing to the drastic internal adjustment applied in that year. In 1991 and 1992 an annual growth rate of 6 per cent and 10 per cent respectively is recovered.

³⁶The remuneration index (INE - National Institute of Statistics) indicates a real average annual increase of 4 per cent for the 1990-1992 triennium, a percentage that exceeds productivity growth.

³⁷The length of the wage readjustments period tends to decrease, and full indexation to past inflation becomes more general in all sectors.

D. Labour reform

In 1990 three projects were presented to Congress and approved towards the end of that year and the beginning of 1991 respectively. The three issues concerned were the following: (i) finalisation of labour contracts and labour stability; (ii) organisation of labour unions; (iii) unions and collective bargaining.

With respect to the first project it is agreed that dismissals must obey a reasonable cause to avoid dismissals depending on the mere whims of employers. Recognised grounds for discharge are the needs of an enterprise arising from modernisation, from productivity gains and from the changes of the market. It is further established that the five year limit with regard to the indemnification at dismissal of one month per year of service, is to be extended to ten years and is now to include social security dues and levies corresponding to the worker.

The second approval recognises the legal right to constitute unions without intervention of the authorities, with full representativeness and freedom of affiliation.

Passing of the third project authorises the following: (i) the reduction of quorums necessary to constitute unions in small enterprises; (ii) the extension to temporary workers of the right to join the unions ; (iii) more protection and financing for union activities; (iv) the widening of the spectrum of topics susceptible to collective bargaining; (v) bargaining at a level which includes several enterprises, without giving up the rights of each individual bargaining partner; and (iv) the voiding of the 60 days duration term for strikes.

E. Minimum wage policy

In 1990, 1991 and 1992 representatives of workers, entrepreneurs and the Government agree to readjustments of the minimum wage which, translated into a cumulative increase of close to 21 per cent in real terms during the triennium³⁸. The fact that this readjustment was concerted among social actors preempted the unfolding of sectoral or aggregate imbalances, besides establishing *ex ante* a high degree of compliance. A second relevant aspect is that in 1991 it is accorded that readjustment of the minimum wage should take into account growth in productivity and the *expected* rise of consumer prices, a criterion that is applied for the first time in 1992. This is an important step since it constitutes the first signal to the private sector to bargain according to the *expected* instead of the past rate of inflation - deindexation of inertial inflation - and it encourages this sector to negotiate productivity incentives.

³⁸6.3 per cent in 1990, 9.3 per cent in 1991 and an estimated 5 per cent in 1992. It is worth bearing in mind that the original diagnostic foresaw the initially existing room in the profit margins to absorb the readjustment without pressures on competitiveness and/or prices. See García (1991a) for a discussion of the macro-economic effects of the readjustment of the minimum wage.

F. Social expenditure and poverty

The tax reform of 1990 and economic growth permitted an increase in direct social expenditure³⁹ of 8.2 per cent in 1990, 12.2 per cent in 1991 and 7.9 per cent in 1992. This constitutes a reversal of the trend manifested in the period 1986-89 and allowed for a substantial improvement in per capita social spending.

A recent investigation (MIDEPLAN, 1992) concludes that increased social expenditure in 1990 and 1991 accounts for 51 per cent of the increment in effective final consumption of the two lowest income quintiles and for 28 per cent of the two following quintiles.

It is estimated that the proportion mentioned of 51 per cent will be maintained throughout 1992, which emphasises the importance of augmenting social spending with a view to bettering the situation of low income households. Nevertheless, the effects of decelerating prices and of the positive evolution of the labour market also proved essential in reducing poverty and improving the situation of the medium income groups⁴⁰.

In MIDEPLAN mentioned study it is further estimated that in 1990 and 1991 the coverage of poverty is assumed to have decreased from 40.1 per cent to 37.6 per cent, which includes a diminution of indigents and of the non-indigent poor⁴¹. Available estimates suggest that this trend will continue in 1992 until reaching approximately 33 per cent of households.

G. Evolution of the labour market in the period 1990-92

The adjustment policy implemented in 1990 decelerated economic growth and resulted in a lower expansion of aggregate employment - which grew 1 per cent - as well as a slight increase in open unemployment, which reached 5.7 per cent. On the other hand, formal employment grew 1.6 per cent annually, that is at a faster pace than the average, while the participation of informal employment dropped to 24.3 per cent⁴². Having weathered the adjustment period, the economy exhibited an accelerating growth rhythm, which contributed to dynamising employment generation in the 1991-1992 biennium. In this period total employment averaged a 3.0 per cent annual growth rate while formal employment rose by more than 4.0 per cent on average. The unemployment rate declined to 4 per cent in 1992

³⁹Subsidies, social security, health, education and housing.

⁴⁰In this respect, MIDEPLAN (1992) indicates that the rise in effective final consumption among poor households in 1991 occurred in a proportion of 70 per cent due autonomous increments in their incomes and in a proportion of 30 per cent owing to social spending.

⁴¹Corresponds to a net reduction of 245 600 household of the total situated below the poverty line.

⁴²Includes domestic service, self-employed workers and unpaid family members.

and the share of informal employment continued to sink until reaching around 23.0 per cent in 1992.

Among the passed-by segments of the labour market, however, the young stood out, since their job opportunities and incomes were insufficient. In 1990 the unemployment rate for young people aged 15-24 was 13.1 per cent - more than twice the national average. Worse yet, unemployment and underemployment among young people pertaining to low-income households was considerably higher still. Hence, in 1991 a youth employment programme is launched, consisting in training and identification of job opportunities, with a goal of attracting 200 000 young applicants in the space of four years⁴³.

It must be pointed out that the behaviour of employment, as described in the foregoing paragraphs, was associated with a *higher* increase in productivity than that registered in the period 1986-89. Thus, in the 1990-92 triennium productivity grew at an annual average pace of 4 per cent. Even faster was the average productivity growth in tradeables, that is exportables and import substitutive goods. This proved a significant stimulus on overall competitiveness, besides creating additional room for raising real remunerations.

Indeed, employment growth was accompanied by a marked rise in real remunerations. During the year of internal adjustment (1990) these grew 2 per cent while the minimum wage rose 6 per cent. Once the adjustment had been accomplished, real remunerations increased by 4.9 per cent in 1991 and by 4.5 per cent in 1992. Meanwhile, real minimum wages continued to grow at a faster rate, i.e. 9.3 per cent in 1991 and 5 per cent in 1992, which constituted a decisive element in improving the situation of low-income groups. Explanations of these increments in real wages can be found in such determinants as the deceleration of prices, the institutional changes in the labour market⁴⁴ and the positive evolution of this market - thus, to cite an example, around the middle of 1992 concerns about a possible shortage of labour in different sectors arise for the first time in 20 years.

H. Redistribution with growth and the labour market

One of the main conclusions that can be derived from the foregoing analysis is that in the 1990-1992 triennium economic policy was successful in two fundamental aspects: (i) impelling a high degree of economic growth based on dynamism in exportables and import competing activities; (ii) achieving a redistribution of this growth towards the poor and medium-income sectors of the population.

⁴³The programme covers agreements with the private sector for training and job identification, paid scholarships and access to training facilities in the public sector.

⁴⁴A more favourable climate for collective and individual bargaining as well as the shorter readjustment intervals and full wage indexation contribute to the wage increases in 1990 and 1991.

The redistribution of growth was successful for the following reasons: First, it did not harm the achievement of high growth rates; second, it also depended on a greater utilisation of internal resources which under different circumstances would have been transferred abroad. Thus, in 1990-92 the diminution of net payments to factors abroad, the reduction of the external trade balance in relation to GDP and the improvement in the terms of trade increased the availability of internal resources at a faster pace than GDP growth⁴⁵. A lower than average growth in incomes in higher strata further contributed to providing room for redistribution.

Redistribution operated in ways that were not conflictive with growth, such as: (i) a significant deceleration of prices; (ii) an appreciable increment in employment; (iii) an enhancement of real remunerations, particularly pronounced in the minimum wage, which did not clash with the deceleration of prices thanks to productivity gains and the foreign exchange rate lag; and (iv) a significant increase of social expenditure, benefiting middle income groups but especially poor households, financed with taxes.

The role of the labour market was important too, since it contributed to employment growth besides making possible the increases in medium wages and assimilating the improvements in the minimum wage. As mentioned before, in 1991 and 1992 a *significant percentage* of the increment in consumption of poor households arose from the autonomous increase of their incomes. This increase would not have occurred without the developments verified in the labour market, with special emphasis on enhanced employment, the decline of underutilisation and the greater incidence of labour market institutional factors on wage raises.

Yet the most relevant factor possibly was the linking of specific policies bearing on redistribution to those that stimulated economic growth. Incremental redistribution relied on mechanisms that did not jeopardise decisions made in the private sector with regard to production and investment. This allowed attaining high growth rates in 1991 and 1992, which in turn paved the way for the concretion of a redistribution of widespread effects. In this context, the positive results outlined arose to a large extent from the capacity for political and social negotiation exhibited by the new administration. Diverse fundamental decisions of economic policy made during this period relied on this negotiating capacity, which contributed to a more efficient implementation of the respective measures.

⁴⁵In the biennium 1990-91 net transfers to factors abroad decrease and the terms of trade experience a recovery but the coefficient of the trade balance rises with respect to GDP. In 1992, however, this coefficient diminishes.

VII. CONCLUSIONS

A. Sequential effects on the labour market

The observations put forward in the preceding chapters confirm that the impact of liberalisation and restructuring on the labour market comprehends effects of distinct signs and a sequence of different net results. From an analytic point of view, in a first phase, in which stabilisation policies and reforms as well as realignment of relative prices and incentives are implemented, net negative effects are expected to predominate. Policies exerting a contractive influence on many activities produce an *immediate* impact whereas *time* is required to achieve resource reallocation towards tradeables and the generation of foreign exchange and savings which facilitate the overall growth of the economy. It is only upon successfully dynamising activities in tradeables with an overflow into the remaining sectors that a net positive effect on the labour market is beginning to prevail (García, 1991b).

In consequence, to assess the efficacy of a transformation strategy it is essential to look not only at the results but also at the magnitude and the duration of the social costs generated during the transition.

In the case of Chile four factors can be singled out considering their contribution to the protracted duration and intensity of the maladjustments of the labour market:

(i) The initial situation preceding adjustment (1971-73) is characterised by profound economic imbalances and a high degree of social conflict, in a period in which accelerated state intervention in the economy reaches its peak. Apart from having to confront the disequilibria, however, the new authorities over-react against state intervention and the pendulum swings to the opposite extreme with the definition of stabilisation policies and reforms essentially based on the free play of the markets. The resulting maladjustments in the labour market were of course more intense than they would have been had a more moderate, pragmatic and selective approach prevailed.

(ii) In the period 1975-81 a particular interaction between reforms and stabilisation policies can be observed, producing repercussions in the labour market. The trade reform and the external financial liberalisation - coupled with internal financial deregulation - take place in the context of a declining real exchange rate, given that the latter is used as a nominal anchor for stabilisation purposes. This leads to a drastic fall of real protection at a time when the labour market is deregulated and labour stability is suspended. The effect is a rapid increase of open unemployment. The quantity adjustment is reinforced by wage indexation to past inflation in a period of decelerating prices. The availability of internal and external credit permits the external disequilibrium to continue accumulating, thus transferring pressures to the future.

(iii) The simultaneity of adjustment and stabilisation policies and reforms - in contrast to a sequential approach in which the latter are started only *after* attaining the targets of fiscal and external adjustments and of stabilisation - generates a series of internal shocks lasting several years as a direct result of applying these two sets of policies jointly. The varied succession of these shocks increases uncertainty, augments the risk rate and affects decision-making in investment and production. All this generates deeper imbalances and

prolongs the adjustment process of the labour market. Since both the transition and the new growth model depended on private investment decisions, a higher degree of uncertainty provoked a lower employment generation

(iv) The external crisis of 1981-82 is all the more devastating in its impact on account of the imbalances accumulated during the preceding period and also because of the obstinacy in maintaining the "automatic adjustment" approach, the implementation of chaotic stabilisation policies in 1982 and the overkill effect of the internal adjustment. Even though the transfer of resources to the financial and non-financial private sector and the reordering of the game rules subsequently succeed in avoiding a financial collapse and in re-establishing appropriate conditions for the functioning of the markets, this process diminishes the resources needed to compensate for the maladjustments of the labour market and to mitigate through social spending the impact on the most affected households.

It must be underscored that the four aspects mentioned are specific of the Chilean experience, cannot be generalised and are not inherent to a structural adjustment policy. This should explain why the experience proved successful from the economic standpoint but also involved enormous social costs and hardships.

Specifically, as stated in Chapter III, the high level and lengthy duration of open unemployment which characterised the adjustment of the labour market in the period 1973-87 can be accounted for by the concurrence of diverse factors, among which the following could be pinpointed: the initial situation; the shock of stabilisation in 1975; the reduction of public employment in 1973-80; the extreme confidence in the automatic adjustment of the markets; the deregulation of the labour market without introducing new guidelines in the period 1973-79 and the institutional changes in 1979-82 that facilitated the dismissals; the interaction between the exchange rate policy, the trade reform and the external financial liberalisation, resulting in an abrupt lowering of real protection; the intensity of the differentiated sectoral shocks caused by the lessening of real protection and the ensuing mismatching between labour demand and labour supply; the rapid rise of labour costs in tradeables in the period 1975-81 on account of wage indexation linked to past inflation in a context of a pronounced price deceleration; the magnitude of the external and internal financial imbalances accumulated in 1975-81; the impact of the crisis 1982-83; the chaotic adjustment and the privileged use of public resources to come to the rescue of wobbling enterprises and banks, a process that diminishes funds for social expenditure.

As mentioned, the intense negative impact on employment and wages during such a protracted period accounts for the bulk of the social costs of the transformation. It is important to bear in mind though that the adjustment of the labour market helped raise the average macro-economic rate of profit between 1973 and 1985, incremented domestic savings to finance the increase of the external trade balance and reallocate labour towards activities in expansion during the 1973-89 period. In this sense, part of the social costs were functional in attaining transformation under the conditions established by the public policies of the period.

B. Productivity, wages and employment

The evidence suggests that it is in the first subperiod under scrutiny - 1974-81 - that an increase in productivity can be verified, above all in tradeables intensive in natural resources. The *average* rise in productivity is not very marked, yet it must be borne in mind that this average comprehends a *decline* in the productivity of *non-tradeables* alongside a significant *rise* in that of *tradeables*, especially in primary activities intensive in natural resources.

Additionally, for extended periods these activities exhibit a wage/productivity ratio below that prevailing *before* the restructuring process.

Consequently, the productivity increase in natural resources intensive tradeables and the decline of the wage/productivity ratio contributed to improving competitiveness and profitability in these sectors. In this manner, savings-investment formation and the generation of foreign exchange were facilitated. This permitted attaining high and sustained growth rates which, starting in 1985, were accompanied by a rapid growth in employment.

Hence, the productivity growth in tradeables, with wages lagging behind, helped create the conditions for a subsequent increase in employment.

The most relevant lesson to be learned for the future is to rely more on productivity gains than on declining wages. This will eventually permit to harmonise increased competitiveness with a significant growth of productive and well remunerated employment. Moreover, considering the omissions verified in the 1973-89 period, it is important to focus on future outlays for health and education since these expenditures translate directly or indirectly into productivity growth. Finally, the reduction of the State in size and interventions, left pending the issue of a systematic improvement of public efficiency - productivity growth within the public sector. This is without doubt one of the challenges of the future.

C. Modernisation, flexibility and adaptation

The transformation not only led to sustained economic growth, based on expansion, diversification and heightened competitiveness in tradeables but also to the modernisation of important segments of the Chilean economy. This modernisation extended to *exportables* such as fruits, lumber, wines, fishing, mining, tourism etc.; *import competing* lines such as dairy products, food grains and diverse areas of the manufacturing industry; *infrastructure supporting* activities such as energy, transport, ports, communications financial services etc.; and *non-tradeable* activities such as residential and industrial construction, trade, personal services, etc.

The outstanding feature of the modernisation - even though there are exceptions in determinate sectors - is the predominance of "soft" innovations as opposed to "hard" ones. This was a process of countless small investments of high productivity coupled with diversification of products, organisational changes and the diffusion of criteria of heightened

efficiency. Among the different changes of the period, the rapid acquisition of know-how in penetrating, amplifying and diversifying foreign markets must be singled out.

From a special survey of industrial establishments carried out for the period 1988-90 (Geller, 1992) it can be gathered that in 56 per cent of the enterprises surveyed the *variety* of products had been expanded, in 55 per cent innovations of a micro-electronic or electromechanical nature in the technical base had been effected and in 42 per cent the changes centered on the labour organisation. As is to be expected, in many establishments the three modernisations - or at least two of them - were enacted simultaneously.

Thus, in 19 per cent of the establishments the three innovations mentioned were introduced jointly, in 33 per cent two were put into practice and 32 per cent incorporated at least one of the modernisations. Only 16 per cent of the enterprises surveyed had *refrained* from adopting any kind of change.

It should be remembered that the export model was based on natural resources intensive activities while in industry import competing predominated. Hence, the information for industry most likely underestimates the intensity of the technological change verified in activities related to exportables.

What then was the role of the labour market in the process of modernisation? Did it further progress or was it a hinderance? Did the public policies, particularly the reforms and labour policies, contribute to flexibility and adaptability?

To answer these questions it is indispensable to make mention of the characteristics that marked the flexibilisation of the labour market.

As has been seen, the emphasis was put on a profound deregulation of the labour market rather than on the creation of new *functional* labour institutions harmonising with a process of productive modernisation. It is only as of 1990 that steps in the latter direction are beginning to be taken.

The flexibilisation of the labour market was to a much greater extent linked to labour instability and high and prolonged open unemployment than to the creation of an institutional framework and the reinforcement of behaviour patterns that would stimulate adaptation. Up to 1990 what really impelled the new labour institutions was the greater freedom on the part of the entrepreneurs - and the ensuing lower costs for them - to dismiss and reallocate personnel and set wages.

An approximate calculation indicates that the turnover of active persons who remained unemployed and then found another job during the period 1975-87 was two and a half times the average labour force during that lapse of time. This figure is *more than twice* the one verified for the period 1965-73, which gives a hint of the intensity of the flexibilisation process in the labour market.

What was lacking, on the other hand, were incentives to increase productivity and institutions to reallocate and retrain human resources. The setting up of this type of systems was inexistent, since the Government did not signal the establishment of incentives, did not

implement or induce any training or qualification programmes nor did attempt to support any labour reconversion whatsoever. The latter led to a *prolongation* of unemployment brought about by mismatching.

As far as wages are concerned, the recommendation - and subsequently legal regulation - that established indexation to past inflation in a period of rapidly decelerating prices tended to rigidify the labour market adjustment in the period 1975-81.

Deindexation in 1982 helps strengthen the capacity of enterprises to adapt to the shock of 1982-83 but it is only as of 1992 that public policies begin to envisage, for the first time, wage adjustments linked to: (i) the *expected* inflation, thus eliminating the inertial component; and (ii) to productivity gains.

There must also be awareness that, as indicated previously, due to the notable fall in real wages in the 1973-75 triennium and subsequently in the period 1982-87, the wage/productivity ratio descends in all sectors of activity and remains at a low level for the better part of the period under study. This decisively boosts the capacity of enterprises to adapt while facilitating the rapid creation of jobs in the years 1984-89.

Hence, the flexibilisation induced in the labour market through reforms and labour policies in the period 1973-89 essentially relied on the quantity adjustment brought about by negative incentives - dismissals - rather than on a price adjustment through positive stimuli. That approach was clearly incompatible with a social dialogue in a democratic framework. Therefore, even though success might have been obtained in reallocating millions of jobs by these means, it remained as an issue the establishing of *participative* labour norms, which besides fortifying the social dialogue could foster productivity gains, induce a civilised reallocation of labour and give priority to the requalification of manpower.

In corroboration of the foregoing, one of the first measures of the democratic Government, inaugurated in 1990, is to implement, as mentioned before, a new labour reform with a view to re-establishing social dialogue and negotiation, banishing the hitherto existing arbitrariness while improving labour stability and strengthening the union movement. Similarly, the first confrontation between the unions and the new Government around the middle of 1992 dealt, among other topics, with the issues of labour reconversion, requalification of affected workers and the demand for an unemployment insurance.

D. Labour market deregulation and wage indexation

One of the most paradoxical aspects of the labour reforms in Chile is the mixture of deregulation either *with* or *without* wage indexation to past inflation.

By having a direct bearing on real labour costs, this tends to curb or else stimulate the creation of jobs, depending on the periods. To summarise, four distinct subperiods can be distinguished.

In the first subperiod (1974-81) labour deregulation, derived from the partial suspension of the existing institutional framework and from trade unions repression, is

accompanied by indexation linked to past inflation in an environment of systematic inflationary deceleration from 600 per cent to 10 per cent per year. In consequence, after a strong decline in 1973, real wages grow rapidly. Employment, on the other hand, after weathering the shock which raises unemployment drastically in the years 1974-1976, recovers slowly in spite of rapid GDP growth, which explains why the elevated unemployment lasts so long and is reabsorbed so slowly. Hence the subperiod is characterised by rapidly growing wages and a gradual expansion of employment.

In the second subperiod (1982-84), the adjustment to external shocks explains why the flexibilisation of the labour market, now associated with a new institutional framework, is combined with wage deindexation in a context of rising inflation. Employment suffers a great impact in 1982-83, with unemployment rising to dizzying heights. Both real wages and employment decline.

In the third subperiod (1985-89), deregulation of the labour market in the context of the new institutional norms coincides with deindexation, which in practice gradually loses its initial harshness in a climate of inflationary deceleration. Real wages begin to grow as late as 1988 while employment, bolstered by the recovery and growth of GDP, expands very rapidly from 1985 onwards. In sum, this is a period in which lagging real wages facilitate a pronounced increase in employment.

In the fourth subperiod (1990-92) a partial labour re-regulation is reintroduced - enhanced stability and decentralised bargaining - with indexation linked to past inflation. Inflation rises in 1990 and decreases in 1991 and 1992. Following the course of GDP, real wages and employment exhibit strong growth. Early in 1992 the Government releases the first signals indicating a change in the indexation criterion from *past* inflation to *expected* inflation plus gains in productivity.

In the context of an open economy, therefore, it can be affirmed that wage indexation linked to past inflation was an important feature in *rigidifying* the labour market adjustment at a time when drastic institutional changes were enacted in other labour ambits tending to *flexibilise* this market. Put in other words, had an income policy mechanism permitting wage deindexation been institutionalised, inflation would have decelerated faster and the impact on employment would have been *less* harsh. One of the outstanding facets of economic policy during 1973-81 was the exacerbation on the acquired rights of the workers while at the same time *maintaining* wage indexation in a context of inflationary *deceleration*.

E. Profitability, restructuring and wages

One of the crucial questions for the future evolution of the labour market is to what extent the new model of economic growth requires a high profitability to induce a rapid increase in private investment. A high rate of profit is transmitted to the remuneration of the higher echelons of the enterprises, such as managers, executives, ranking employees, professional technicians, consultants etc. but it imposes a close restraint to the growth of wages. This leads to reinforcing wage and salary dispersion and to concentrating income.

During the 1973-89 period the process of restructuring the economy in Chile did not depend on a reconversion *aided* by public policies but on the free play of the markets, with the support of public resources to overcome the financial chaos of the years 1982-85. This strategy implied a rise in the average macro-economic rate of profit with respect to the one prevalent before the restructuring process, which in turn was conducive to a reorientation of investment. As of 1982, this applies particularly to tradeables. The raised profitability triggered private investment and production decisions. The transformation was therefore led by private investment based on a notably high profitability. The deregulation of the labour market not only contributed to labour reallocation but also to keeping a lower wage/productivity ratio with the consequent effect on macro-economic profitability.

It is useful to remember that in the 80s the high real interest rate abroad sets a high floor for the rate of return in Chile and is one of the reasons why profitability has to be kept high during those years. In the same way the decline of the real interest rate abroad in the late 80s and beginning of the 90s favours the reduction of internal interest rates and of profitability.

In the light of these observations, three points should be highlighted. The fact of having relied on a notably high rate of return to induce the process of transformation does not imply that the same rate has to be sustained in the future. The requisite is rather to maintain an average macro-economic profitability more rewarding than the one offered by external alternatives, which does not necessarily mean that it has to be four times as high as the external prospects. Therefore, the first relevant point is that in the future the rate of profit can continue being higher than the one prevailing before the restructuring process but does not have to maintain the level registered during the period of major transformations. In fact, between 1990 and 1992 significant changes in this direction could already be appreciated.

Nevertheless, pressures for high rates of return are still to be expected in a rapid growth model that depends on private investment and productivity growth in tradeables and supporting activities. Consequently, the second point is recognising that the main mechanism permitting an increase in real wages, without interfering with the rate of profit and competitiveness, is the attainment of a high and sustained productivity growth. This refers particularly to an increased efficiency in the use of invested capital and a higher degree of productivity in new investments⁴⁶. Both aspects lead to the issues of *labour collaboration* and more efficient *entrepreneurial management* in the context of an open economy.

The third point is related to the distributive implications of a high rate of profit. If the purpose is to avoid an increasing inequality of opportunities, compensatory policies must be implemented. Among the latter, the most congruent will be those that favour sustained productivity growth in the long run. Thus, the use of taxation imposed on individuals - distributed profits and rents - could be employed not only to improve the quality of education and health but also to facilitate the access to these systems, which would help

⁴⁶In a simplified approach, the rate of profit (P/K) depends on the wage/productivity ratio (w/y) and on the productivity of capital (y/k). Therefore, $P/K = (1-w/y) * y/k$.

deconcentrating incomes, bettering opportunities for the disfavoured and fortifying the sustained long-run growth of productivity.

F. Structural change and social incorporation

One of the chief problems of the successful productive transformation of Chile in the period 1973-92 is the slow integration of the bulk of the population into the benefits of modernisation. Taking into account only labour income, the following figures are registered after almost 20 years of transformation: 20 per cent of the employed receive a monthly average of US\$ 700; 40 per cent earn an average of US\$ 250; and the remaining 40 per cent have to do with less than a monthly average of US\$ 140⁴⁷. The last group includes unemployed, underemployed and temporary workers. It is particularly noteworthy that the average income from work of the lowest group is exiguous compared to the per capita labour income of the country⁴⁸. In consequence, the creation of new jobs with a higher degree of productivity and an appropriate remuneration continue to be a relevant objective. Hence, the shifting of approximately one-third of the labour force towards these new occupations constitutes a prime challenge in attaining a fuller social incorporation into the new model of economic growth.

All this naturally exerts an influence over the poverty situation, since, as already mentioned, one-third of households in Chile are still situated below the poverty line.

Hence, one of the main conclusions is that the economic success of the productive transformation lacked mechanisms for the necessary social integration. The latter was not generated by spontaneous market adjustments. A society, in turn, which fails to incorporate large segments of the population and remains in a fragmentary state, tends to present a greater hazard to the stability of the democratic system and to social coexistence.

Thus, the creation of productive jobs with decent remuneration levels remains a strategic priority to achieve social integration in a framework of democratic coexistence.

G. Social dialogue and productive transformation

Still, looking ahead, the setting up of an institutional labour framework in step with the ongoing economic modernisation will require a more comprehensive social dialogue,

⁴⁷Data in Chilean pesos from MIDEPLAN, based on information from 1990 CASEN surveys. The influence of unemployment, underemployment and temporary jobs is felt on the third average.

⁴⁸Estimated at US\$ 2 500 for 1992. It must be underlined that if non-labour incomes are added to income from labour, the distributive inequality would become even more accentuated and the average income of the least privileged group would improve only negligibly.

especially regarding these two issues: (i) the gradual raising of a social safety network⁴⁹, including measures such as unemployment insurance; (ii) the implementation of an assisted labour reconversion with special emphasis on qualification and retraining. It seems important that part of the resources generated by future growth be destined to achieving these goals in view of their bearing for productivity growth and impact on social peace and justice. To the extent that the new model of growth tends to press towards increasing profitability and wage dispersion, one of the few instruments that can be resorted to in the endeavour to equalise opportunities is associated with education and retraining. The attainment of appropriate conditions for an aided labour reconversion represents without doubt the principal mode of adaptation of both labour and enterprises to the changes of an open economy.

⁴⁹Indispensable to be prepared to mitigate the partial adjustments in an economy more exposed to external shocks.

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