International Labour Office

CHILE
MINIMUM-WAGE SETTING IN TIMES OF CRISIS

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In Chile, the minimum wage level is adjusted annually, the new levels coming into effect each year on July 1. This year, the adjustment will take place in a context of international crisis resulting in a fall in output, a significant rise in unemployment, and a major drop in the rate of inflation. While changes in such variables need to be read with care, the particular features of the crisis render it necessary to protect domestic consumption, which hinges mainly on employment and worker income. On the positive side, we find that Chile has consistently reappraised the minimum wage for many years now, which enables it to apply a moderate adjustment without greatly disturbing the minimum- to average-wage ratio or the evolution of productivity, as reflected in estimates based on three different increase scenarios. Finally, the rate of unemployment must be included as a key variable to determine the pace of future increases to the minimum wage.

1. Introduction

In Chile, the minimum wage is adjusted annually. Discussions take place in May and June, and the new figure comes into effect on July 1. The adjustment for 2009 is framed in a context of economic contraction resulting from worldwide financial crisis, which has had major repercussions on the labour market and triggered a significant rise to close to two digits in the open unemployment rate.

The most recent historical contraction of the economy with an ensuing rise in unemployment took place in Chile as a result of the Asian crisis in the late 90s. On that occasion, however, the minimum-wage increase was predetermined by an adjustment of three years' duration, which fixed the applicable increments for each successive year. The amount of such increments had been determined considering inflation and growth forecasts, the latter being quite high (close to 7%). The Asian crisis radically modified the growth parameters, in spite of which the planned minimum-wage increments were not changed. Major real increments in the minimum wage (nearly 17% per annum) did not affect compliance with the rule, nor were they transferred to the wage scale as had previously been the case, and worker concentration rose in segments close to the minimum wage. The effects on employment appear to have been restricted to the youth segment, while some analysts blame this situation for the slow recovery of employment.[2]

2. Description of the MW situation

A distinctive feature of the Chilean case is that the minimum wage has risen consistently in real terms for 22 years. Throughout this period, Chile showed significant economic growth, interrupted only by the Asian crisis and –at present– by the international financial crisis. Therefore, through the minimum wage, the good performance of the economy has also come to benefit wage-earners at the lowest income levels.

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2 The findings of studies on this topic are summarized in Marinakis and Velasco (2005).

A second situational feature is that in the course of 2008 Chile underwent a significant rise in prices leading to nearly 10% annual inflation, mainly owing to higher international food and oil prices. As a result, the increment to the minimum wage effective in July 2008 was neutralized. In the first five months of the present year, the consumer price index has accumulated a 1% drop, while accumulated inflation in the last 12 months is 3%. Inflation forecasts for the next year are around that level.

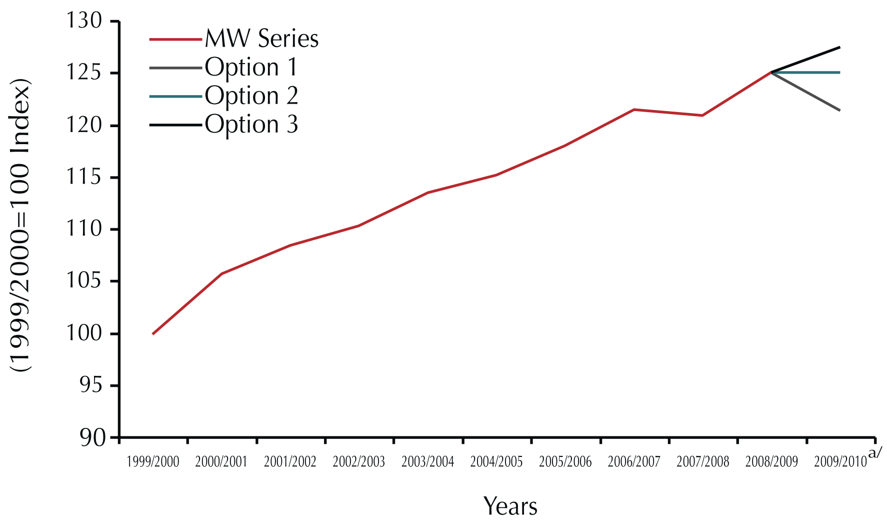
In brief, the crisis has found the Chilean minimum wage at significant levels –although still insufficient to cover the basic shopping basket of a typical family– as a result of sustained revaluation together with the falling rate of inflation, which offsets the loss without the need to apply very major increments.

The discussions on minimum-wage adjustments for the current year included proposals to freeze the present level, proposals to offset the inflation of the last 12 months or the inflation forecast –since both are now equally around 3%– and a third position based on the view that there is room for a real increase which, for the purposes of this analysis, we have placed at 2% (that is, nominal 5%). To examine the situation we will utilize these three adjustment scenarios.

3. Assessment indicators

Graph 1 shows the evolution of purchasing power for the minimum wage over the past 11 years, a projection of what would happen in the three increment scenarios, with inflation estimated at 3% for the period in effect.

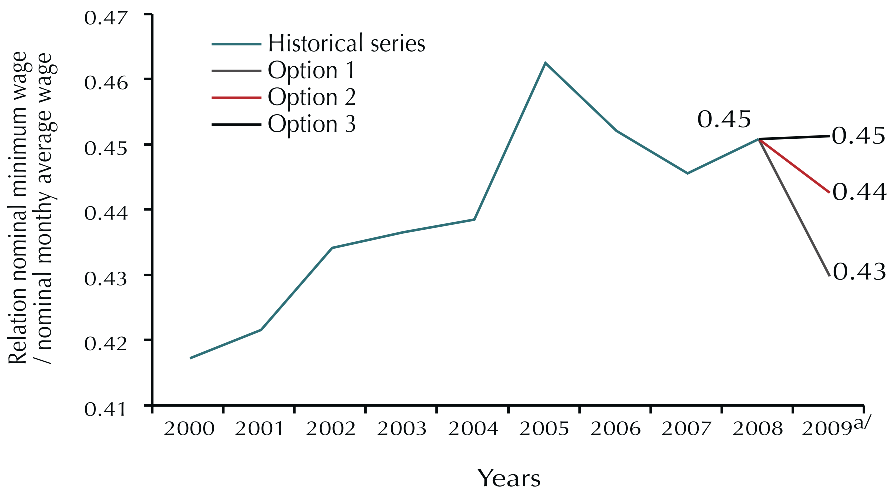
Graph 1
Evolution of MW purchasing power over the past 11 years, 1999/2000 - 2009/2010
(using July-June average)



Source: Prepared by ILO based on *Instituto Nacional de Estadísticas (INE)* and *Banco Central de Chile* data
a/ Option 1 shows 0 MW increase and annual inflation for the reference period estimated at 3%. Option 2 shows MW increase equal to inflation estimated at 3%. Option 3 suggests an adjustment 2% over annual inflation (5%)

A basic benchmark for the minimum wage is the ratio between the latter and the average wage. For this purpose, the mean wage registered under the INE Survey of Compensations is taken, which is representative of private wage-earning workers in the formal sector of the economy. It is estimated that in the 12 months when the minimum wage is in effect, the mean monthly wage will have increased by a nominal 4.9%. Thus the ratio between the 5% increment in the minimum wage and the mean wage would remain constant at the level of the last 3 years. Lesser increases would result in lowering this ratio.

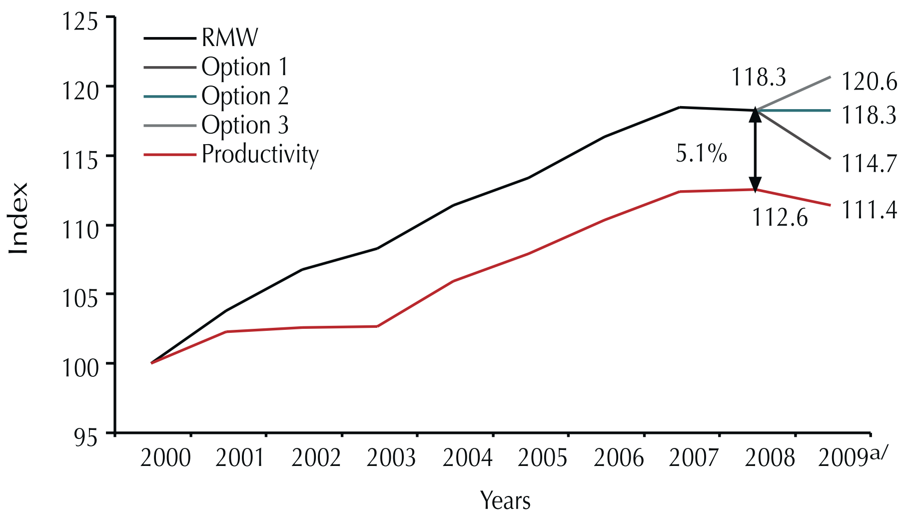
Graph 2
Evolution of the ratio between minimum wage and mean monthly nominal wage, 2000-2009
(at July of each year)



Source: Prepared by ILO based on *Instituto Nacional de Estadísticas (INE)*
a/ An increase of 4.9% in mean monthly wage is considered in all cases. Option 1 shows 0 MW increase. Option 2 shows MW increase equal to inflation estimated at 3%. Option 3 suggests 5% adjustment of the MW

Another indicator to be considered for minimum-wage adjustment is output evolution per employed worker. As shown in Graph 3, evolution of the real minimum wage and the above indicator has developed along similar lines in the recent past, whereas at this point in the decade a 5% gap would appear to have accumulated in favour of the minimum wage. Estimates for 2009 calculate that output will drop by 1%, while the number of employed workers is expected to remain relatively constant.

Graph 3
Evolution of real MW and output, 2000-2009
(1989-1990 = 100 Index)



Source: Prepared by ILO based on *Instituto Nacional de Estadísticas (INE)*
a/ Based on 1% drop in productivity. Option 1 shows 0 MW increase. Option 2 shows MW increase equal to inflation, estimated at 3%. Option 3 suggests 5% MW adjustment

4. Conclusions

Contrary to previous crises and given the international situation, emerging from the crisis this time will not will not happen through improving Chile´s competitive position to increase exports. Although the foreign sector should not be ignored, protecting the domestic market will play a fundamental role. In this context, it is important to protect employment and worker income, hence calculating the minimum wage is a key element.

Sustained growth of the real minimum wage over more than two decades, together with a significant drop in the inflation rate, make it plausible that the minimum wage to be set this year could be moderate, which would not affect employment while protecting the purchasing power of wages. A key variable to be included when considering minimum-wage adjustments is the evolution of the unemployment rate. Just as when open unemployment reaches 10%, the contingency fund which activates emergency employment programmes is set in motion, the same figure might similarly imply that setting the minimum wage requires some moderation. Then, when the unemployment rate recovers its customary levels (6% to 7%), it would be reasonable to expect a wider margin in minimum wage increments.

References

Marinakis, A. and Velasco, J. J. (eds.) (2005) *¿Para qué sirve el salario mínimo? Elementos para su determinación en los países del Cono Sur* (Santiago, ILO).

Annex
Key data to determine the minimum wage

Chile: Main indicators related to the minimum wage, 1999-2009

Years[f/]	Per capita GDP variation[a/]	Variation of inflation[b/]	Unemployment rate[c/]	Nominal minimum wage[d/]	Variation of real MW[e/]	MW/mean wage ratio[e/]	Minimum wage in current US dollars[e/]	MW/real exchange rate ratio[a/]
1999 - 2000		3.8	9.8	90,500	6.5	0.42	184	152.6
2000 - 2001	2.2	3.2	9.8	100,000	2.2	0.42	161	142.3
2001 - 2002	1.0	2.6	9.5	105,500	2.7	0.43	160	144.7
2002 - 2003	2.8	3.1	9.4	111,200	0.9	0.44	165	136.3
2003 - 2004	4.8	1.4	10.3	115,648	2.4	0.44	190	147.4
2004 - 2005	4.6	3.1	9.3	120,000	3.1	0.46	221	156.6
2005 - 2006	2.9	3.8	8.1	127,500	2.0	0.45	250	166.6
2006 - 2007	3.6	3.8	6.4	135,000	2.7	0.45	277	165.7
2007 - 2008	2.1	9.5	7.8	144,000	0.9	0.45	317	162.0
2008 - 2009[g/]		3.0	10.2	159,000				

Source: Prepared by ILO based on Instituto Nacional de Estadísticas (INE) and Banco Central de Chile data, and official and private estimates

a/ Corresponds to current calendar year, beginning year 2000

b/ Annualized inflation at July each year

c/ Unemployment rate for mobile quarter May-July each year

d/ Until 2004, minimum wages came into effect in the month of June each year. Since 2005, MWs come into effect in the month of July each year

e/ At July each year

f/ June-July each year

g/ Estimate