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ILO NOTES ON THE CRISIS

CHILE
FISCAL POLICY AND EMPLOYMENT
THE CONTINGENCY PROGRAMME AGAINST UNEMPLOYMENT

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The Contingency Programme Against Unemployment was set up in Chile in 2006, in the framework of the Fiscal Responsibility Law. Its aim was to strengthen the array of counter-cyclical policies which has characterized the design and implementation of economic policies since 2001. This initiative links employment policy to fiscal policy, formalizing the decision to implement counter-cyclical employment policies, funded from general revenue, when the labour market at national level deteriorates. However, it also operates when significant levels of unemployment are detected in particular geographic areas. In the framework of the present financial crisis, the Programme has shown its efficacy, activated during the current year together with a number of other supplementary measures of a counter-cyclical nature. Results suggest positive effects on unemployment, since the latest information is that during the current year, the upward trend of unemployment across the nation was arrested, isolated from seasonal factors.

1. Introduction

Since 2001, Chilean fiscal policy followed the structural balance rule, which states that the level of public spending in each period must be equal to structural or permanent Fiscal revenue. This seeks to isolate public spending decisions, particularly in terms of social expenditure and investment, from swings in the economic cycle and especially from short-term fluctuations in the price of copper (second source of income after taxation). This approach, therefore, acts as a stabilizing factor for aggregate demand and output.

The structural balance rule was applied to attain a Central Government structural surplus equal to 1% of GDP. Such target was justified by the existence of a structural deficit of the Central Bank, resulting from the bale-out of the banking system in the eighties and the exchange policy of the nineties, contingent liabilities linked to pension system guarantees and benefits, together with external vulnerabilities and potential limitations to foreign debt. Therefore, this aim is justifiable while the conditions that originally gave rise to it continue, unless a drastic change in economic conditions warrant a modification, as happened recently with temporary substitution by a surplus of 0% of GDP with which to face the effects of the current financial crisis.

Application of the above rule strengthened implementation of a counter-cyclical economic policy, which helped to attenuate the breadth of economic cycles and ensure, among other effects, the sustainable funding for public policies and long-term planning for social programmes.

One important supplement to this rule is the Law on Fiscal Accountability; while the former regulates income flows and fiscal spending, the Law provides rules and institutions for administration of fiscal assets resulting from its application. Indeed, together with establishing the Contingency Programme Against Unemployment and making it permanent by providing an aim, requirements, and funding under the budget law, the above Law also makes it mandatory to accumulate assets in the Pension Reserve Fund and the Social and Economic Stability Fund, in order to reduce the

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risk of fiscal crises. In this way, a core aspect of the fiscal policy includes the possibility of actively intervening in the labour market when it deteriorates, providing it with the necessary funds charged to the Nation's general revenue.

2. Prior experience in a context of employment slump

Setting up the Contingency Programme against Unemployment in 2006 was preceded by a period of high and persistent unemployment, which began in 1999 due to the effect of the Asian crisis, and which only showed a slight downward trend in subsequent years, although since 2000 the economy resumed its growth.

Indeed, the rate of unemployment went from 5.3% in the first quarter of 1998 to 11.4% in the third quarter of 1999, and since then remained at relatively high levels, for it dropped by only 1.2 percentage points in the five following years. Economic recovery until 2003 was not only modest but also unstable, as most labour-intensive sectors faced difficulties in resuming their dynamism. This situation only began to turn-around after 2005, which resulted in more demand for labour, greater real rises in mean wages, and a significant drop in unemployment.

During this period a set of labour-market policies, both active and passive, were implemented, and a significant investment was made in the development of institutional design, and coordination among government entities made it possible to achieve positive outcomes and valuable experience with which to face the difficulties created by the lack of dynamism in job creation.

The funding for direct and indirect employment programmes implemented since 2001 came from budget allocations by the Ministry of Finance for the Contingency Fund Against Unemployment. Through this mechanism fiscal resources were channelled to fund plans, programmes, and public investment to create jobs. The fund was put into operation when unemployment reached 10% or when the national rate equalled 9% and it was expected to rise beyond such level in the course of the three following months. However, the Fund was not defined as a permanent source of financing and could only operate under the specified conditions.

Notwithstanding the above, already in 2005 the first changes in policy criteria for such matters were observed in terms of strengthening development of programmes of this kind, supported by permanent funding. The importance of the Contingency Fund diminished as a source of funding: while in 2001 72.8% of total funding came from the Fund, in 2005 this proportion had shrunk to barely 30.2%, simultaneously with the rising weight of programmes with funding under the Budget Law. Creation of the Contingency Programme Against Unemployment thus consolidated the learning gained in previous years, in terms of having a permanent funding mechanism with which to face times of high unemployment together with implementing employment plans in specific geographic areas where unemployment is high.

3. Programme description

The aim is to finance labour-intensive initiatives or programmes, boost job creation and, in general, all measures designed to lessen the effects of unemployment at national, regional, or local level. It is activated when the following conditions are present:

- The national quarterly unemployment rate exceeds the average of the five previous years, or when the national quarterly unemployment rate is equal to or higher than 10% of the labour force

- When in one or more regions or particular provinces the unemployment rate is equal to or greater than 10%, applicable to the municipalities in the region or province showing the highest rates. It also applies when the unemployment rate in a municipality is equal to or higher than such percentage, although the rate for the region or province is lower.

Programme resources are applied pursuant to Rules issued by the Ministry of Finance and countersigned by the Minister for Labour and Social Security. Statistics must also be published on regular basis covering beneficiaries of the programmes conducted by the Ministry for Labour and Social Security, and other employment initiatives financed with direct fiscal contributions.

The legal framework provides that the Budget Law, which applies in the year following its approval, shall include the item for the Programme described, which is set up by means of an allocation for opening a budget entry; henceforth, allocations are made on the basis of actual spending, charged to general revenue. The Ministry of Finance, through the Budget Department, provides the Finance Commissions in the Senate and the Chamber of Deputies, and the Special Budget Commission, with monthly detailed information on the resource supplements received by the Programme, in addition to outlays and transfers made by the Programme.

Finally, the Ministry for Labour and Social Security, through the Office of the Under Secretary for Labour, coordinates direct employment programmes with fiscal support. For this purpose there is a Follow-up Committee, composed of the Under Secretary for Labour, who chairs the persons in charge of national programmes conducted by public agencies, and a representative of the Budget Department. This Committee provides management guidelines to ensure programme efficacy, and applies for transfers of funds from the Ministry of Finance.

4. Application and outcomes

Evolution of beneficiary coverage under the employment programme financed by the Contingency Programme Against Unemployment, direct and indirect, is illustrated in the following chart. Also shown is evolution of the unemployment rate (calculated on the basis of quarterly moving averages), from 2000 on. As stated above, the Programme began operating in 2006; previously, a Contingency Fund was in operation and provided resources for the same aims and was managed with similar criteria.

The information presented shows that since 2001 the number of beneficiaries evolved complementing the rate of unemployment, whether in the context of annual evolution, which is affected by seasonality factors, or of inter-annual variations. In the former case, it explains rising unemployment in the intermediate or winter months, when demand for work slows down, and dropping unemployment rate when the summer months begin, especially linked to activities like agriculture.

Regarding the inter-annual trajectory, it can be seen that in 2005, once the unemployment rate began to give way before the recovered dynamism of job creation, programme coverage also fell, consistent with its counter-cyclical nature. Nevertheless, composition changes with the cycle, for once economic recovery stabilizes, the weight of indirect employment programmes increases.

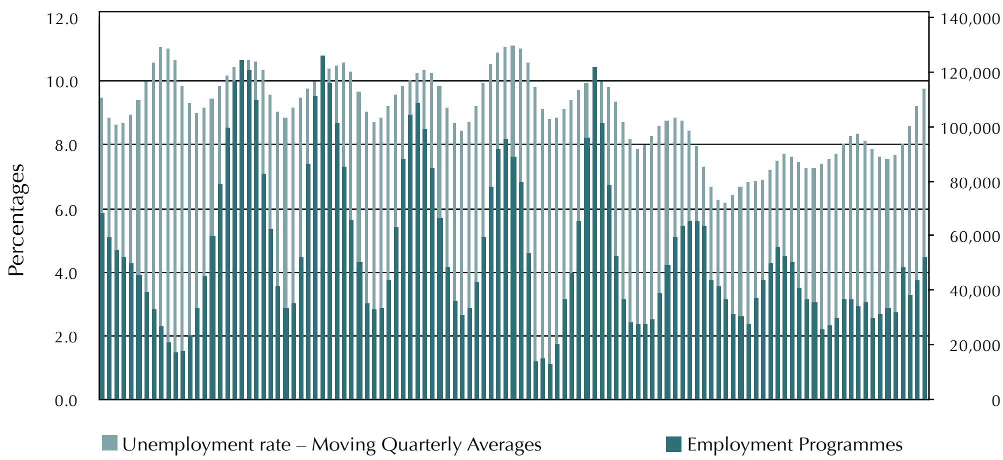
The information presented only shows the evolution of national unemployment, which, though significant for activating the Contingency Programme Against Unemployment, fails to account for changes in regions, provinces or municipalities. For this reason, it is only possible to visualize Programme activation when the national quarterly unemployment rate exceeds the average for the five previous years, or when the national quarterly unemployment rate is equal to or greater than 10% of the labour force.

Hence, and according to the information examined, the following conditions took place in February to June 2009. In February and March, the condition met was exceeding the unemployment average for the last five years, when the unemployment rates recorded were 9.2% and 9.8% respectively.

Graph 1

Employment programmes and unemployment rate, 2000-2009

(in numbers of persons and percentage of the labour force)



Source: *Dirección de Presupuestos del Ministerio de Hacienda and Instituto Nacional de Estadísticas*

Conversely, in April, May, and July, the Programme was activated because both conditions were met simultaneously, as the unemployment rates exceeded 10% of the labour force.

Finally, it should be borne in mind that the Contingency Programme Against Unemployment has operated under a series of counter-cyclical measures designed to face the effects of the financial crisis, with a significant fiscal package for the purpose, in the order of US$ 4,000 MM, which includes public investment in infrastructure, stimuli for investment, and direct transfers to the poorest households. A mechanism of Unemployment Insurance for countercyclical adjustment was also put in motion, allowing the duration of benefits to be extended when unemployment increased above its trend. Such measures, supplemented by new policies for labour-hiring subsidies, such as the recent National Agreement for Employment and Training (*Acuerdo Nacional por el Empleo y la Capacitación)* have begun to show positive effects, as the unemployment rate recently showed a change in its upward trend.

Creation and extension of the Contingency Programme Against Unemployment has thus allowed linking the employment policy to the fiscal policy and so formalizing the decision to implement counter-cyclical employment policies, with known activation rules, ample coverage, and permanent sources of funding.