

Wage rigidity in Chile

Andrés Marinakis

One issue in the debate about the workings of the labour market is its degree of flexibility. In the case of Chile, the Asian crisis of late 1997 led to a large increase in the unemployment rate, while the hourly wage index produced by the National Institute of Statistics rose steadily in real terms. This gave rise to the idea that wage rigidity might exist. The present article seeks to qualify this conclusion by detailing the limitations of the index when it comes to recording more volatile items of remuneration, and shows that the average monthly wage rose only by small amounts, while the minimum wage appears to have followed a different path from market wages. Lastly, this article discusses the advisability of setting a special minimum wage for the young and introducing a variable component into pay, two proposals that are often made in the interests of greater wage flexibility.

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I

Introduction

After more than a decade of high and sustained growth, Chile was caught unaware by the Asian crisis in late 1997. One of its first effects was to increase the unemployment rate from 6% or so in 1997 to 9.8% in 1999. Once growth resumed, net job creation was rather small and unemployment was slow to fall.

A number of analysts put this situation down to wage rigidity in Chile, arguing that this caused the burden of adjustment to fall on employment rather than being spread among all wage earners in the form of lower pay.¹ This outcome is quite surprising in an economy that has less heavily regulated labour relations than the other countries in the region. The wage rigidity theory, which is based on very aggregate data, has been widely accepted in some academic circles and by the press generally.

According to data produced by the National Institute of Statistics (INE), real hourly wage growth fell but still averaged around 2.5% in 1998 and 1999,

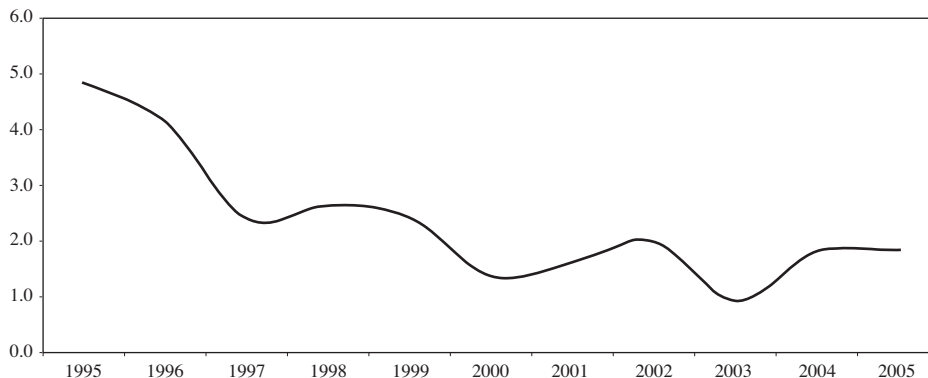
which is quite a high figure for the economic conditions of the time. Between 2000 and 2004, real hourly wages rose by between 1% and 2%, with an average of 1.5% (figure 1). Although these figures reveal a decline in growth rates in general, it could be argued that these rates were still high given the situation of economic recession and recovery in those years.

Another indicator used to buttress the wage rigidity argument is the evolution of the minimum wage. At the time of the Asian crisis, a system of three-yearly adjustment was in place, having been established when the economy was growing at 7% and there was no expectation of any crisis. The minimum wage increases in those years were very substantial in real terms, especially considering that the economy was stagnant.

Thus, the idea that wages in Chile are downwardly rigid comes mainly from these two items of information, i.e., developments in real hourly wage rates and the

FIGURE 1

Chile: Real hourly wage, 1995-2005
(Annual variations)



Source: Prepared by the International Labour Office (ILO) with data from the National Institute of Statistics (INE) remuneration survey.

□ The opinions expressed here are the author's and do not necessarily represent those of the organization to which he belongs. The author is grateful for the assistance of Jacobo Velasco in preparing the data

presented in this article, and for the comments of an anonymous referee.

¹ See Cowan and Micco (2005) and Céspedes and Tokman (2005).

real minimum wage. On the basis of this conclusion, three different policy proposals have arisen. Some economists suggest lowering the minimum wage. Others argue for the introduction of a special minimum wage for young people aged between 18 and 24, which would be lower than the general minimum wage. Lastly, others again suggest the introduction of a variable pay component based on performance or profit-sharing (Bravo, Larrañaga and Ramos, 2003).

The debate is by no means confined to these options, however. In fact, there seems to be a need to

look more closely at the existing indicators in order to obtain a fuller picture of the situation.

Although the information on which the studies are based is accurate and these proposals may seem reasonable to some degree, a more detailed reading of the wage statistics methodology used and of the workings of the labour market reveals that wages in Chile are not as rigid as they are claimed to be and that some of the measures proposed are not in fact very suitable. The purpose of the present article is to justify this alternative view.

II

What does the National Institute of Statistics remuneration index measure?

The INE survey² encompasses all economic activities except agriculture, hunting, fishing and forestry, and is based on a sample of formal-sector establishments employing 10 or more workers.³ In other words, it covers about 40% of all those in work. From this segment it is also necessary to deduct a number of workers whose pay is not recorded. The survey does not include employees of external contractors, even if they are working for a company included in the survey.

The first thing to be said here is that the survey only records those who have a strict relationship of employment with the businesses surveyed. Furthermore, it only includes those who have a contract with the company and have worked for at least 20 hours during the week, and excludes those working for companies for a fixed period (to carry out specific projects, for example). Of all workers, then, the remuneration

survey only covers the segment with the most stable employment, and thus with the least volatile pay.

The remuneration index covers compensation in money and kind received by workers under their employment contracts. It excludes components which behave variably over time or fluctuate greatly over the course of the year. These are:

- Overtime payments.
- Non-monthly bonuses and profit-sharing payments. Monthly bonuses and supplementary payments might include a qualifications allowance, payments for years of service, and isolated working or responsibility bonuses, all of them paid monthly.
- Additional payments for holidays and gratuities (INE, 1994).

In other words, the survey does not include bonus or incentive payments for production, productivity, attendance and/or punctuality unless they are paid regularly every month. The second point to be made, then, is that large variations are hardly to be expected in an index that only incorporates the most stable components of pay. In analysing the remuneration index data, therefore, it has to be remembered that this only records developments in the most regular components and not in total worker remuneration.

According to the 2002 labour survey (ENCLA), an average of 25% of total remuneration is variable. The percentage ranges from 14.5% in small enterprises

² INE (1993). This series has been available monthly since 1993, has national coverage, and presents information by occupational category and branch of activity. Its frequency makes it useful for analysing wage variability, by contrast with the National Socio-Economic Survey (CASEN), which was conducted every two years in the 1990s and has been triennial since 2000. Statistics generated from records like those of the Chilean Safety Association (Asociación Chilena de Seguridad) require some work to produce a sample of companies that is stable over time and to remove seasonal factors, as they were designed for specific purposes.

³ In the case of construction, it only covers firms employing 50 or more.

to 25.6% in medium-sized ones and 27.2% in large companies (Dirección del Trabajo, 2003). Furthermore, 60% of medium-sized and large enterprises apply productivity incentive and bonus systems, so that a sizeable (and variable) percentage of total remuneration is not being included in the INE wage data.

A third point is that the remuneration data are averages for occupational groups in each establishment and not measurements for individual workers (INE, 1994). Consequently, not only does the remuneration of the individuals covered vary substantially, but so do the number and composition of workers. For example, a company that kept its wages constant would show a rise in its remuneration index if it cut back the number of lower-paid employees working there.

If companies had dismissed mainly low-paid workers during the crisis years, this could have caused the remuneration index to rise in real terms, reflecting the composition of employment rather than wage developments.

In summary, the remuneration index deals with the most stable segment of formal-sector workers in companies with more than 10 employees and does not include the more variable components of pay. For methodological reasons, too, the changes in remuneration recorded can be affected when there is a disproportionate reduction in the number of lower-paid employees (the remuneration index rises) or in the number of higher-paid employees (the remuneration index falls). All these factors need to be taken into account when wage developments in Chile are assessed.

III

How are wage increases determined?

There are major differences in the way employee remuneration is determined. One group of workers negotiate pay conditions through their unions or other representative bodies, leading to the signing of collective agreements or contracts. The terms agreed upon in collective instruments of this kind are binding as long as they remain in force.

Most collective instruments make two references to the calculation of wage increases. First, they establish an initial increase to be applied when the instrument comes into force. In the case of collective instruments signed during 2005 which included a clause of this type, the weighted average of this initial increase was 0.68%. Only 63% of workers covered by collective instruments benefited from this initial real adjustment clause.⁴

Second, there has been a decline in the initial real-term increases established. As figure 2 shows, whereas the initial real-term increase averaged 1.43% in 1996 and 1997, before the crisis, the figure had dropped to 0.55% by 1999 and has since remained in the 0.6% to 0.7% range.

Again, most collective instruments include clauses providing for future increases tied to changes in the

consumer price index (CPI). It is usually stipulated that adjustment will take place every 6 to 8 months (in 2005, the average was 6.7 months) and inflation is compensated for in full (in 2005, the average adjustment was 100% of the CPI). The future real-term adjustment clause was found in 70% of collective instruments.⁵

It is clauses like this which give rise to the belief that wages in Chile are downwardly rigid and that a kind of index-linking operates. Although the results of collective bargaining are to some extent taken as a reference price in setting wage levels, their value is purely indicative for the universe of workers not covered by collective instruments. It is well known that the coverage of collective instruments in Chile is very limited, so this mechanism would not be expected to be the predominant one. In recent years, furthermore, there has been a downward trend in the number of workers included in collective instruments of any kind.

To give an idea, 4,046 instruments were recorded as being in force in 2005, covering 343,420 workers.⁶

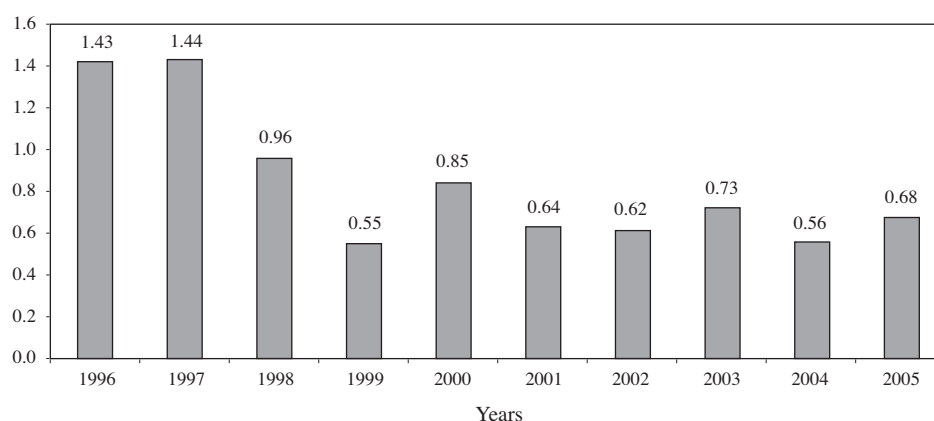
⁴ Labour Office, Labour Relations Department, Ministry of Labour and Social Security.

⁵ Labour Office, Labour Relations Department, Ministry of Labour and Social Security.

⁶ These figures were obtained by adding together the numbers for collective instruments concluded in 2004 and 2005, since they last at least two years (Dirección Nacional del Trabajo, 2005).

FIGURE 2

Chile: Initial real-term increases. Basic pay in collective bargaining, 1996-2005
(Percentages)



Source: Labour Office, Labour Relations Department, Ministry of Labour and Social Security.

In other words, just 10.6% of private-sector workers are covered by clauses of this type. Furthermore, this rate is significantly lower than it was in 1997, when collective bargaining covered 14.4% of private-sector workers. Thus, even if all collective instruments included index-linking clauses of this type, it does not seem reasonable to think that this would lead to rigidity in the wage structure of the private sector as a whole.

The remaining workers, meanwhile, do not have any such explicit coverage. For them, the pay increases established in collective instruments are only a reference price that may be taken into account when their wages are set, but is not binding on the parties. For this segment, the only legally binding limit is the minimum wage.

An important question is whether it is real wages or nominal wages that are set by employers in the segment without collective coverage. In most cases, each company sets the nominal wages of its workers. To determine them, employers go by market wages (taking into account the information in collective agreements), recent inflation and forecasts for the conditions in which each company will have to operate. In addition to considerations of inflation and company projections, however, things like improved qualifications, individual performance and years of service are also taken into account when wages are set. In these cases, the real wage is known only at the end of the period analysed, and this information is important for measuring the change in purchasing power.

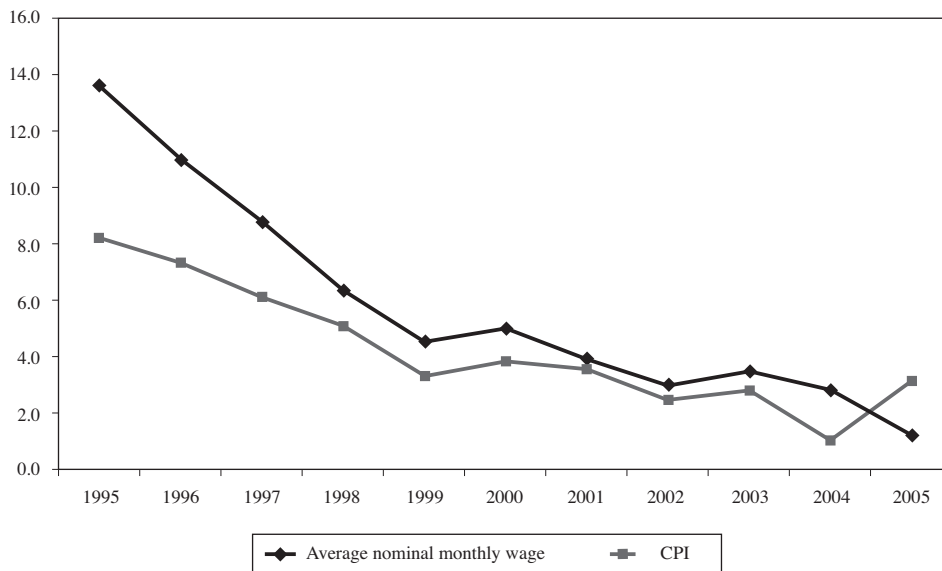
Average growth in nominal wages, whether hourly or monthly, began to fall steadily from 1995 onward, from 13.6% that year to 1.2% in 2005. This downward trend in the average wage increases granted by companies was not noticed until 2004 because the CPI rose by even less, resulting in positive real wage growth (figure 3). In 2004, the CPI varied by a mere 1%, while in 2005 the figure was 3.2%

When setting wages, companies consider the level of inflation in the period immediately beforehand. Although there was an expectation of lower inflation in the second half of the 1990s, since this was a fundamental objective of Central Bank monetary policy, the reduction might not have been expected to be as fast and effective as it ultimately proved to be. Furthermore, the recession resulting from the Asian crisis undoubtedly caused inflation to fall by more than anticipated.

The clearest example of this can be found in 2004. The average wage increase recorded that year was 2.9%. Since inflation in the period was an unusually low (1.1%), the average hourly wage rose by 1.8% in real terms. Conversely, if inflation had been close to the levels of recent years and the Central Bank target (2.1%), as might have been expected, wages would hardly have changed at all in real terms. If we also consider that wage increases ought to reflect increases in qualifications, productivity and years of service, it becomes even clearer that wage rises were very moderate in the period.

FIGURE 3

Chile: Average nominal monthly wage and the consumer price index, 1995-2005
(Annual variations)



Source: Prepared by the International Labour Office (ILO) with data from the National Institute of Statistics (INE) remuneration survey.

For the coming years, it is important to bear in mind that, by contrast with the situation in the 1990s, the inflation rate in Chile can be deemed to have stabilized at a rate of 2.5% or 3%, and it is not reasonable to expect real wages to be boosted by falling inflation. Thus, nominal wage rises at these same levels will be doing no more than compensate for inflation.

Again, the lower the level of inflation in a country, the less reliance can be placed on “inflation flexibility” as a source of wage adjustment. This being so, the success of the price stability policy operated by the Central Bank of Chile has reduced companies’ room for manoeuvre and made it necessary to seek other sources of flexibility.

IV

The silent wage adjustment

Besides the trend towards lower wage rises discussed above, there has been a low-key wage adjustment process which has gone largely unremarked upon by analysts, and which concerns the differing trends of the monthly and hourly remuneration indexes. While hourly wages are an important indicator for analysing labour productivity, monthly wages are a better indicator of workers’ consumption capacity. For example, given constant wages, if the amount of time worked were

to fall then the hourly wage would increase, while the purchasing power of that wage (best reflected by the monthly wage) would remain unchanged. Figure 4 shows the trend followed by the two series, revealing that the average real monthly wage has consistently grown more slowly than the real hourly wage.

The first significant difference is seen in 1998 and 1999, when the effects of the Asian crisis were being felt most strongly. In addition to the job cuts made by

companies, which were reflected in the unemployment rate, the wage series show a difference that derives from a reduction in hours worked (another form of adjustment). Undoubtedly, this reduction in hours was largely confined to overtime. Although the remuneration index does not include overtime pay, it does record the number of hours worked. Thus, while real hourly wages apparently continued to grow by 2.5%, workers' real monthly take-home pay was actually rising far more slowly, by 1.3%, without considering the loss of additional pay because of overtime cutbacks.

There was also a large difference between hourly and monthly wage developments in 2001 and 2002. Whereas the hourly wage grew by 1.8%, the monthly wage rose by a mere 0.4%. In this second period, the divergence between the two series might have been partly due to the progressive reduction of the working week from 48 to 45 hours, as provided by the Labour Reform. The most significant difference, however, arose in 2005, when the new 45-hour working week came fully into force. According to the remuneration survey, the number of hours worked fell by 3.7% in 2005, indicating that most firms left it to the last moment to make the working time adjustment. This is borne out by the INE household survey data (table 1).

In 2005, the lowest increase in nominal monthly wages since the series began in 1993 (just 1.2%) was combined with a large reduction in hours worked, while inflation picked up (from 1% in 2004 to 3.2% in 2005). Thus, while the real hourly wage rose by 1.9%, the real monthly wage fell by the same amount. Going by this indicator, then, in 2005 workers saw the first drop in their real purchasing power since the return to

TABLE 1

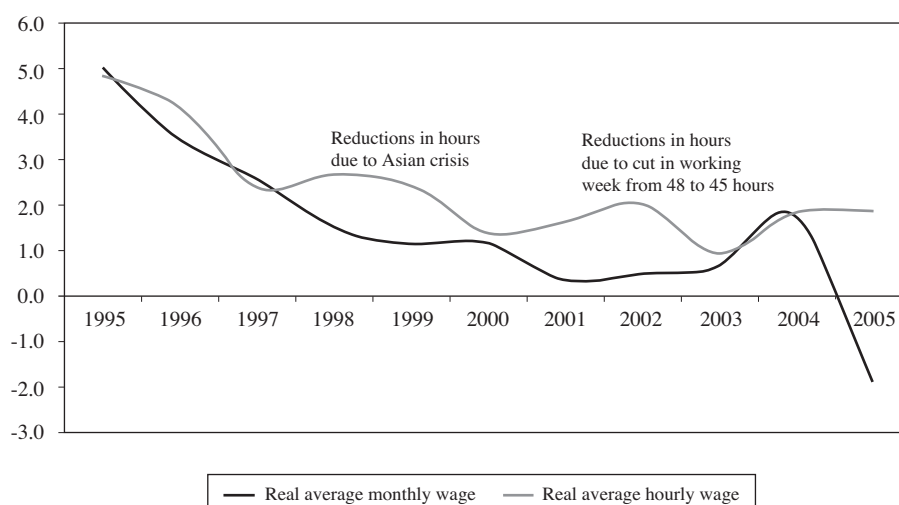
Chile: Variation in hours worked, 2000-2005

	Remuneration survey (workplaces)	Employment survey (households)
2000	-0.2	-0.6
2001	-1.2	-0.9
2002	-1.5	0.4
2003	-0.3	-0.7
2004	0.0	-0.1
2005	-3.7	-3.7

Source: Prepared by the International Labour Office (ILO) with data from the National Institute of Statistics (INE) remuneration survey and employment survey.

FIGURE 4

Chile: Average hourly and monthly wages, 1995-2005
(Annual variations)



Source: Prepared by the International Labour Office (ILO) with data from the National Institute of Statistics (INE) remuneration survey.

democracy. In a way, the cost of shortening the working day was transferred to workers.

Besides what happened in 2005, it is clear that the real wages received by workers (and paid by employers) have not risen by as much as it appears when the average hourly wage series is considered in isolation. Since the growth of workers' purchasing power is

linked to the growth of their real take-home wages, it is clear that low monthly wage increases account for the slowness of the recovery in domestic demand, with all the constraints this implies for economic growth. It can also be held partly responsible for the weakness of economic growth in 2006, when international conditions were ideal.

V

A jarring note: the real minimum wage

Until 1997, the minimum wage tracked average wages in the economy very closely. From 1998 onward, however, these two wage categories followed sharply divergent paths. This gap was the result of the three-yearly adjustment system established in March 1998. While the expected inflation rate on which it was based followed the forecast trend, productivity gains proved far more modest than anticipated (figure 5).

Without a doubt, the emphasis on raising the minimum wage led to a greater concentration of wage earners at levels close to the minimum. Whereas in 1998 some 28% of non-agricultural private-sector workers earned up to 1.5 times the minimum wage, by 2000 this proportion had risen to 35%.⁷ In some sectors, such as construction, average wages for unskilled workers were barely more than the minimum wage (in 2003, the minimum wage represented 94% of the average wage for unskilled workers in this industry).

A remarkable amount of emphasis has been placed on minimum wage policy. Although it is very positive that increases in the minimum wage have been sustained over time, starting from a very low base, it has to be asked whether this is the best policy for the goal being pursued, or for optimum labour market performance.

Regarding the first question, the main objective of the minimum wage is to protect the lowest-paid workers, especially those who are not represented in

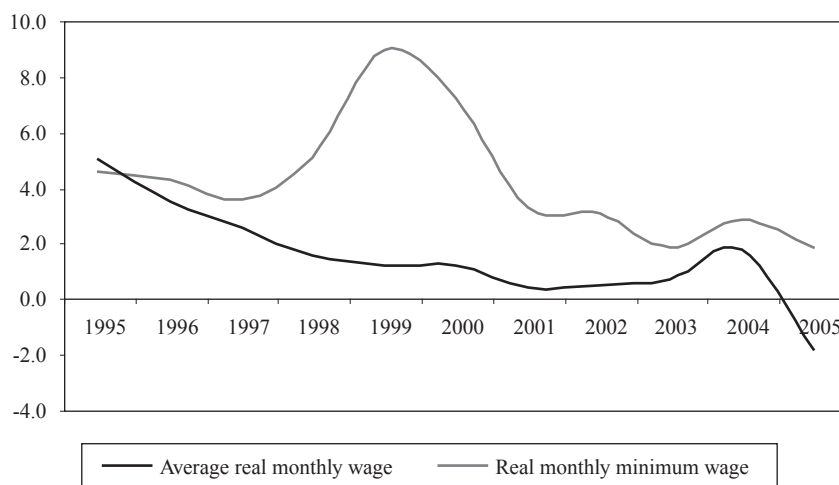
any way or covered by a collective instrument. Since the early 1990s, when it was increased substantially in relation to market wages, the minimum wage has fulfilled this purpose. While it remains low compared to workers' needs, there can be no doubt that their purchasing power has increased substantially. Again, successive increases were on the whole very well absorbed by companies until 1997. In the 1998-2000 period, on the other hand, companies were unable to pass on the percentage increase in the minimum wage up the whole of their wage scale, as had happened in earlier years, and the result was a greater concentration of workers at levels close to the minimum wage. In that period, many companies, especially smaller ones and those operating in particular sectors, had difficulty paying the minimum wage. To this extent, it seems to have adversely affected the working of the labour market.

There have also been questions about the effect of the minimum wage in reducing poverty and improving income distribution. Although it has been important in both cases, especially the former, it is not reasonable to think that it is the only wage policy instrument that might serve to improve both aspects. Again, while both poverty and income inequality are addressed through social policies, wage policy ought to be an important element, particularly when it comes to reducing inequality. Clearly, though, a wage policy whose only instrument is the minimum wage is going to be too weak to attain this goal. It is therefore essential to strengthen collective bargaining arrangements in which the minimum wage is only the base of a system capable of reconciling the different situations found in the various sectors of activity and in different companies.

⁷ According to the author's own calculations from the 1998 and 2000 CASEN surveys.

FIGURE 5

Chile: Average real monthly wage and real minimum wage, 1995-2005
(Annual variations)



Source: Prepared by the International Labour Office (ILO) with data from the National Institute of Statistics (INE) remuneration survey.

VI

Should there be a special minimum wage for the young?

Since the youth unemployment rate is double the average, one of the most frequently voiced proposals for improving wage flexibility has been to establish a special minimum wage for young workers.⁸ The reasoning here is that the minimum wage acts as an entry-level wage for young people starting work and that its current level is an obstacle for them since, for a given wage level, companies prefer people with work experience, believing it to be indicative of higher productivity. Thus, if young people had an entry wage lower than the general minimum wage, there would be an incentive to hire them that would correct the imbalance currently existing in the labour market. At present, there is a differentiated minimum wage for

young people under 18, equivalent to 75% of the adult minimum wage.

To determine whether this theory holds good, what is needed is a more detailed analysis of how the youth labour force is distributed in comparison with the adult labour force. If we find that young people are underrepresented in formal private-sector companies, this will confirm that there is some obstacle to their recruitment. We shall not take under-18s into account here, since they already have a minimum wage lower than the general one and they are few in number; besides, it seems better to encourage them to remain in the education system until they have completed their formal studies than to ease them into the labour market early with few qualifications.

Accordingly, what we shall do here is compare the employment situation of the young economically active population (EAP), i.e., those aged between 19 and 24, with the employment situation of the

⁸ See, for example, Instituto Libertad y Desarrollo (2005).

EAP aged 25 and over. Right away, we see that in 2003 the percentage of young people working in the private sector was larger than the percentage of adults (53% and 48%, respectively). We also observe large differences in the percentages of workers employed in the informal sector (11% of young people and 22% of adults) and in the public sector (4% of young people and 10% of adults), while percentage participation in the agricultural sector is very similar for young people and adults (figure 6).

It might be expected, however, that young people in formal jobs would more frequently be employed under insecure conditions, to avoid paying the minimum wage. This is the case to some extent in private-sector companies, domestic service and the public sector, where a smaller percentage of young people than of adults are employed under contract (figure 7).

To summarize, the problem seems to lie not so much in the private sector as in the inability of young people to establish themselves as self-employed (7% of the youth EAP and 18% of the adult EAP) and the difficulty they have in entering the public sector, where employment contracts seem to be given for preference to people who have more training and experience, and are thus older. Lowering the minimum wage would clearly not solve these problems, nor does

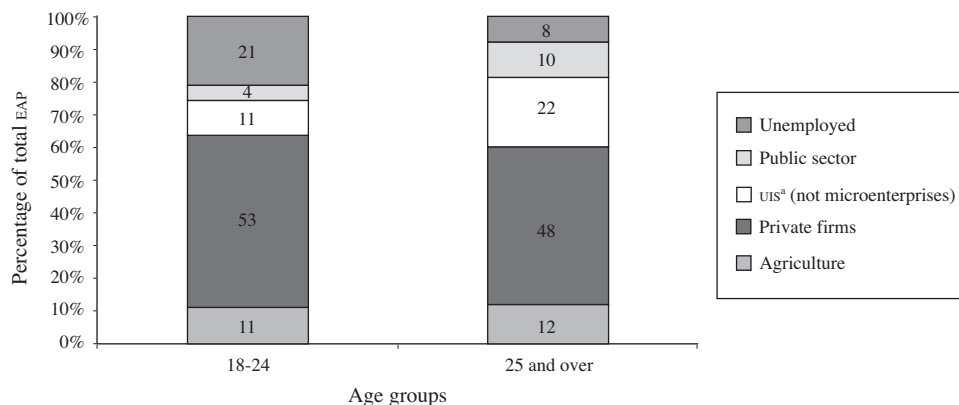
it seem reasonable to think that all young people should be wage earners in the private sector. Accordingly, creating a minimum wage for young people does not seem the most appropriate policy.

In addition, we need to ask whether it is advisable to encourage young people to take up poorly paid jobs at an early age by establishing a low minimum wage, or whether it is better to encourage them to stay in the education system. The demands of globalization would seem to indicate that this second strategy is the more appropriate one, as it would yield a workforce that is more highly educated, and with greater development potential. The recent extension of compulsory education certainly comes down on the side of this second option.

The data categorically bear out the difficulty young people have in entering the labour market. What our analysis of the distribution of the youth EAP suggests to us, however, is that it is not “price” but other factors that play the preponderant role in this. These factors include the lack of relevance of formal education curricula to the world of work, the low value set by society on technical skills, a lack of experience and resources for starting up small-scale enterprises, and the slow growth of public-sector employment, for which ever greater qualifications are being required.

FIGURE 6

Chile: Distribution of the youth and adult economically active population (EAP), 2003
(Percentages)

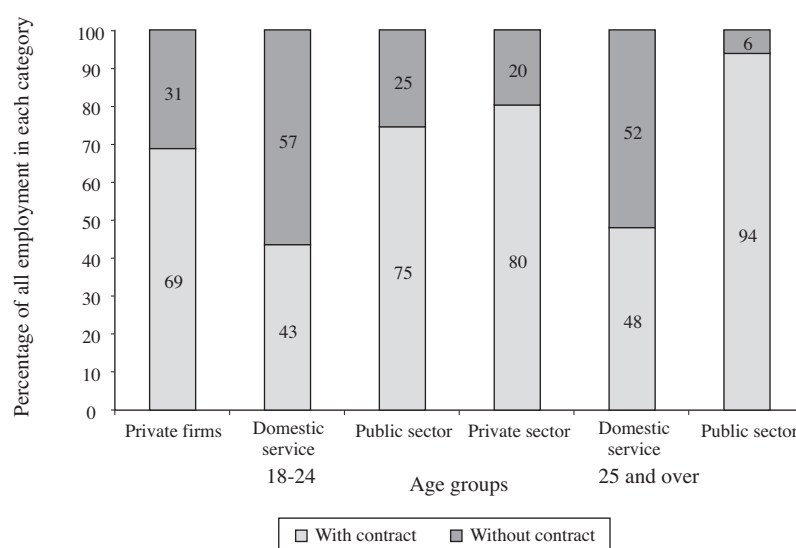


Source: Prepared by the International Labour Office (ILO) with data from the 2003 CASEN survey.

^a Urban informal sector.

FIGURE 7

Chile: Distribution of employment by contractual status, youths and adults, 2003
(Percentages)



Source: Prepared by the International Labour Office (ILO) with data from the 2003 CASEN survey.

VII

Worker profit-sharing: a variable component of remunerations?

We said earlier that the INE remuneration index did not take account of bonuses and profit-sharing payments that were not disbursed monthly or of overtime payments (variable components of remuneration), so that we did not know the size of these components in the universe covered by the survey. We do know, however, that under the provisions of the Labour Code,⁹ companies required to keep accounts are obliged to give their workers a share of their profits.¹⁰

According to the specialist literature, such components of total worker remuneration are a basic element of flexibility. While significant amounts are distributed on this basis at times when profits are high, in periods of crisis these components are automatically adjusted in companies as profits decline (or disappear) and so, accordingly, are the workers' share of them (Weitzman, 1984). If Chile has an instrument of this type, why do we not see a cushioning effect on employment in periods of recession like the one that recently ended?

Part of the answer is to be found in the specifications of the Chilean profit-sharing model. Although the percentage to be distributed is set at 30% (article 47), the Labour Code establishes an alternative that releases companies from this obligation: that of paying workers a proportion of their annual wage (25%), with a ceiling

⁹ Chile, Código del Trabajo, Capítulo V: de las remuneraciones, artículos 47 to 52.

¹⁰ Net profit is calculated by deducting 10% from the amount declared for corporation tax (without deducting losses from previous years) as return on the employer's equity.

TABLE 2

Employment: Company with 100 workers earning more than 1.6 times the minimum wage a month^{a b}

Company profits (millions of pesos) Articles of the Labour Code		Profits to be distributed to workers (millions of pesos)	Worker share of profits (percentages)
5.8	Art. 47	1.7	30.0
58	Art. 47	17.3	30.0
580	Art. 50	60.5	10.4
5 800	Art. 50	60.5	1.0

^a Equivalent to 204,000 pesos a month given the minimum wage in force since 1 July 2005 (127,500 pesos).

^b Maximum share per worker: 605,625 pesos (4.75 x 127,500 pesos).

per worker of 4.75 times the minimum wage (article 50). The combination of these two limiting factors means that any worker earning more than 1.6 times the minimum wage¹¹ (204,000 pesos as of July 2005) receives less than 25% of his or her annual wage.

This alternative allows companies making large profits to limit what they distribute by way of profit-sharing, with a ceiling that is also quite low. Thus, the higher a company's profits, the lower the percentage that will be distributed on a profit-sharing basis.

According to the minimum wage values in force since 1 July 2005, the maximum profit share per worker is 605,625 pesos (4.75 x 127,500 pesos). This amount applies to all workers earning more than 1.6 times the minimum wage (or 204,000 pesos a month given the same minimum wage). Workers who earn exactly the minimum wage each month will receive a maximum share of three times the minimum wage, since a ceiling of 25% of the annual wage is applied (i.e., 382,500 pesos).

To better illustrate how the profit-sharing system works, we shall take as an example a company with 100 workers whose wages exceed 1.6 times the minimum wage each month (i.e., 204,000 pesos). Table 2 presents hypothetical profits ranging from 5.8 million pesos (equivalent to US\$ 10,000) to 5.8 billion pesos (equivalent to US\$ 10 million).¹² The third column

of the table shows that when the company's profits are 5.8 million pesos or 58 million pesos, it has to distribute 30% of these profits among its workforce, since the amounts to be distributed are less than 25% of annual remuneration and than 4.75 times the minimum wage. If the company has profits of 580 million pesos, however, it will suit it to apply article 50, under which it can pay its workers 25% of their annual wages with a ceiling of 4.75 times the minimum wage. Thus, instead of having to distribute 174 million pesos among its workers (30% of profits), it will have to distribute 60.5 million (100 x 4.75 x 127,500), i.e., 10.4% of its profits. If its profits were 5.8 billion pesos, it would have to distribute a mere 1% of this amount.

According to the 2004 ENCLA, 12% of the companies surveyed distributed 30% of profits, 75% paid bonuses in accordance with article 50, 8% paid some other type of bonus exceeding the legal requirement under the terms of a collective agreement, and the rest paid no bonus. Payment of bonuses under the 30% of profits rule or some negotiated formula becomes more common as company size increases. Whereas only 10% of microenterprises and small businesses pay out 30% of profits, the proportion of large companies doing so is 18%.

Companies have to choose between the two alternatives each year. In the opinion of a consultant who advises companies, "the article 50 formula has its advantages from the financial point of view, as it allows the annual budget to be planned and there are no surprises" (Peñaloza, 2005).

Another very useful way of reaching a better understanding of how this instrument is actually applied in practice is to analyse the periodicity with

¹¹ This threshold of 1.6 times the minimum wage (*MW*) is arrived at by resolving the equation $(12 \cdot X) \cdot 25\% = 4.75 \text{ MW}$, where X is the monthly wage.

¹² In the interests of simplification, the 10% for the return on the employer's equity has not been deducted from the profit figures.

which payments are made on this basis. According to the 2004 ENCLA, in cases where 30% of profits are paid out the most common frequency is once a year (78% of cases). Among companies that opt to pay 25% of annual remuneration, on the other hand, the usual periodicity is monthly (84% of cases). In the latter case, this portion of earnings merges into basic pay because of the regularity with which it is paid each month and the uniformity of the amounts, so that it is captured by the INE remuneration survey.

From everything analysed here, three conclusions can be drawn. First, the limits established by the law favour companies with higher profits. Second, it is clear that the larger a company's profits, the less important the variable component is as a cushion in times of recession. Lastly, most companies opt in practice to apply article 50, giving rise to payment of a fixed sum that in most cases is distributed monthly, supplementing basic pay.

VIII

Variable wages in some sectors

While it is true that making a portion of worker remuneration variable really does offer an alternative to adjusting employment in a situation of crisis, it is important for this variable component to possess certain characteristics. For example, the variable part must not be a very large proportion of total pay. Otherwise, the effect would be to safeguard the interests of the company at the cost of passing on all the risk to workers, who might see their total income reduced to levels insufficient to meet their basic needs.

This very situation has been complained of on some occasions, as there are companies in the commerce sector that calculate all remuneration on the basis of sales made. While it is common in commerce for a portion of remuneration to be based on sales, it is also usual for workers to have a basic salary paid each month by way of compensation for the time worked, their experience and their training for the job, among other factors.

Another basic condition for variable components is that they must be designed with a view to optimizing the way work is performed in every respect. An incentive system is badly designed if it results in higher productivity but at the cost of product quality, something that is also applicable to services. For example, in the system of

All this indicates that while company profit-sharing is typically categorized as a variable instrument, it has actually become just another component of fixed remuneration. What is being lost by this is the possibility of having a cushioning element in place in the event of a recession that affects company profits. It would be worth conducting an in-depth examination to determine whether the profit-sharing system as currently applied is the most suitable instrument at the present time. Although it is during periods of recession that calls for wage flexibility are heard, it is only if substantial sums are distributed during growth periods that a margin of adjustment will be available. It is not reasonable to expect that already low wages can be cut significantly in the event of a crisis. This margin should be generated during periods of growth like the one Chile is currently experiencing.

remuneration used by bus operators in the Chilean capital pending implementation of the new public transport plan, Transantiago, the more tickets drivers sell the more they are paid, with the result that they are more interested in picking up passengers than in obeying traffic rules or operating the service as the timetable requires. In this case, a monetary incentive has resulted in lower service quality and greater risk on the roads.

Lastly, there are a number of occupations where the link between the company and the worker is limited to the performance of a specific piece of work for a certain period of time, as happens in construction. The volatility of remuneration in this sector arises not while contracts are in force but every time a job is completed and the worker is hired again for a new one. This means that the worker is forced to carry out pay negotiations very frequently, sometimes more than once a year. Given that the construction sector is characterized by low pay, those working there are poorly placed when they come to look for a new job because in most cases they lack the savings to cope with periods of unemployment and have not paid social security contributions in sufficient quantities or for long enough to benefit from unemployment insurance.

According to the INE remuneration index for the construction sector, in 2004 the real hourly wage in this sector was three percentage points lower than in 1997 and had remained unchanged for over three years, despite the strong upturn in activity. Real monthly wages in construction, meanwhile, have fallen steadily since 1997, so that by 2004 they were 20% lower than in that year.

IX

Conclusions

Contrary to the perception of those who believe wages in Chile are rigid, a more detailed analysis indicates that they did adjust in various ways during the crisis period. First, in the case of wages determined by collective instruments, initial increases were reduced in real terms. Second, the number of hours worked was adjusted, resulting in monthly wages that were broadly stable. Lastly, real wage increases were possible, but mainly because inflation fell to levels even lower than expected. The minimum wage moved against this trend, continuing to rise strongly despite the crisis.

One striking thing in the particular case of the minimum wage is that throughout the period when adjustments were being implemented every three years, employers' organizations did not speak out about the discrepancy between the resulting increases and developments in the economy. Two factors must certainly be at work here. First, we know that the minimum wage is the actual wage for many people employed by smaller companies. It is possible that employers in the upper reaches of business were not sufficiently aware of how seriously their smaller counterparts were being affected by this decision, and were not pressed by them to represent their interests more actively.

The second and probably more important factor is that the periodic consultations conducted by the government whenever the minimum wage is due to be set have not followed a formal institutionalized procedure whereby all parties are provided with a basic report prepared by a special expert committee and can present their own technical reports to back up their own positions. Under these circumstances, employers' representatives appear to have held back from a debate whose primary focus was political.

The characteristics described (high job turnover and low wages) suggest that in this particular case there is a need to re-establish sectoral bargaining arrangements so that an effective wage floor can be set by agreement between the parties. The levels thus agreed upon would provide a basis for companies to compete within a framework of relatively stable employment conditions.

There seems to be a need to consider whether it is advisable for consultations among the actors concerned to follow the same format as hitherto or whether it would be more helpful to institutionalize a procedure that encourages not just the active participation of actors in the debate but also the provision of useful technical information.

Still on the subject of this negotiating deficit, there needs to be an in-depth analysis of collective bargaining arrangements. The persistent decline in the proportion of wage earners involved in such bargaining is worrying, as it means that an important instrument for establishing more modern labour relations is being neglected. Again, there is a need for dialogue between the parties to resolve situations of unstable employment and hence working conditions that characterize specific sectors, as indicated when the subject of wage-setting in the construction sector was looked at.

Something that will have to be kept very much in mind over the coming years is that the success of macroeconomic policy, and monetary policy in particular, has led to low inflation, reducing the "inflation flexibility" of wages. Logically enough, this situation has led to a concern to introduce a variable component into pay. A review of current legislation shows that the Labour Code provides for workers to receive a share of company profits, which is an appropriate instrument for cushioning the effect of recessions by reducing labour costs, and for distributing revenues in periods of profitability in accordance with the contribution made by workers.

The great majority of companies, however, prefer to apply the alternative formula provided for, which sets an upper limit on the amounts to be distributed per worker and thus makes the total distribution easier to

predict. In this way, a “variable” instrument becomes another “fixed” component of pay. Given that it is companies that decide how to apply the profit-sharing instrument, we must assume that in making this choice they see the desirability for the company of limiting profit distribution and, should a period of crisis occur, adjusting working hours and possibly employment.

For many years now, therefore, profit-sharing has not provided what the labour market currently needs to work better. There are not many examples in Latin America of practices that might provide material for reflection in Chile, although the case of Brazil may well be of interest. In the mid-1990s, the country introduced a provision for workers to share in the profits of companies or specific production results; with an obligation for the parties to negotiate, albeit with a wide margin of discretion as to the formula ultimately adopted. The objective in Brazil was to encourage more harmonious labour relations so as to improve company performance while at the same time rewarding the workers who made this possible.¹³ It offers companies

the opportunity of setting agreed targets to improve their performance and competitiveness. This strategy clearly fits well with Chile’s ongoing integration into world trade, which will force the country to make a great effort to modernize labour relations, starting with recognition of the need for solid worker representation and a system of bipartite dialogue. Lastly, although calls for flexibility are usually heard when periods of recession begin, it must be understood that flexibility can only materialize if substantial sums are distributed to workers during periods of growth to reward them for their contribution to higher profits. As was said earlier, it is not reasonable to expect that already low wages¹⁴ can be cut significantly during a crisis. The variable component of pay could serve this purpose, however, and accordingly it ought to be introduced at a time of strong economic growth, like the one Chile is currently experiencing.

(Original: Spanish)

¹³ See Marinakis (1999) for further information.

¹⁴ According to the 2003 CASEN survey, 60% of wage earners received less than twice the minimum wage (Marinakis and Velasco, 2006).

APPENDIX

Chile: Wage indicators, 1995-2005 (Annual variations)

Year	Real average monthly wage ^a	Real average hourly wage ^a	Real monthly minimum wage ^a	Nominal average monthly wage ^a	Nominal average hourly wage ^a	Nominal monthly minimum wage ^a	Consumer price index ^a
1995	5.0	4.8	4.5	13.6	13.5	13.1	8.2
1996	3.4	4.1	4.2	11.0	11.8	11.9	7.4
1997	2.6	2.4	3.6	8.8	8.7	9.9	6.1
1998	1.5	2.7	5.1	6.4	7.9	1.3	5.1
1999	1.2	2.4	8.9	4.5	5.8	12.5	3.3
2000	1.2	1.4	7.2	5.0	5.3	11.2	3.8
2001	0.4	1.6	3.3	3.9	5.2	6.9	3.6
2002	0.5	2.0	3.1	3.0	4.6	5.6	2.5
2003	0.6	0.9	1.8	3.5	3.8	4.6	2.8
2004	1.8	1.8	2.8	2.8	2.9	3.9	1.1
2005	-1.9	1.9	1.8	1.2	5.0	5.0	3.2

Source: Prepared by the International Labour Office (ILO) with data from the Chilean National Institute of Statistics (INE).

^a Average annual variation.

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