Crises and Social Protection in Developing Countries: Chile in the 1998 downturn

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Outline

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Introduction

- Increasing worldwide consensus on the mix social protection+fiscal discipline+inclusive growth.
- Chile is considered one of the leaders in developing innovative social protection solutions.
- This paper: assesses the Chilean experience during the 1998 global financial crisis.
- It looks at
  - private coping mechanisms
  - government policy responses

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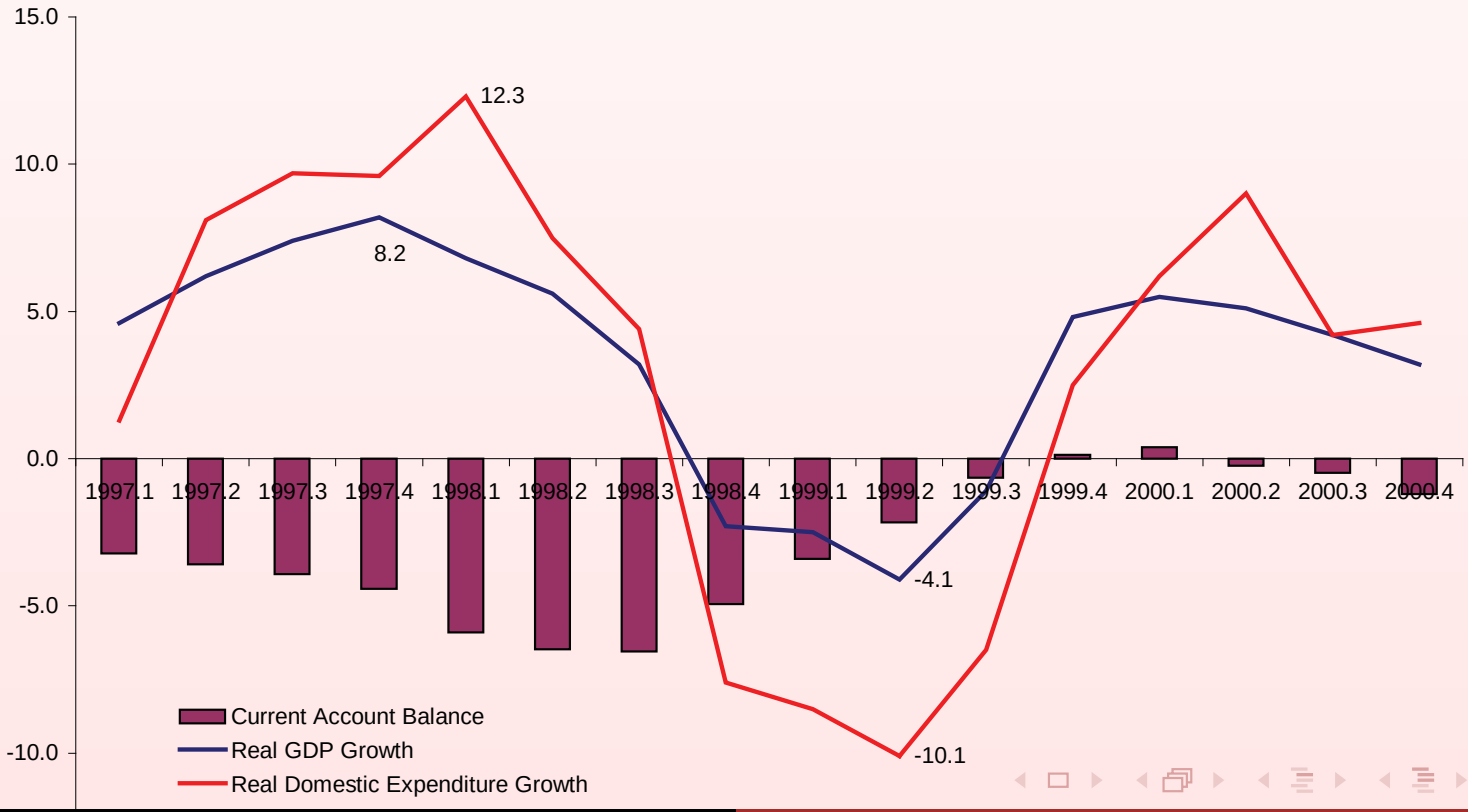
The Nature of the 1999 Downturn

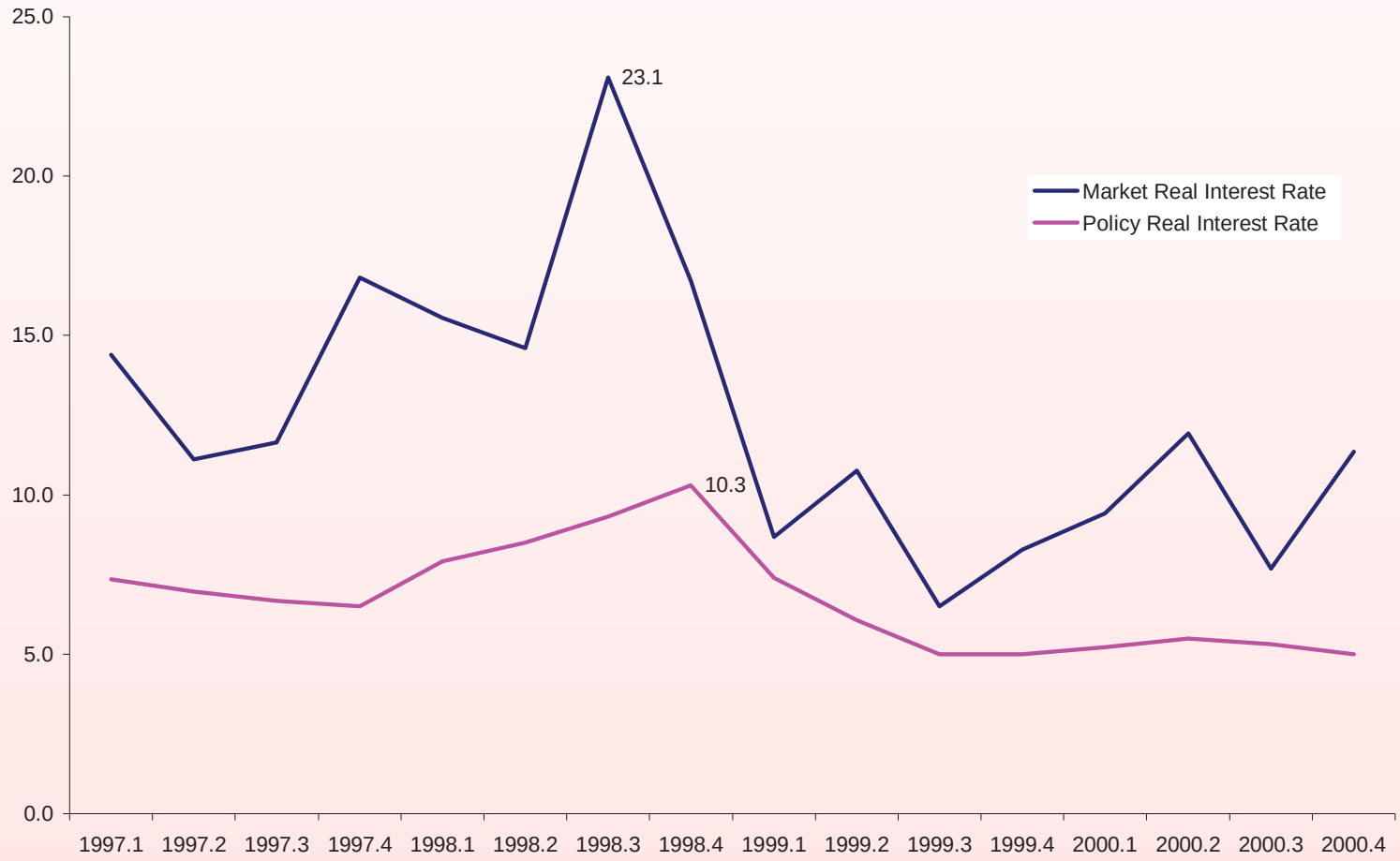
- 1998: external conditions deeply changed (Asian Crisis).
- The economy was already overheated.

Figure 1: Current account balance, GDP and domestic expenditure 1997-2000



The Nature of the 1999 Downturn

- Adjustment coincided with expansionary fiscal policy⇒disproportionated monetary adjustment.



The 1999 Downturn: Effects

- Persistent effect on unemployment

The 1999 Downturn: Effects

- Small effect on aggregate poverty (1998: 21.7%; 2000:20.6%)
- Heterogenous effects across groups

Table 7: Evolution of Selected Variables 1998-2000, percentage of change

	Total Households % var. 2000 vs 1998	1st Decil % var. 2000 vs 1998	2nd Decil % var. 2000 vs 1998	3rd Decil % var. 2000 vs 1998
Total income	2.9	7.0	9.6	9.3
Average household income	-0.5	3.4	6.0	5.6
Average per capita income	0.3	3.0	4.8	3.0
Number of workers per household receiving income	-3.6	4.0	0.9	0.8
Labor income (average per worker)	1.1	0.9	3.2	2.6
Primary income (average)	1.2	4.1	5.8	7.9
Number of workers receiving income	-0.2	7.5	4.2	3.9
Number of unemployed	5.7	-4.2	10.4	19.0
Rate of unemployment (change in percent points)	0.3	-5.4	0.2	1.3

Source: Feres (2001) based on CASEN 1998 and CASEN 2000

Outline

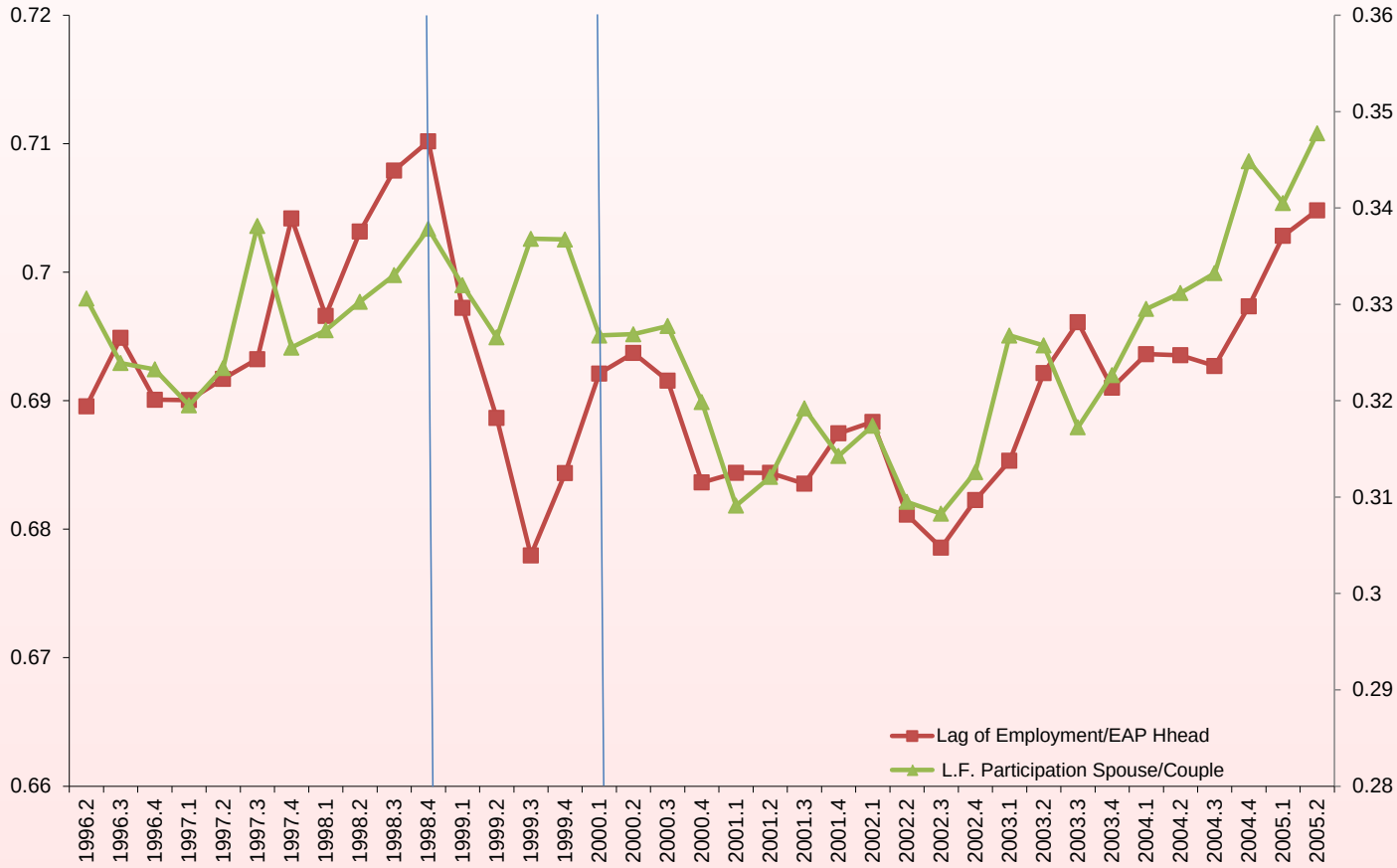
Private Coping Mechanisms

- Coping strategies analyzed in this paper
  - Underused family labor supply (wives and children)
  - Early retirement in case of unemployment
  - Transition from private (Isapres) to public (Fonasa) health insurance

Underused family labor supply: wives

- Suggestive evidence of added worker effect during crisis

Figure 3: Labor force and employment participation of household heads and spouses/couples



Source: author's own calculations using aggregate data from Encuesta Nacional de Empleo (ENE), INE. The lag of

Underused family labor supply: wives

- Dependent variable: labor force participation of wife

Added Worker Effect				
	xtreg1 b	xtreg2 b	xtreg3 b	xtreg4 b
desocupjhom2	**0.0146****	**0.0348****	**0.0404****	**0.0403****
desocupjhom2_crisis1				**0.0008**
edadjhom		0.0174**	-0.0037**	-0.0037**
edadsqjhom		-0.0002**	0.0000**	0.0000**
aestudjhom		0.0015**	0.0125**	0.0125**
aestudsqjhom		0.0011**	-0.0007**	-0.0007**
edadconmuj			0.0265**	0.0265**
edadsqconmuj			-0.0003**	-0.0003**
aestudconmuj			-0.0307**	-0.0307**
aestudsqconmuj			0.0036**	0.0036**
nchildren5			-0.0432**	-0.0432**
Region by Quarter fixed effect	Yes	Yes	Yes	Yes
N	993913	990310	988830	988830
r2_a	0	0.044	0.106	0.106

* p<0.05, ** p<0.01

Underused family labor supply: wives

- Dependent variable: labor force participation of wife

Added Worker Effect				
	xtreg1 b	xtreg2 b	xtreg3 b	xtreg4 b
semunempjhom	**0.0009****	**0.0010****	**0.0009****	**0.0009****
semunempjhom_crisis1				**0.0012****
edadjhom		0.0202**	-0.0021**	-0.0021**
edadsqjhom		-0.0002**	0.0000**	0.0000**
aestudjhom		-0.0010*	0.0104**	0.0104**
aestudsqjhom		0.0012**	-0.0007**	-0.0007**
edadconmuj			0.0280**	0.0280**
edadsqconmuj			-0.0003**	-0.0003**
aestudconmuj			-0.0312**	-0.0312**
aestudsqconmuj			0.0036**	0.0036**
nchildren5			-0.0418**	-0.0418**
Region by Quarter fixed effect	Yes	Yes	Yes	Yes
N	1058462	1054604	1053012	1053012
r2_a	0	0.044	0.106	0.106

* p<0.05, ** p<0.01

Underused family labor supply: children

- Dependent variable: labor force participation of child

Added Worker Effect	Mujer xtreg4 b	Hombre xtreg4 b
desocupjhom2	-0.0005	-0.0392**
desocupjhom2_crisis1	0.009	-0.0358**
Region by Quarter fixed effect	Yes	Yes
N	154637	164337
r2_a	0.045	0.2
semunempjhom	-0.0001*	-0.0008**
semunempjhom_crisis1	0.0006	-0.0012*
Region by Quarter fixed effect	Yes	Yes
N	162177	172492
r2_a	0.045	0.199

* p<0.05, ** p<0.01

Early Retirement

- Proportion of early retirement increased from 53% (1999) to 70% (2001).

Figure 5: Proportion of early retirements and Unemployment Rate of 50 years old and over

Early Retirement

- 1% increase on lag of unemployment 50+ is associated with 4.9% increase on proportion of early retirements.

Table 10: Proportion of early retirements and Unemployment Rate of 50 years old and over

Dependent Variable: Proportion of Early Retirements								
	glm1		glm2		glm3		glm4	
	b	se	b	se	b	se	b	se
(1) L.unemp50	3.792	(8.142)	9.528	(7.084)	6.018	(6.135)	20.439	(8.817)*
(2) L.dumunemp50_96			-0.193	(0.108)	-0.361	(0.213)	-0.347	(0.137)*
(3) trend					0.035	(0.047)	0.264	(0.058)**
(4) trend squared							-0.017	(0.005)**
(5) N	12		12		12		12	
(6) Log likelihood	-5.358		-5.349		-5.345		-5.312	
	meff	se	meff	se	meff	se	meff	se
(7) L.unemp50	0.918	1.967	2.304	1.697	1.454	1.481	4.912	2.100

* p<0.05, ** p<0.01

Source: author's own calculations using aggregate data from the Encuesta de Prevision Social 2002 (EPS, 2002) and the Encuesta Nacional de Empleo (ENE), INE. Each model is estimated as a Generalized Linear Model (GLM) for proportion data using data from 1990-2002. Models 3 include a linear time trend and Model 4 a linear and a quadratic time trend for each year. The dependent variable is the proportion of early retirements, calculated from the Encuesta de Prevision Social 2002 (EPS, 2002) as the ratio between the flow of early retirements and the flow of total retirements each year. The lag of the unemployment rate of people 50 years old and over (L.unemp50) is

Transition from Isapres to Fonasa

Figure 6: Number of contributors to private (ISAPRES) and public (FONASA) health insurance

Source: Fonasa and Superintendencia de Salud

Transition from Isapres to Fonasa

Table 11: Number of beneficiaries of private (ISAPRES) and public (FONASA) health insurance

Dependent Variable: Beneficiaries of public health insurance (FONASA)						
	reg1		reg2		reg3	
	b	se	b	se	b	se
(1) ben_isapres	-0.912	(0.284)**	-1.013	(0.069)**	-0.955	(0.070)**
(2) trend			123824.130	(8849.017)**	123109.783	(8310.488)**
(3) L.crisis					302379.691	(114870.724)*
(4) N	14		14		13	
(5) r2	0.416		0.966		0.979	

* p<0.05, ** p<0.01

Source: author's own calculations using aggregate data from the Superintendencia de Salud and Fonasa. Each model is estimated by a linear regression using data from 1990-2003. Models 2 and 3 include a linear trend for each year. The dependent variable is the stock of beneficiaries of the public health insurance system (FONASA) at December of each year. The beneficiaries of the private health insurance system, ISAPRES, (ben_isapres) are the stock of beneficiaries in any ISAPRE at December of each year. L.crisis is an indicator variable that equals 1 if the lag of yearly GDP growth is negative (1999).The table shows the estimated coefficients and their standard errors.

Outline

Macro Policies

- Lack of coordination between fiscal and monetary policies
  - Fiscal policy: expansionary budget for 1998 (assuming GDP growth) of 7%)
  - Three-year plan for mininum wage: 10% increase annually
  - This forced a disproportionated monetary adjustment
- Since second half of 1999: new mix of monetary and fiscal policy
  - Inflation target: from point estimate to 2-4% range
  - Exchange rate policy: from band system to floating rate
  - Fiscal policy: new fiscal rule based on structural surplus of 1% of GDP

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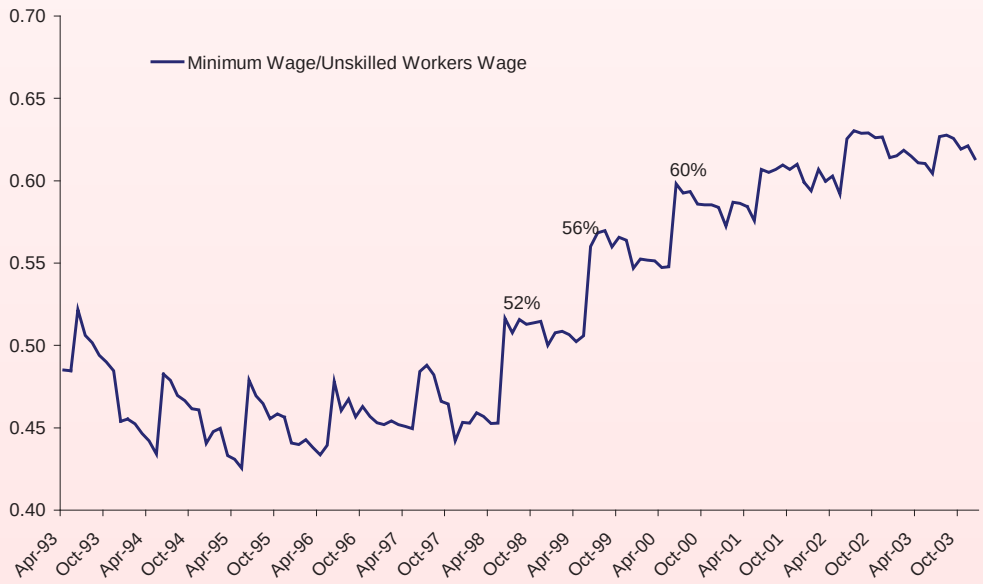
Macro Policies: Lessons

- Main Lessons:
  - Adjustment policy response exacerbated the effects of 1998 external shocks.
  - Ideal mix: moderated fiscal spending + monetary policy aimed at inducing a real exchange depreciation.
  - Correct mix of policies *before* and *after* the crisis:
    - Public debt reduction during 90´s.
    - Copper Stabilization Fund (1987).
    - Structural Surplus Rule (2001)
    - New combination of monetary and fiscal policies (target inflation range + floating exchange rate system).
  - This allowed a countercyclical fiscal policy during 2000-2003.

Labor Policies

- Active labor policies: flexibility reforms and minimum wage.
  - Flexibility: slow recovery of employment after 1999 $\Rightarrow$debate on possible lack of flexibility (mixed evidence).
  - Minimum wage/unskilled worker wage: rose from 52% (june 2008) to 60% (june 2000).

Figure 8: Minimum wage and Unskilled Workers Wage 1993-2003



Source: INE

Labor Policies

- Passive labor policies: unemployment insurance (UI).
  - Began in may 2002.
  - Contributory UI: mixes savings and market-type risk pooling.
  - Designed to avoid traditional fiscal imbalances and employment search disincentives.

Labor Policies: Lessons

- Main lessons
  - The three-year plan of minimum wage increase tied the hands of the government in the middle of the crisis.
  - Long term adjustment of the minimum wage can be an effective instrument (reducing uncertainty, political pressure, and costly bargain processes), but it should consider contingent adjustment mechanisms.
  - Scope for further advances in labor market flexibility (e.g., distribution of work hours, severance payment), but avoiding precarious jobs creation.
  - Unemployment Insurance:
    - Promising system to balance efficiency and social equity.
    - Further expansions on the benefits and/or coverage: to be judged from the learning process.

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Employment Programs

- Employment Programs with Fiscal Support + Acceleration of investment projects.
  - Employment Programs:
    - (1) direct employment programs (Proempleo, Fosac, PMU, etc.)
    - (2) employment subsidies (Sence, Fosis)

Employment Programs

Table 12: Summary of the Main Employment Programs

Name of the Program	Proempleo-Subsecretaria	EEP-CONAF	FOSAC-Interior	PMU	Proempleo-SENCE	Reinsercion-Fosis
Type of program	Direct	Direct	Direct	Direct	Indirect	Indirect
Institution responsible	Ministry of Labor	Conaf	Undersecretary of Inrerior	Subdere	SENCE, Ministry of Labor	Fosis
Year of beginning	2001	2001	1999	1987	2001	2000
Executors	Private and Public Institutions	Conaf	Private and Public Institutions	Municipalities	Private employers	Private and Public Institutions
Beneficiaries	unemployed household head	unemployed household head	unemployed household head in poverty condition	unemployed household head in poverty condition	unemployed	unemployed household head in poverty condition
Elegibility Criteria and targeting system	Self declaration of being a household head and unemployment, registered OMILs	Self declaration of being a household head and unemployment, registered OMILs	Self declaration of being a household head and unemployment, registered OMILs	Self declaration of being a household head and unemployment, registered OMILs	Self declaration of being a household head and unemployment, registered OMILs	Self declaration of being a household head and unemployment, registered OMILs

Source: University of Chile (2005)

Employment Programs

- 1st Stage (1999-2000):
  - expansion of programs already in operation.
  - Municipalities as executors.
- 2nd Stage (2001-):
  - New programs.
  - Indirect programs got preponderance.
  - Incorporation of private executors.

Employment Programs: Lessons

- Main Lessons:
  - Substantial effort to build a new generation of public employment programs after 1999.
  - Main concerns:
    - Absence of a self-selection mechanisms (relatively well-paid jobs) $\Rightarrow$ difficult to eliminate positions and induced an increase on labor force.
    - Absence of a self-targeting mechanism (proof of unemployment) $\Rightarrow$ leaves informal workers out.
    - Possible low impact of the employment subsidies on the number of new jobs generated *as a result* of the program.
  - Contingent Unemployment Fund (2001 and 2006):
    - Attractive fiscal instrument
    - Fiscal flexibility to allocate resources avoiding commiting a priori excessive resources to employment programs.

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Employment Programs: Lessons

- Employment Programs (EP) as structural poverty interventions:
  - Since 2004 EP re-oriented from anti-crisis tools toward structural poverty interventions (e.g., training component has increased).
  - This opens the discussion toward the ideal design of public EP as a permanent safety net policy.
  - For example: fully self-targeting programs? informal workers?

Conditioning Factors

- Positive Factors:
  - The public debt reduction in the 1990s as mechanism of self-protection.
  - The Copper Stabilization Fund as a mechanism of self-insurance.
  - The structural surplus rule as a mechanism of self-insurance.
  - The new combination of monetary, exchange rate and fiscal policy.
- Negative Factors:
  - Absence of systematic interaction among programs and duplicity of functions and objectives.
  - Insufficient installed administrative capacity before the crisis.
  - Inertia in expenditures committed before the crisis.

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General Conclusions

- Overall, the Chilean experience during the 1999 crisis is a notable case for analysis in order to adopt social protection policies within a context of fiscal discipline and inclusive growth.
- This has increasingly become necessary worldwide, specially among European countries.