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Reducing Poverty in Chile: Cash Transfers and Better Jobs

Nicola Brandt

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REDUCING POVERTY IN CHILE: CASH TRANSFERS AND BETTER JOBS

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By Nicola Brandt

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ABSTRACT/RÉSUMÉ

Reducing poverty in Chile: cash transfers and better jobs

Notwithstanding impressive progress, poverty and inequality remain high in Chile in OECD comparison, and the tax-benefit system does little to improve on this. The government plans to introduce a new cash transfer for the poor, the *Ingreso Ético Familiar*. This is a welcome initiative. However, the transfer will be modest by OECD standards, at least initially, and it will be quite narrowly targeted at families living in extreme poverty. Over time, the government should consider increasing the size of this transfer and opening it to a wider range of beneficiaries through gradual benefit withdrawal. Strong support for the poor to find jobs of decent quality will be key to help them overcome poverty in a sustainable way. *Ingreso Ético Familiar* will come with an employment programme for beneficiaries. This should build on the existing infrastructure of active labour market policies, which will need to improve at the same time. The government should strengthen the capacity of local labour offices and use the current evaluation of training programmes to retain only those of proven effectiveness, while focusing them more on low-skilled workers and the unemployed. Strengthening unemployment benefits, while limiting severance pay, would make employment protection more effective and do more to avoid labour market duality.

This Working Paper relates to the 2012 OECD Economic Survey of Chile (www.oecd.org/eco/surveys/*chile*).

JEL Classification: H52; H53; H55; J2; J5; I32.
Keywords: Poverty; Inequality; Cash Transfers; Labour Market.

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Réduire la pauvreté au Chili grâce aux transferts monétaires et à de meilleures possibilités d'emploi

En dépit des impressionnants progrès accomplis, la pauvreté et les inégalités demeurent fortes au Chili par comparaison avec les autres pays membres de l'OCDE, et le système de prélèvements et de transferts ne contribue guère à améliorer la situation. Les autorités envisagent d'introduire un nouveau transfert monétaire destiné aux pauvres : Ingreso Ético Familiar. C'est une initiative qui va dans le bon sens. Cependant, au moins au début, le transfert sera modeste par rapport aux critères de la zone OCDE, et il sera ciblé très étroitement sur les familles vivant dans l'extrême pauvreté. A terme, il faudrait prévoir d'augmenter son montant et d'élargir l'éventail de ses bénéficiaires en instaurant une progressivité dans la suppression de la prestation. Il sera essentiel d'apporter aux pauvres un solide appui dans la recherche d'un emploi décent afin de les aider à sortir durablement de la pauvreté. Ingreso Ético Familiar s'accompagnera d'un programme pour l'emploi à l'intention des bénéficiaires. Ce dispositif devrait s'appuyer sur l'infrastructure existante des politiques actives du marché du travail, qu'il faudra améliorer parallèlement. Les autorités devraient renforcer les capacités des agences locales pour l'emploi et se fonder sur l'évaluation existante des programmes de formation pour ne conserver que ceux dont l'efficacité est prouvée, tout en les axant davantage sur les travailleurs peu qualifiés et les chômeurs. L'amélioration de l'indemnisation du chômage, couplée à la limitation des indemnités de licenciement, accroîtrait l'efficacité de la protection de l'emploi et contribuerait mieux à éviter le dualisme du marché du travail

Ce Document de travail se rapporte à l'Etude économique de l'OCDE du Chili 2012 (www.oecd.org/eco/etudes/*chili*).

Classification: H52; H53; H55; J2; J5; I32
Mots clés: La pauvreté; l'inégalité, transferts d'argent; le marché du travail.

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Reducing poverty in Chile: Cash transfers and better jobs

By Nicola Brandt[1]

Introduction

Chile has made remarkable progress in reducing poverty over the last 20 years and it has now one of the lowest poverty rates in Latin America. Inequality has declined, as well, although more recently and much more modestly. Nevertheless, poverty and inequality remain high by OECD standards. Reducing poverty further would help reduce social problems. At the same time, education, social and labour market policies that help the poor invest in their human capital and strengthen their productivity would also contribute to unleashing growth potential. While Chile is currently enjoying strong growth, in part related to high commodity prices, the large share of poor workers with low productivity can quickly become a bottleneck for innovation and diversification.

The Chilean government has set itself the ambitious goal to eradicate extreme poverty by 2014, setting the foundations to eliminate poverty by 2018. One instrument to achieve this will be the introduction of the *Ingreso Ético Familiar*, a new cash transfer system for the poor. Higher cash transfers can help poor people save and invest in physical and human capital and they would make the tax-benefit-system more progressive, in particular when financed by closing regressive tax loopholes or increasing wealth taxes. The government has set itself the goal to achieve annual average growth of GDP of 6% and create a million new jobs – an increase by 15% - by 2014. Better job opportunities for the poor will be important to help them overcome poverty.

This paper analyses Chile's opportunities to lower poverty and inequality further through social and labour market policies. It is structured as follows: The first part gives an overview over recent developments in poverty, income and wage inequality in Chile. The second part discusses the factors that will be important to consider for the Chilean government when designing its new cash transfer programme *Ingreso Ético Familiar*, in particular targeting, conditionality, the size of transfers and the quality of complementary government services. Perhaps the most important factor to help people leave poverty or avoid falling into it will be to strengthen their capacity to find employment. Female household heads and low-skilled workers, who are characterized by particularly low labour market participation, low wages and a high incidence of poverty, will need strong help. The third part of this paper therefore discusses policies that would help more Chileans find a job of decent quality. It discusses the role of job intermediation, training programmes, in-work benefits, unemployment protection and family policies for more and better jobs.

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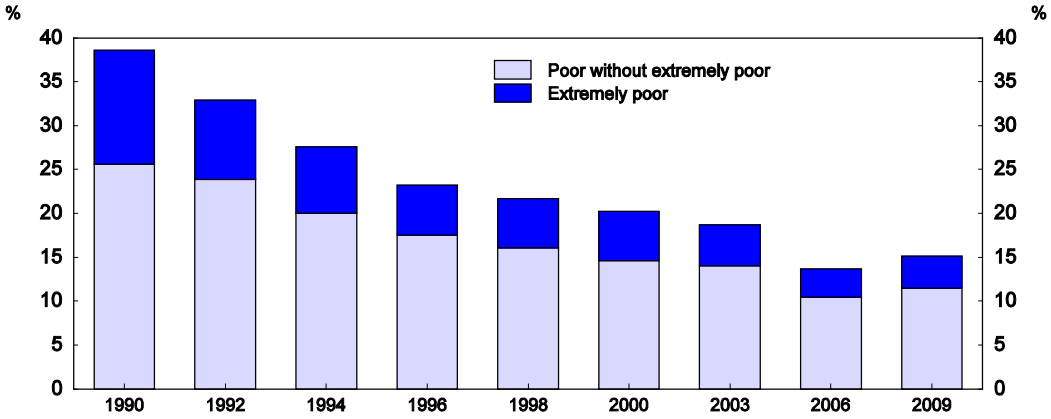
Poverty and inequality in Chile

Recent developments

Chile has experienced a remarkable decline in poverty over the last 20 years, with the share of people living below the national poverty line falling dramatically (Figure 1). Relative poverty, as measured by the share of the population living with less than 50% of the median income, has fallen as well. It is now among the lowest in Latin America (Figure 2) although it remains higher than in most OECD countries (Figure 3). Like in other countries households frequently move into and out of poverty in Chile, (Neilson *et al.*, 2008).

Figure 1. Poverty rates in Chile

People with income below the national poverty line (absolute poverty) as per cent of population



Source: CASEN.

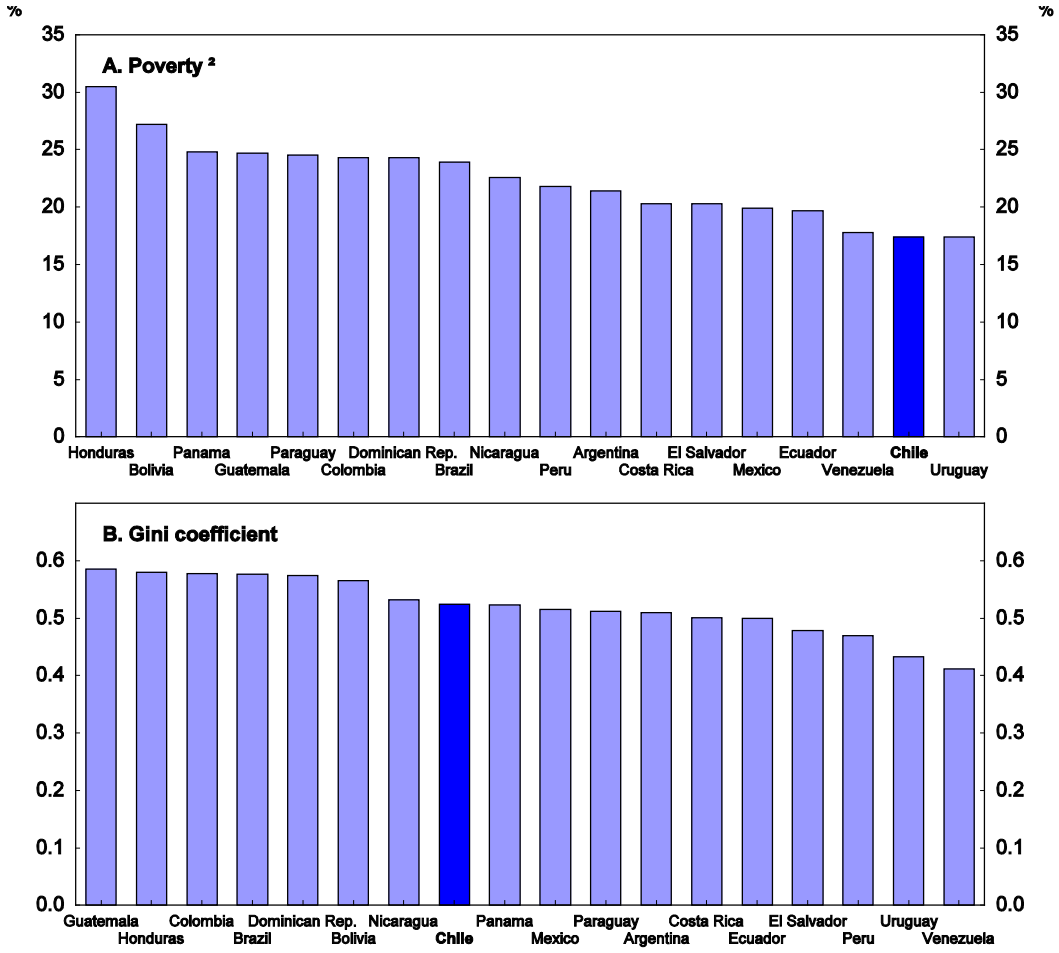
Children are in particular danger of being poor in Chile, while seniors are less likely to be poor than working age individuals (Table 1.). In fact, the presence of a pensioner in the household lowers the probability of being poor, while the poverty risk increases monotonically with the number of children in the family, reaching more than 50% for households with more than 5 children (not shown). The low risk of poverty for people of pension-age is probably evidence that Chile's non-contributory pension scheme for the poor is effective. Single-parented households have a particularly high incidence of poverty. More than 85% of these households are headed by a female and the incidence of poverty among single-parented households with a male head is actually much lower. The poverty risk falls monotonically with the number of employed workers in the household, but households which depend only on informal workers have a higher poverty risk than those where some workers have a formal job.

Table 1. Poverty across different groups, 2009
Headcount of people with income below the national poverty line as per cent of the corresponding group

Group	All people	Children	People of working age	People above 65	Individuals in households without children	Individuals in households with at least 2 children	Individuals in households with a pensioner
Poverty rate	15.1	22.1	13.7	8.1	7.4	25.9	10.9
Group	Individuals in households with children, headed by a couple	Individuals in single-parented households	Individuals in households without workers	Individuals in households with at least one worker	Individuals in households with at least two workers	Individuals in households with informal workers only (no written contract)	Individuals whose households head has less than secondary education
Poverty rate	17	29.3	37.5	12.6	4.3	18.8	21

Source: OECD based on Encuesta de Caracterización Socioeconómica Nacional (CASEN), 2009

Figure 2. Poverty and inequality in Latin America comparison[1]
2009 or latest year available



1. Household income, including labour and capital income as well as cash transfers, is adjusted by the household size.
2. Percentage of persons with household income less than 50% of the median.

Source: United Nations, ECLAC, Panorama Social.

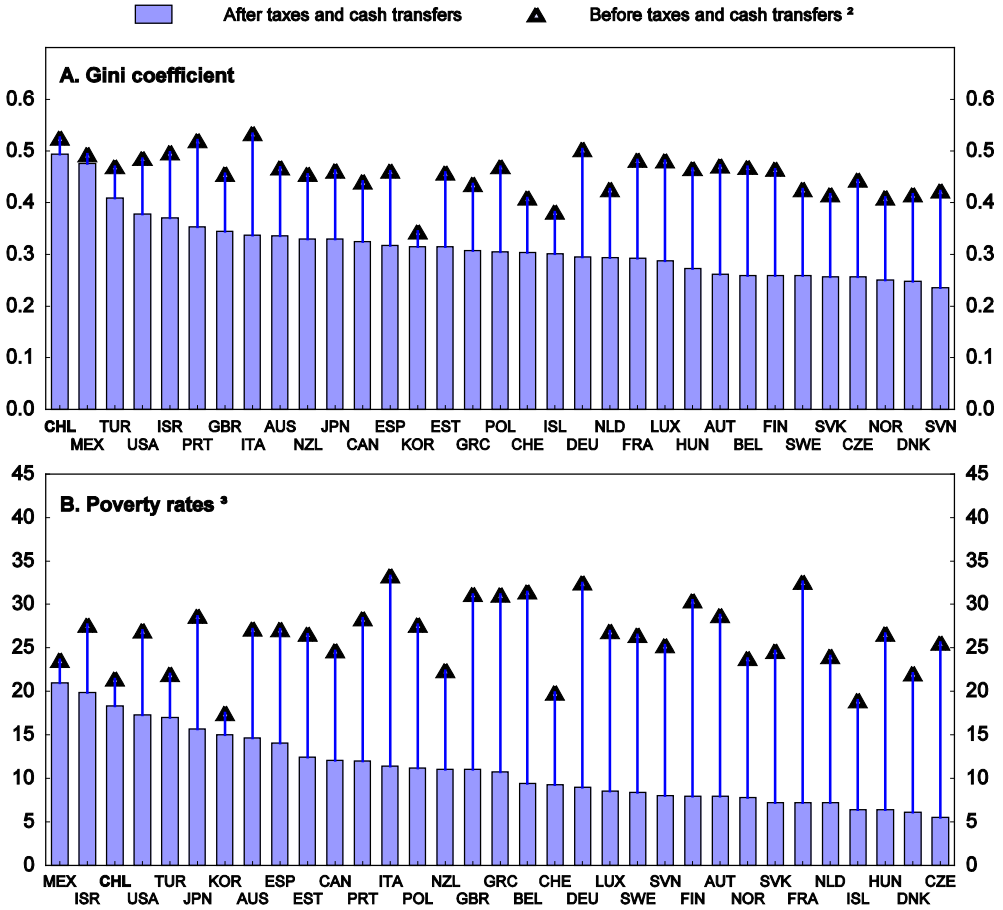
Income inequality has started to decline, as well, although much more recently and more modestly than poverty. It remains important even in Latin America comparison (Figure 2) and is higher than anywhere in the OECD (Figure 3). The reason why income inequality has hardly moved despite an impressive decline in poverty is that the largest inequalities can be found at the top of the income distribution. The average income of the top decile is almost three times as high as the average income of the decile just below that (Figure 4). In contrast, income is distributed relatively equally among the rest of the population.

Poverty would perhaps be less of an issue if people were able to overcome it relatively easily by themselves. However, intergenerational social mobility is comparatively low in Chile, which is typical for countries with high inequality (Causa and Johansson., 2009). The intergenerational income elasticity, which measures the degree to which a man's income is determined by the income of his father, is higher in Chile than in other OECD countries (Figure 5). Recent estimates range from 0.57 to 0.74 (Nuñez and Miranda, 2010). This implies that a Chilean whose father earns twice as much as the father of – say – a friend is likely to earn 60-70% more than this friend.

The measures discussed in this paper are mainly directed at reducing poverty. They will also contribute to reducing inequality, but since the largest inequalities come from the top of the income distribution, this will only go so far. There are complementary policies that will help further equity and have beneficial effects on productivity growth at the same time. Stronger competition policies, would strengthen productivity growth, while also reducing rents of incumbents and enhance business opportunities for newcomers, thus potentially contributing to social mobility. Raising the quality and equity of education (OECD, 2010) would strengthen the country's human capital and contribute to reducing inequality. Limiting tax exemptions and loopholes, that mainly benefit higher-income earners, would strengthen tax revenues, creating more room for higher, progressive cash transfers or stronger education and social policies.

Figure 3. Inequality and poverty across OECD countries [1]

2009 or latest year available



1. Household income is adjusted by the square-root of the number of persons in the household. Provisional estimates.

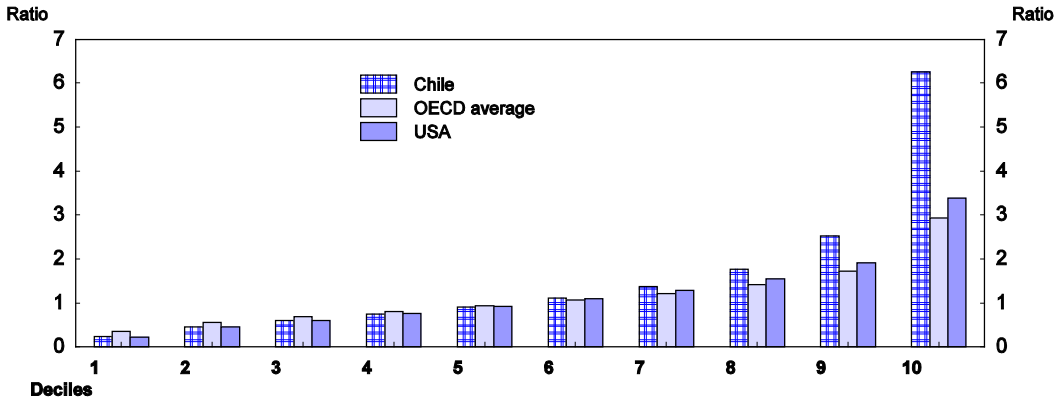
2. Before transfers only for Greece, Hungary, Mexico and Turkey, transfers do not include subsidies for buying a home in Chile.

3. Poverty line defined at 50% of the current median income.

Source: OECD, Income Distribution Database.

4. Average household income by income decile

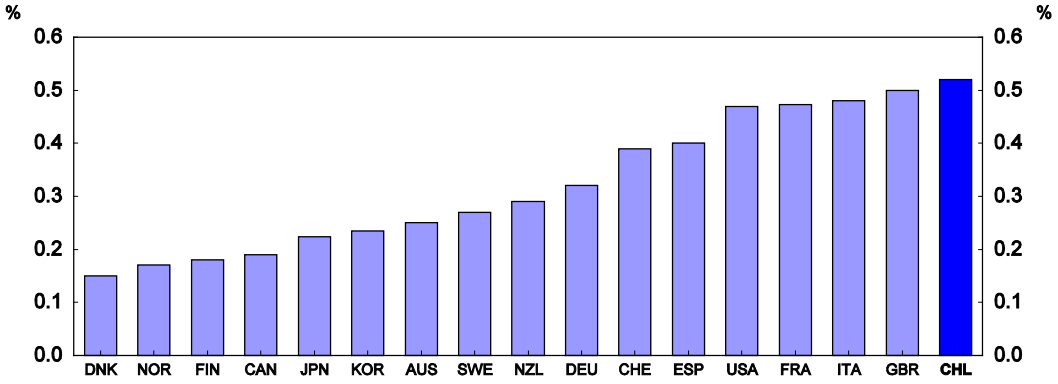
Normalised with median household income[1]



1. Relative poverty line at 50% of household median income. 2009 for Chile, latest year available for other countries.

Source: OECD Income Distribution and Poverty Database.

Figure 5. Intergenerational earnings elasticity estimates[1]



1. The height of each bar represents the best point estimate of the intergenerational earnings elasticity resulting from the extensive meta-analysis carried out by Corak (2006). The higher the parameter, the higher is the persistence of earning across generations and thus the lower is intergenerational earnings mobility.

Source: OECD, Social Mobility in OECD countries: Evidence and Policy Implications (forthcoming).

What accounts for the decrease in poverty and income inequality?

Economic growth, with rising labour income for all income deciles, social policies and rising educational attainment, explain a part of the decrease in poverty and inequality in Chile. Labour income of the lowest income quintile rose on average 38% in real terms between 1990 and 2009 (Table 2). While the labour and capital incomes of higher income deciles rose even faster than that, a marked increase in monetary transfers that was strongest for the lowest income decile compensated for this difference. Research suggests that a decline in wage inequality that began in 1987 – after a strong increase since the early 1970s - can be attributed to a significant increase in the supply of workers with tertiary education (Eberhard and Engel, 2008). Nevertheless, wage inequality remains high in Chile in international comparison (Figure 6)

Table 2. Real income increases by quintiles of per capita household income between 1990 and 2009[1]

in per cent

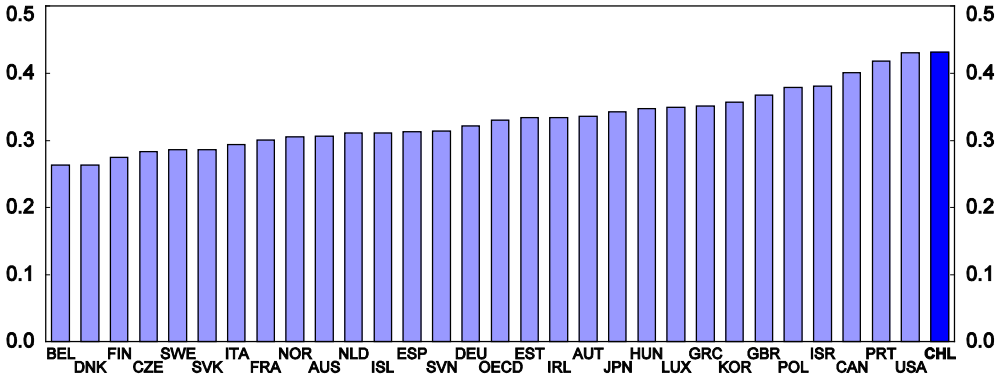
	I	II	II	IV	V	Total
Capital and Labour Income	38	64	63	73	55	59
Monetary Transfers	492	369	305	236	89	352
Total Income	69	72	67	74	55	62

1. 2009 values are deflated with the deflator of the urban poverty line

Source: Encuesta de Caracterización Socioeconómica Nacional (CASEN)

Figure 6. Gini coefficients for the earnings of full-time employees

15 to 64 year olds, 2008[1]



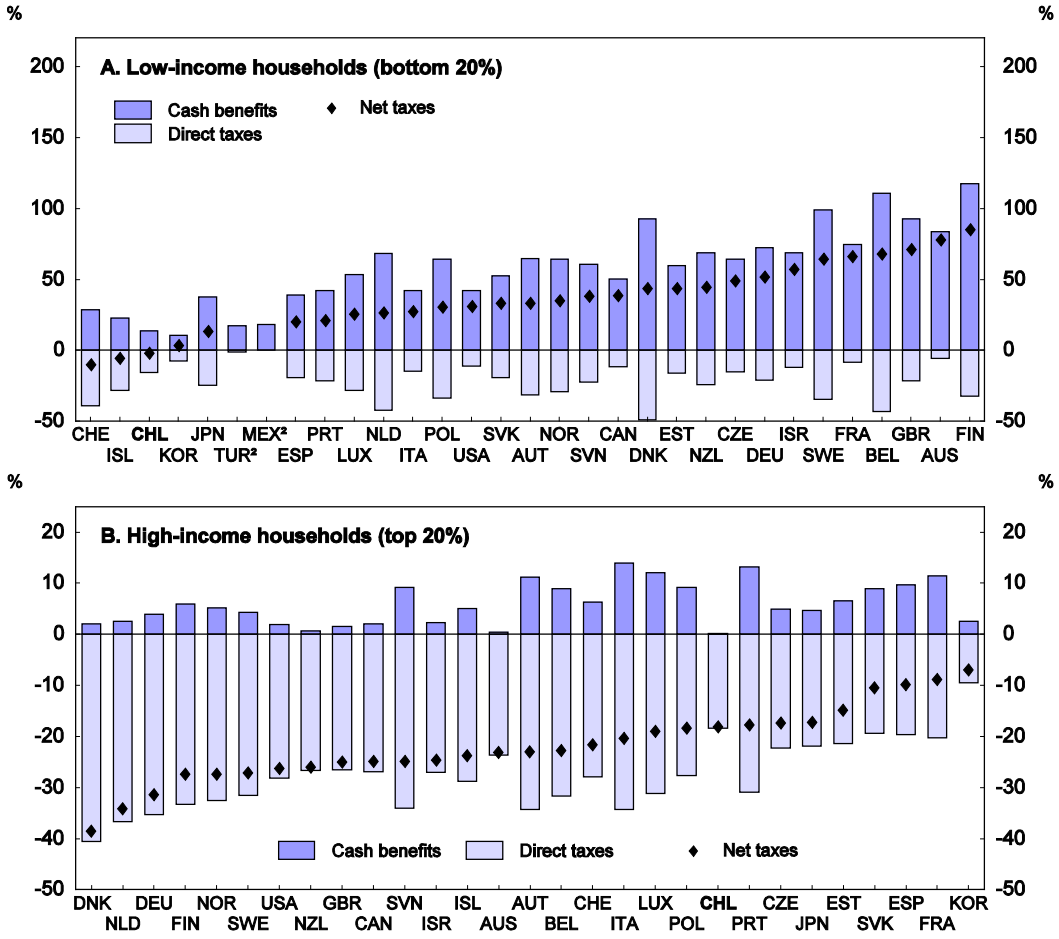
1. 2005 for Israel, 2007 for France, Korea and the United States and 2009 for Chile and Japan.

Source: Koske *et al.*,"Less income inequality and more growth are they compatible? Part II. The distribution of labour income"(2012).

However, the positive impact of the tax-and-benefit system on equality is much lower than elsewhere in the OECD, owing to a less progressive tax system and a comparatively small size of cash transfers (Figure 7). While the inequality of market income before taxes and transfers is, in fact, quite similar to Chile's in a number of OECD countries, taxes and transfers lower the Gini coefficient in these countries by an average of 10 points. In contrast, the impact of the tax-benefit-system on inequality is low in Chile and many other Latin American countries (see Figure 3), mainly owing to the low size of redistributive transfers and a low share of progressive income taxes in overall revenues.

Figure 7. Tax and benefits for low and high income households[1]

As per cent of pre-transfer labour and capital income



1. Headed by working-age individuals. 2009 or latest year available.

2. Pre-transfer income is net of taxes.

Source: OECD, Income Distribution and Poverty Database.

Cash transfers as an instrument to reduce poverty

The role of cash transfers for bolstering the income of the poor and increasing their productivity

While cash transfers are well-established in OECD countries as an instrument to reduce poverty and inequality, their use is less common in developing or emerging countries. Following the success of Mexico's conditional cash transfer programme *Oportunidades*, many Latin American governments have introduced similar programmes. The Mexican programme is conditional in the sense that recipients are required to send their children to school and to health checks, while participating in information sessions about health and other issues. Otherwise their benefits will be reduced or scrapped. Cash transfers for the poor also exist in developing and medium-income countries across Africa and Asia. Some of them come with conditions, others are unconditional.

Studies show that cash transfers – whether conditional or unconditional – can help improve beneficiaries' wellbeing and their productivity on a wide range of dimensions. They improve child

nutrition and health (Aguëro *et al.,* 2006; Duflo, 2003; Paxson and Schady, 2007), language skills (Fernald and Hidrobo, 2011, Paxson and Schady, 2007) and educational attainment (Case, Hosegood and Lund, 2005; for literature overviews see Hanlon *et al.*, 2010; Fiszbein and Schady, 2009) – all of which are important factors for children to grow up to become an autonomous and productive person with a good capacity to generate income. As an example, children's nutrition with its positive influence on health is important, because healthier children have been shown to achieve better results in cognitive skills tests and earn significantly more as adults (Case and Paxson 2008). The programmes have also been shown to reduce child labour (Edmonds and Schady, 2009).

Research suggests that cash transfer programmes increase households' capacity to save and invest, thus generating higher income. Gertler *et al.* (2006) find that Mexico's *Oportunidades* programme helped poor rural households to invest in microenterprises and agricultural activities with an estimated rate of return of 17%. In South Africa recipients of the child support grant are twice as likely as comparable non-recipients to have a bank account or some form of savings (Delany *et al.,* 2008). Martínez (2004) shows that a universal pension in Bolivia helped poor households increase their food consumption by more than one and a half times the value of the pension. This resulted to a large extent from increased home production of meat and vegetables thanks to a more intense use of land when extra money was available to invest in animal ownership, crops and agricultural inputs. This suggests that cash transfers can help households, who have no or limited access to credit, to invest in improving their living standards.

Health, cognitive skills, education and people's ability to invest are important factors improving their productivity and well-being. Well-designed transfers could thus help Chile reduce poverty, while improving the productivity of its workforce, thus also strengthening the economy's growth potential. The impact on poverty would thus be both direct – through the transfer itself – and indirect, through the impact that transfers can have on recipients' health, education and skills and thus their ability to generate income. Ultimately, if this contributes to stronger economic growth, poverty can be further reduced through the effects that a general rise in incomes has on the low end of the income distribution.

Cash transfers to date in Chile

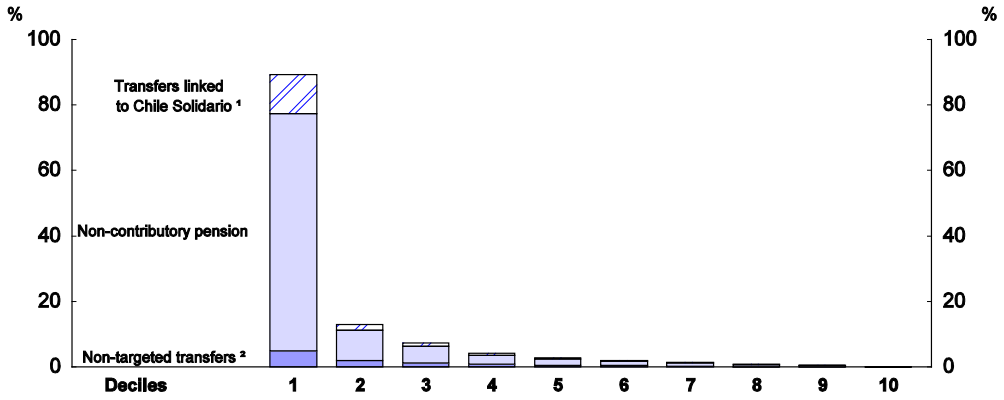
Chile has a range of different cash transfers (Box 1.) targeted with a proxy means test that assigns scores to families based on employment, actual and imputed potential income, health status and family composition (*Ficha de Protección Social, FPS*). Cash transfers in Chile are currently rather small in size and quite narrowly targeted. Transfers connected to *Chile Solidario* increase household income by around 10% for the lowest income decile, and much less for income deciles above that (Figure 8). Only the non-contributory basic solidarity pension makes up a large share of pre-transfer income, although only for the lowest income decile. As a comparison, the Mexican *Oportunidades* programme increases pre-transfer consumption of households in the two lowest income deciles by 33% on average (Fiszbein and Schady, 2009).

Box 1. Cash transfers for poor families in Chile

Chile Solidario targets families who live in extreme poverty (with a score in the proxy means test, the *Ficha de Protección Social*, FPS, below 4.213). There is a special programme for the sole elderly, the homeless and children with a parent in prison. Beneficiaries are granted preferential access to a range of social services, including housing, employment, healthcare, education and childcare. With the support of a social worker *Chile Solidario* recipients design an action plan, which is supposed to help them exit poverty. The plan is based on 79 minimum conditions out of which recipients are meant to achieve at least 13, in areas as diverse as housing, employment, education, health and domestic violence. There are regular meetings with the social worker to monitor progress. Benefits are decreasing over the first 24 months falling from 26 USD per month to 14 USD. After that beneficiaries receive an exit grant equivalent to 13.5 USD per month for 3 years. Given its relatively small size the benefit is mainly meant to motivate families to participate in the programme. *Chile Solidario* participants have preferential access to a number of other cash transfers, provided they qualify for them. This includes all cash transfers described in this box, but also the increased school voucher subsidy for poor children (*Subvención Preferencial Escolar*) and a subsidy for schools to help retain children in school the next year (*Subvención pro Retención Escolar*). These two subsidies go to the school, where the children are enrolled, not to its family. Preferential access is important, because most social programmes in Chile are rationed.

Subsidio Único Familiar (SUF) is an allowance for poor families with pregnant women, school-age children or a disabled member who do not qualify for the contributory family allowance for dependent employees, because nobody in the family is affiliated with a social security institute. Thus, undeclared dependent employees and poor dependent workers can qualify for the benefit, as well as the inactive or unemployed. The allowance amounts to 6 776 Chilean pesos (13.5 USD) per month for households with a *Ficha de Protección Social* score below 11 734, which would correspond to the bottom 40% of the income distribution. This transfer is conditional on regular medical controls for children under 6 years and regular school attendance for children aged 6-18.

Figure 8. Share of transfers in pre-transfer household income by decile, 2009



1. Chile Solidario, Subsidio Único Familiar and water subsidy.
2. Unemployment benefits and social security family allowance.

Source: CASEN 2009.

Subsidio a la Cédula de Identidad is a financial support of 500 Chilean pesos (approximately 1 USD) to obtain an identity card for people who receive Chile Solidario.

Subsidio al Pago del Consumo de Agua Potable y Servicio de Alcantarillado de Aguas Servidas (SAP) is a subsidy for obtaining drinkable water, which covers the bill for 15 m^3 of water use each month for Chile Solidario recipients who are connected to the network.

Pension Basica Solidaria (PBS) and *Aporte Previsional Solidario* (APS) are the non-contributory basic solidarity pension and top-ups respectively for retired and disabled workers with savings shortfalls in the private pension system. Recipients need to have a FPS score of 12.185 or below to qualify.

The government has recently made the decision to increase the cash transfers associated with *Chile Solidario* significantly with the new transfer system, the *Ingreso Ético Familiar*. The president sent the law proposal to Congress in late September 2011 and it is now under debate (Box 2).

Box 2. The law proposal for Ingreso Ético Familiar

The subsidy will be targeted at those living in extreme poverty, around 170 000 families. Some bonuses will be available to a wider range of families, those belonging to the 30% poorest in the country. The government expects to spend 95 bn Pesos (190 million USD) or 0.07% of GDP in 2012.

In addition to the social worker, who helps Chile Solidario families cope with social and employment programmes (see Box 1.), recipients will be required to enrol in a further employment programme. Current thinking is that this could be a coach who would help adult family members find a job and improve their employability.

There will be a monthly base transfer of 13 000 Pesos (around 26 USD) per family plus an extra 6 000 Pesos (around 12 USD), which will be available for families who live in extreme poverty.

There will also be a conditional transfer, namely an extra monthly 8 000 Pesos (16 USD) per child for families in extreme poverty who comply with certain conditions, including regular health checks for their children and regular school attendance – more than 90% of the time for primary school children and 85% of the time for secondary school children.

These payments will be available for 24 months.

In addition, there will be a range of bonuses for families who belong to the 30% poorest:

- Families with a child in the top 15% of his or her class will receive an extra 50 000 Pesos (100 USD) per year and those with a child in the second 15% of his or her class an extra 30 000 Pesos (60 USD).
- There will be an employment subsidy for working females from families whose incomes are among the 30% lowest in the country (the 40% lowest after 2012). It can reach up to 15% of their salary within a certain range, with an estimated average 25 000 Pesos (50 USD). The subsidy is gradually phased in and phased out and will be paid to the worker and her employer in equal parts. It is rationed to 100 000 women initially.
- Adults who receive *Ingreso Ético* and complete secondary education can receive a one-time bonus.
- There will be a one-time bonus for recipients graduating from the employment programme early by finding a job.
- There will be further bonuses for different achievements in the areas of education, health, employment and savings.

When thinking about the design of *Ingreso Ético Familiar* it is important to assess *Chile Solidario*, on which the new transfer system should build. The small cash transfer that comes with *Chile Solidario* is not intended to lift people out of poverty by itself. Rather, it is meant as an incentive for recipients to make better use of social services and build a strategy to exit poverty with the help of a social worker. The main idea is that the poor lack the capacity and information to access cash transfers and social services, and that they need assistance to use these programmes effectively and develop skills to overcome poverty. Studies have found a positive impact of *Chile Solidario* on the take-up of transfers (Galasso, 2006; Carneiro *et al.*, 2009), such as *Subsidio Único Familiar* (Box 1.). This effect is stronger in municipalities where different social services are better coordinated, for families served by social workers with lower caseloads and for families whose head has a relatively low educational attainment (Carneiro *et al.,* 2009). These findings point to the role of the quality of complementary social services in ensuring success of cash transfer

programmes. Amior *et al.* (2010) suggest that neighbours' participation in *Chile Solidario* also has a positive effect on the take up of subsidies for households who do not receive *Chile Solidario* themselves. The authors provide some evidence that this is due both to better awareness of the existence of cash transfers and social programmes and a reduction of transaction costs, perhaps because the *Chile Solidario* programme spreads information on how to access these programmes to friends and neighbours. Studies have also found a positive effect on school enrolment (Galasso, 2006), on access to housing and employment programmes (Perticara, 2007; Galasso, 2006; Carneiro *et al.*, 2009) and on housing conditions (Larrañaga *et al.*, 2009; Carneiro *et al*., 2009).

However, results on the effect of *Chile Solidario* on employment, income and poverty are more mixed. While Galasso (2006) finds no positive effect on employment or income, Perticara (2007) finds a positive effect in rural, but not in urban areas. Larrañaga *et al.* (2009) find a positive impact on the number of employed people in participant households. Carneiro *et al*. (2009) find a positive effect on the employment of second earners, but none for household heads, including when they are single females. Gains in labour income per capita and a reduction in poverty, including extreme poverty, is confined to rural areas and to families with a head whose educational attainment is low according to this study. Larrañaga *et al.* (2009) find a negative impact on market income for urban, although not for rural households. The database they use does not allow the authors to assess the impact on disposable income, including transfers. Given that *Chile Solidario* provides recipients with preferential access to cash transfers, the authors conjecture that participants may replace market income with transfers to some extent. One theory why the impact of Chile Solidario in rural areas is stronger would be that access to information about cash transfers and employment services in the absence of *Chile Solidario* is more difficult in these areas than in cities, where people can more easily obtain information through neighbours or other networks. Overall, these results suggests that better help is needed for transfer recipients to find employment that allows them overcome poverty.

The role of transfer size

One aim of the new *Ingreso Ético Familiar* is to increase cash transfers and thus help lift more people out of poverty. In principle, Chile can afford reducing poverty significantly through transfers alone. Poverty gaps suggest that the country would have to invest less than 1% of GDP to lift all citizens above the national poverty line or even 10% above that (see Table 3), although it is important to note that this a static accounting exercise that does not take into account behavioural changes. Another way to look at this is to ask which share of their income relatively rich people would have to transfer to the poor to close the poverty gap. For example, income that is more than 2½ times above the poverty line, or within the top four income deciles, seems high enough to ask people to transfer part of their earnings above that to the poor. An income surtax with a marginal tax rate of 3% for income above this line would be sufficient to lift all Chileans out of poverty (Table 3). Increasing cash incentives so that fiscal costs increase by 1% of GDP, however, may undermine work incentives. Limiting cash transfers, while financing other social policies that help people overcome poverty, including education, training and employment programmes, may thus be preferable. Nevertheless, the poverty gap is a useful measure to assess the scope of the poverty challenge. In China, as an example, closing the poverty gap with a poverty line of 2 USD in purchasing power parity terms, which is well below the national poverty line in Chile, would require taxing richer individuals – those who earn more than 2½ time the Chilean poverty line – with prohibitive rates of around 100% (Ravallion, 2009). Compared to that, the Chilean problem is more manageable. However, for the moment the sum that the government plans to invest in additional cash transfers, 0.07% of GDP, is an order of magnitude smaller than the poverty gap. In fact the stated aim is to close the gap between families' income, including subsidies they receive now, and the national line for extreme poverty - not poverty - by no more than 85% with the monthly transfers.

How many people can be lifted out of poverty with cash transfers is not the only aspect to consider when deciding on the size of the transfer. Research has shown that transfer size can matter for the impact on recipients' ability to invest. Fernald *et al.* (2008) show that a doubling of cumulative transfers in Mexico's *Oportunidades* was associated with higher height-for-age scores, a lower incidence of stunting and better motor and language development. De Janvry and Sadoulet (2006) conclude that the marginal impact of transfers on school enrolment is large, as every 10 USD results in an additional 1½ percentage points in enrolment. They also note, however, that the impact of larger transfers depends much on children's and families' characteristics and is larger for older children and those living farther away from the nearest school. These researchers impose linearity on the relationship between the size of transfers and enrolment, thus not allowing for declining marginal impacts. Todd and Wolpin (2006) estimate a structural dynamic model of *Oportunidades* incorporating fertility and schooling choices and conclude, based on model simulations, that the positive impact on the number of years of schooling is linearly increasing up to the actual transfer amount. Thereafter, it increases at a slightly diminishing rate. Filmer and Schady (2011) find a strongly diminishing marginal impact on schooling of cash transfers that were allocated randomly at different sizes to different families in Cambodia. The role of the size of transfers for other dimensions, such as health and ability to make productive investments, however, has been less well researched.

Table 3. Poverty rates and gaps depending on the poverty line, 2009

Poverty line in % of the national poverty line	0.50	0.75	0.90	1.00	1.10	1.25
Poverty line; monthly per capita household income in US PPP	83.19	124.34	149.43	166.21	182.69	207.34
poverty rate	3.74	8.12	12.01	15.12	18.23	23.30
poverty gaps[1] as a % of GDP	0.10	0.28	0.48	0.65	0.86	1.27
tax on income above 2½ times the urban poverty line that would close the poverty gap	0.48	1.33	2.24	3.06	4.07	5.96

1. The sum of all income shortfalls with respect to the poverty line in % of GDP.

Source: OECD based on Encuesta de Caracterización Socioeconómica Nacional (CASEN).

One problem might be that larger cash transfers could undermine people's work incentives, which would limit the positive impact on output and productivity. Research suggests, though, that such fears may be exaggerated at least in an emerging country context where these transfers tend to be small and beneficiaries have difficulties to make ends meet even if they have access to them. Studies of conditional cash transfer programmes in Brazil, Mexico, Nicaragua and Honduras suggest that they have no or very small effects on adult labour participation or hours, which are in some cases positive (Foguel and Paes de Barros, 2010; Parker and Skoufias, 2000; Alzúa *et al.*, 2010). Eyal and Wollard (2010) find a positive effect of South Africa's child support grant on the probability that mothers of recipient children participate in the labour force or are employed and a negative effect on their unemployment rates. OECD (2011) confirms these positive effects on labour market outcomes for poorer recipient mothers, while the positive impact on labour force participation in the sample comprising all recipient mothers comes with a higher probability of being unemployed.

Studies of programmes with larger cash transfers are more likely to find a negative impact on labour force participation or hours worked, although there are nuances to these results. Carvalho Filho (2008) finds that old-age pensions for rural workers in Brazil, which typically correspond to a minimum wage, reduced total hours and the probability that recipients worked. Bertrand *et al*. (2003) find a drop in hours worked for prime-aged individuals living with pensioners in South Africa, who receive comparatively

generous benefits. The employment probability for prime-aged men falls according to these results, although the same does not hold for women. OECD (2011) results suggest that the presence of a pensioner in the household has a negative effect on females' probability to be employed, although there is no significant impact on their labour force participation. There is a negative effect on male labour force participation, although broad labour force participation is not affected significantly. This latter concept includes discouraged individuals who would be willing to take up a job offer, but have stopped active job search. However, there is a qualification to these results. Once migrating household members are taken into account, there is a small positive impact on employment of prime-aged adults with pensioners belonging to their household (Ardington *et al.*, 2009). One interpretation would be that increased household resources can be used to support migrants until they become self-sufficient, while pensioners can look after small children, allowing prime-aged adults to look for work elsewhere. Overall, these results suggest that cash transfers in middle income countries probably have to be quite large to undermine work incentives.

This suggests that unless Chile was to increase benefits significantly above those in Brazil or Mexico, the danger that there might be negative effects on work incentives is likely to be limited. Once cash transfers increase beyond that, though, Chile might want to monitor whether work incentives are undermined. Well enforced job search and work requirements would then be a solution. *Ingreso Ético Familiar* recipients will, in fact, be required to enrol in employment programmes, which may involve a coach who helps them improve their employability and find employment according to current thinking.

Once the first phase of *Ingreso Ético Familiar* is firmly established Chile could experiment in pilot studies with different increases in transfer sizes to study the impact on health, education, skills and employment. This would be important information to decide on possible future increases in transfer size. *Ingreso Ético Familiar* should build on existing cash transfers and over time it should be better integrated with at least some of them. The targeting mechanism for *Ingreso Ético Familiar* will take other transfers into account, but there will still be different procedures and conditions for access. Stronger integration would make the cash transfer system overall simpler, more transparent and easier to administer.

The role of targeting

The proxy means test that Chile uses for a wide range of social programmes has been successful in targeting various social programmes to the poorest, but it is probably quite costly. Eligibility is determined through interviews based on a questionnaire, the *Ficha de Protección Social* (FPS). Household's earnings capacity is evaluated with econometric methods predicting household members' potential income with information on their educational attainment, occupational status and history. Declared earned income only accounts for 10% of the score for potential earnings. Other variables that are considered are household composition and health status among members. The Ministry of Social Affairs transforms the indicators collected by interviewers at the municipal level into a score for each household with a method that is not revealed to interviewers or potential beneficiaries. A range of social programmes are then targeted based on discrete cut-off scores that differ from programme to programme. A recent review (Comité de Expertos, 2010), revealed a number of weaknesses. These are related to the incentives set through discrete cut-off points with immediate benefit withdrawal and relatively loose verification of complex information with weak sanctions.

Given the discrete cut-off points for eligibility potential beneficiaries have incentives to make false declarations on their characteristics that they believe may have a strong influence on their score, such as household composition and the educational attainment and disability status of members. Until recently there were no systematic documentation requirements for the information provided by households, it was up to interviewers and municipalities how they verify the information they receive and controls or

sanctions for interviewees, interviewers or their supervising authorities were weak or non-existent. Households can ask for a re-assessment, but only those who believe that they would have a lower score than before are likely to do so. Otherwise, there is no mechanism to systematically update the scores. There is evidence that the accuracy of information is indeed questionable, as households and the incidence of disability according to the *Ficha de Protección Social* are much more numerous than they should be according to household survey data. More than 22% received a score that would correspond to the lowest decile of the score distribution according to a simulation with household survey data, thus more than double of what it should be (Comité de Expertos, 2010). These points to serious underreporting of various aspects of potential income or overreporting of needs.

Following the recommendations of the expert committee, the government wants to simplify the *Ficha de Protección Social*, to put more emphasis on verifiable data, thus allowing for cross-checking the information provided by families with administrative data sources, and to fight fraud with risk models. Scores will expire after two years and thus need to be updated regularly. These initiatives are welcome.

Withdrawing benefits more gradually would be an important complementary measure to attenuate incentives to make false declarations or avoid taking up employment. There is some anecdotic evidence that *Chile Solidario* recipients sometimes try to avoid taking up employment for fear of benefit loss (ClioDinamica, 2010). Opening the transfers to a wider range of beneficiaries over time would also avoid households above the cut-off point not receiving benefits, despite being relatively poor. This is a real issue in the Chilean context where the income distribution is narrow at the lower end, as noted above. Currently the government plans to keep targeting narrow under *Ingreso Ético Familiar*.

Given that Chile's means test is complex and that applying stronger verification would make it even more costly, one question is whether there would be more cost-effective targeting mechanisms. Madeiro *et al*. (2008) show that Brazil's targeted cash transfer programme, *Bolsa Familia*, which is mainly based on declared income, is almost as well-targeted as Mexico's and Chile's programme with their intricate proxy means tests. Chile might therefore want to consider targeting benefits mainly based on declared income, perhaps complemented by a small set of needs indicators, such as the number of dependent household members and disability among them. There could also be some complementary indicators for the specific social programme for which the means test is used, for example housing conditions in the case of housing subsidies. Household survey data suggests that it is possible to verify all income sources with administrative data for nearly 50% of all households in the lower half of the income distribution. In addition to that, random checks will be needed to verify that households do not have informal income in addition to their formal revenues. While this will require substantial investments in authorities' ability to verify benefit claims, this would hardly be more expensive than verifying information based on the *Ficha de Protección Social* and carrying forward its relatively complicated administration. Moreover, these investments are desirable by themselves, as they would help the government to fight informality and tax evasion more effectively.

Using declared income and updating the means test regularly rather than trying to assess potential income with a complex methodology would have the added benefit that the transfer could evolve into an income risk insurance over time. With a means test based on potential income that is not frequently updated, people who fall into poverty will often not be eligible for transfers. This would change if the means test was based on current, declared income. Such a test would allow the government to use cash transfers to protect households from income shocks, thus strengthening the automatic stabilisers of the economy. Gradual benefit withdrawal would also be easier with a simpler targeting mechanism.

Conditionality

Like many other cash transfer programmes in Latin America, *Chile Solidario* and *Subsidio Único Familiar* require recipients to comply with certain conditions to receive the transfers. In the case of *Chile Solidario* these conditions are personalised and developed by the recipient family with the support of social workers. They can concern health, education, employment housing, income, family life and legal documentation. The *Subsidio Único Familiar* requires regular medical controls for children under 6 and regular school attendance for children between 6 and 18. There will be similar conditions tied to the *Ingreso Ético Familiar* transfer.

One issue is whether conditionality is really necessary or effective to achieve the desired result. Monitoring conditionality is costly, and complying with the co-responsibilities is time-consuming for the household. If the poor invest too little into education or healthcare because they are credit-constrained and would be unable to satisfy their basic needs when investing, then unconditional cash transfers would be sufficient to solve the problem. They would also be more efficient, because they avoid enforcement costs and possible distortions, for example through inefficiently high investment in health or education.

Conditionality, on the other hand, may be justified if it enhances political acceptance of the cash transfers. Another issue may be that parents are misinformed about the returns to investments in education and health or their preferences may not be well aligned with those of their children. However, in those cases better information may be more efficient than imposing conditions on benefit recipients. Visits of social workers and mandatory participation in workshops may play this role in providing better information in Chile.

Some studies suggest that other characteristics than conditionality are more important for the success of cash transfers. In a statistical meta-analysis of research assessing the impact of cash transfer programmes on children's nutrition, Manley *et al*. (2011) find that the impact is not distinguishable for unconditional cash transfers and those with healthcare conditions, while programmes with conditions related to work and savings fare worse. Fernald *et al*. (2008) find that the cash component of the *Oportunidades* programme was associated with greater height, as well as better cognitive and language performance of children receiving the benefit, independently of conditions or nutritional supplements. On the other hand, there is also evidence indicating that, with good design, imposing conditionality can yield additional benefits. De Brauw and Hoddinott (2010) find that conditionality by itself did increase the impact of Mexico's *Oportunidades* on school attendance. This impact was particularly strong during the transition to lower secondary school, whereas there was no measurable effect on children continuing primary school. Results obtained by Attanasio *et al*. (2005) suggest that this may be due to the costs of schooling increasing with age. Thus, raising the grant for older children, while lowering it for smaller children, as an alternative to conditionality, can increase the effectiveness of the programme.

The conclusion for Chile would be that it is important to evaluate whether conditionality comes with additional benefits. *Ingreso Ético Familiar*, as conceived now, would have numerous different elements, some unconditional and many others tied to different conditionalities (see Box 2.). Choosing a simpler set-up with requirements for adults to search for employment and enrol in training, if necessary to improve their employability, would be much easier to administer and may well be the most effective way to help the poor strengthen their capacity to improve their living standards. Unlike in other countries in the region, the incidence of malnutrition among children in Chile is low (comparable to that in the richest OECD countries), school attendance is compulsory and it is generally high, although in the target group almost 60% of the children miss more than 5% of their classes. Thus, conditions regarding medical checkups and higher school attendance are in some sense redundant, although they may create further incentives for poor families to comply with the law. However, this should be enforced for all children, not only the poor.

Some of the conditions to which the government plans to tie benefits may even have harmful side effects. One example is the transfer that families, whose income is in the lower third of the income distribution, can obtain based on their children's ranking in their class (Box 2.). In particular, tying a large part of the benefits to children's ranking in school should be revisited, as it can be divisive. It will put a lot of pressure on teachers grading these children and discourage parents from sending their children to better schools.

To go for a simpler model, the government could launch a political discussion on what should be the base income that a household should receive when it can temporarily not secure any income. This transfer could be tied to training and job search requirements, along with support, and the transfer could be gradually withdrawn. This would be akin to France's *Revenue de Solidarité Active* (RSA). The transfer should be evaluated to understand the features that are most effective in strengthening poor households' capacity to overcome poverty for good.

The quality of complementary social services

When trying to enhance the poor's investment in human capital and their capacity to generate income, imposing employment, education or health conditions on benefit recipients is not sufficient. If schools or health services in poor neighbourhoods are of poor quality or not available at all, neither transfers nor conditions attached to them can be very effective. In Chile school enrolment is high, but the government needs to do more to close the gap in learning results between rich and poor children (OECD, 2010). The government currently invests a lot in schooling for poorer children. As long as results are evaluated to correct design, if needed, and ensure that the extra money is well spent, this may go a long way in providing better access to high-quality schooling for poor children. Chile should continue its efforts to invest more in the education of poor students.

Studies suggest that there are supply side constraints that can limit the success of *Chile Solidario* (OECD, 2009). Workloads for social workers are high in many cases and there is high turnover related to relatively low wages (Grupo de Politica Social, 2010). A study noted that employment programmes within Chile Solidario were not very well tailored to participant's needs nor to the local characteristics of the labour market. The programmes are often poorly coordinated with the business sector (Sur Profesionales Consultores, 2005). According to household survey data only 2% of *Chile Solidario* recipients stated that they had found a job through the local labour offices, and 4.5% thanks to *Chile Solidario* or the social worker that attends to them.

Municipalities differ strongly in resources and the capacity of their personnel to administer education and social programmes. The main source of own income for municipalities are property taxes, but these are subject to relatively high exemption thresholds, and thus revenues in poor municipalities with a lot of low-value houses are very weak. There is some redistribution of property tax revenues through the *Fondo Común Municipal* and there are central government transfers for various municipal tasks. However, the resulting degree of equalisation is weak compared with other OECD countries (Table 4). Average per capita revenues of the richest decile of municipalities is more than twice as high as those of the poorest decile even after fiscal equalisation. Within Greater Santiago the three richest municipalities have more than five times more resources per inhabitant than the three poorest ones. The Gini coefficient for average per capita fiscal revenues by decile also suggests that fiscal disparities across municipalities are high in Chile and fiscal equalisation does relatively little to correct this.

The central government is currently envisaging larger transfers to municipalities with weak tax revenues and a scheme to improve the qualification of the personnel who administer municipalities and this is welcome. Poorer municipalities need stronger resources to provide their citizens with high-quality services that help them overcome poverty. In the medium term, the government should consider

developing fiscal equalisation further, either by devoting a larger share of municipal or central tax revenues to the redistribution fund, or by increasing earmarked central government transfers to poorer communities, as in the case of increased voucher subsidy for poor children. Increasing property tax revenues along the lines suggested above would provide municipalities with vital extra resources. If municipalities participated more in the revaluation of housing and decided on tax rates within limits set by the central government, this would also enhance accountability. The example of several OECD countries, including Switzerland and Sweden, shows that a high degree of fiscal equalisation is possible, while maintaining incentives for subnational governments to collect more revenues at the margin.

The government should also regularly evaluate *Ingreso Ético Familiar* and the associated social programmes in terms of the impact on employment, wages, housing conditions or other desired results, as planned. This will help the government to correct design, if needed. When introducing new features of *Ingreso Ético Familiar*, such as employment or training programmes, it would be helpful to conduct pilot studies and test the impact of the programmes before rolling them out in the entire country.

Table 4. Fiscal disparities before and after equalisation[1]

	Highest capacity/lowest capacity[2]		Gini	
	Before equalisation	After equalisation	Before equalisation	After equalisation
Federal/ regional countries				
Australia	1.3	1	5.0	0.0
Canada	2.4	1.7	10.0	7.0
Germany[1]	1.7	1.1	6.0	2.0
Spain	2.1	1.4	15.0	4.0
Switzerland	3.8	2.5	15.0	11.0
Unitary countries				
Denmark	2.2	2	8.0	4.0
Finland	1.8	1.1	11.0	3.0
Norway	2.2	1.2	13.0	5.0
Japan	3.1		20.0	
Sweden	1.4	1.1	6.0	0.0
Portugal	12.7	2.1	34.0	14.0
Turkey	85.6	1.7	53.8	8.0
Chile	**20.6**	**2.3**	**48.7**	**13.7**

1. 2005 for Germany, 2010 for Chile, 2004 for all other countries; the data show actual revenues for Chile and revenue capacity for all other countries.

2. Ratio of maximum and minimum fiscal capacity of subnational governments before and after equalisation. For federal/regional countries the indicators are calculated for the state/regional level. For unitary countries revenues per capita are averaged by decile. In these cases, the table shows revenues per capita of the richest decile as a ratio of revenues per capita of the poorest decile.

Source: Bloechliger and Charbit (2008), Sistema Nacional de Información Municipal for Chile

Box 3. Recommendations to improve anti-poverty policies

- Continue to increase cash transfers, while further ensuring their effectiveness.
- Over time streamline the number of cash transfer programmes, by integrating them with the new *Ingreso Ético Familiar*.
- Keep the design of the new cash transfer simple and limit conditions, perhaps to job search and training requirements. Impose further conditions only if they are of proven effectiveness.
- Simplify targeting by relying mainly on household income. Over time make the benefits available to a wider range of beneficiaries, including by withdrawing benefits only gradually as income increases. Further pursue efforts to fight fraud more effectively.
- *Once the basis for Ingreso Ético* is firmly established, evaluate the effectiveness of the transfer and its different features, such as transfer size and conditionality, as planned, in improving households' ability to overcome poverty. Adjust design accordingly.
- Enhance fiscal equalisation to ensure that poor municipalities have sufficient resources to provide their citizens with high-quality services and continue efforts to improve these.

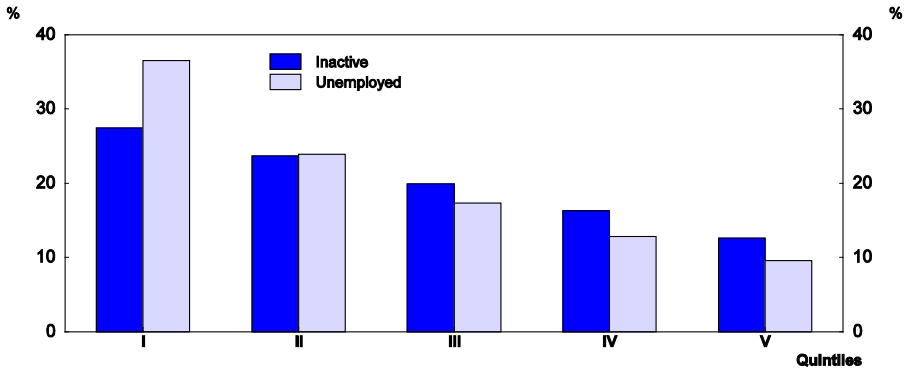
Improving labour market outcomes for workers at risk of poverty

Women, youth and the poor need help to improve their labour market outcomes

One of the key ingredients to help lift transfer recipients out of poverty in a self-sustaining way will be to help them find employment and develop their skills. Unemployment, inactivity and informality are particularly widespread among the poorest households (Figure 1.9 and 1.10). Low-skilled workers are much more likely to oscillate between the formal and the informal sector and inactivity or unemployment than workers with higher skills. This will have a negative impact on their retirement income later on, but also on the development of their skills through training-on-the-job and experience. Thus, supporting policies are needed to ensure that low-skilled and poorer workers can develop their full potential on the labour market and obtain employment.

Figure 9. Inactive and unemployed people across income quintiles

As per cent of total



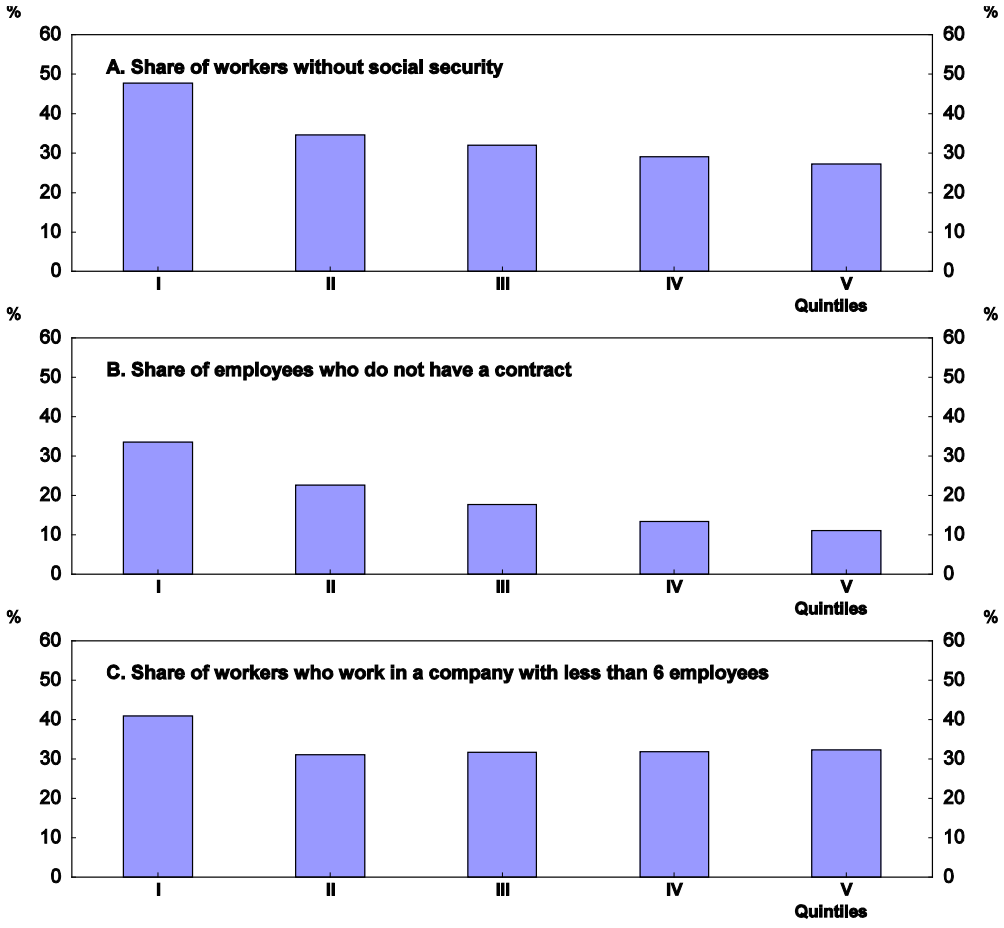
Source: CASEN 2009.

Overall, recent labour market performance in Chile has been good. Unemployment has decreased from above 10% in early 2009 to 7%. More than 950 000 new jobs have been created since January 2009. While 55% of this job growth is accounted for by low-paid activities - own-account workers without employees, household services and unpaid family members – the quality of salaried employed has improved to some extent. The number of temporary jobs and of jobs without any social security or a work contract has contracted, while indefinite employment relations and those with a work contract and pension health and unemployment insurance have increased, lifting their shares in total dependent employment.

Yet, overall the Chilean labour market shows clear signs of duality, as the shares of temporary work (28%) and employment without social security (more than 20%) remain large, with negative consequences for employers' and employees incentives to invest in human capital, in particular if it is firm-specific. Temp agency jobs have increased almost five-fold since early 2010 and employment with subcontractors has grown by 15%, while jobs with a direct relationship to the employer have contracted. Subcontracting and temp agency jobs, which now account for 17% of salaried employment, tend to be less well paid than employment with a direct relationship to the employer, with mean wages more than 20% lower than for regular work relationships. In addition, there is a risk that incentives to invest in human capital are weakened, when the employment relationship is not direct.

Figure 10. Informality and job quality across income quintiles

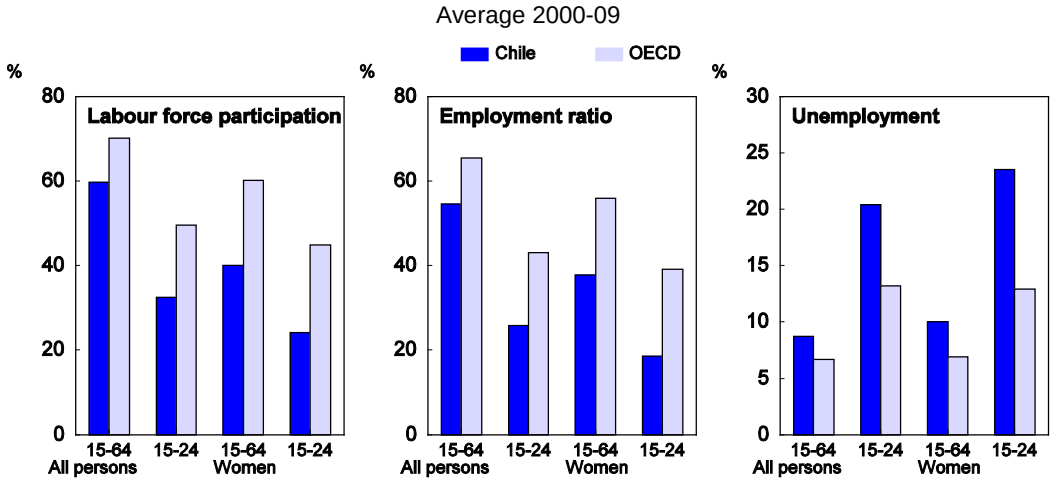
As per cent of total in the quintile



Source: CASEN 2009.

Notwithstanding recent improvements, unemployment has been higher in Chile than in the OECD on average, although this picture has changed somewhat after the recent recession, as employment recovered quickly in Chile in contrast to a number of OECD countries. The overall unemployment rate in Chile is now in line with the OECD average. However, the youth and female unemployment rates are still well above the OECD average, although the gap has narrowed compared to the average over the last 10 years, which was substantial (Figure 11). Labour force participation, in turn, continues to remain well below the OECD average in Chile, mainly owing to a particularly low female labour force participation – among the lowest in the OECD.

Figure 11. Young people and women in the labour market



Source: OECD, Labour Force Statistics Database.

Women earn much lower wages than men, with salaries of 85% of those of men, and 70% if the self-employed are included. Over the last 20 years, only the gender wage gap for workers with more than 13 years of education has diminished with women's salaries climbing from 55% of those of men to 67%. While some of this is due to observed and unobserved characteristics, such as education, work experience, pure discrimination is consistent with the available data and models (Bravo *et al*, 2008). Discrimination between men and women is unconstitutional in Chile. To enhance this, the government passed a law in 2009 that explicitly disallows discriminating wages between men and women who perform similar tasks.

Training and job placement services

Strengthening the local labour offices

Important elements to help low-skilled workers, women and youths improve their prospects on the labour market will be effective job counseling that guides them towards training and places them in jobs that fit their skills. In these areas there is room for Chile to make further progress.

Chile's local labour offices (*Oficinas Municipales de Intermediación Laboral*, OMIL) are relatively underdeveloped. They vary a lot in terms of technical equipment and qualified personnel. Capacity to provide effective job counseling is lacking in particular in rural areas. A study on the government's re-inforcement programme for labour offices suggests that some small and rural offices lack basic equipment to the point that they used the placement incentive pay they received from the Ministry of Labour for acquiring basic material, while bigger and better equipped offices were able to invest this money in

personnel to liaise with enterprises (ClioDinamica, 2010). According to household survey data only a bit above 1% of employees feels that an OMIL has helped them find a job.

Networks of local labour offices with local businesses are often weak, which makes it more difficult for job counselors to match employers and employees effectively. In a number of cases, the skills of the job placement personnel are not sufficient to perform their tasks effectively. Hiring and training well-qualified staff will be particularly important to help low-skilled workers, guide them towards training and place them in formal, dependent employment or help them to create their own business. The labour offices are often not well prepared to counsel low-skilled workers, such as *Chile Solidario* participants. The fact that only 3% of *Chile Solidario* recipients are registered with OMILs may well be a testimony to the weak confidence that these clients have in the value of OMIL services. The low skills of these workers and the fact that they are used to informal and independent work, but generally have little experience with formal, dependent employment, requires experienced job counselors who are well prepared to work with these clients.

The government is working to improve the functioning of job intermediation services, tripling resources allocated to local employment offices in 2011 (now 2.4 billion pesos, or 0.002% of GDP). The programme includes flat transfers and an incentive pay system for successful job placement as well as training for the personnel of the local labour offices. One question is whether it makes sense in the current context, where OMILs have such different capacity, to assign performance bonuses. Maybe the focus in the first stage of reinforcement should be to level the basic capacity of OMILs that are particularly weak. In the second stage, when the capacity of different OMILs is more even, the central government could then move towards assigning performance bonuses, as well.

The government has recently started a training programme for OMIL employees. The seminars focus on skills to adjust intermediation services to individual clients as well as to local labour market conditions and to build networks with local businesses. The aim is to establish a permanent training programme for OMIL personnel provided by a university.

Chile should continue these important efforts. In particular, the government should assess what needs to be done to ensure that local labour offices have comparable capacity across the country. This may require more effective fiscal equalisation, as discussed above. Low-income municipalities with many low-skilled citizens, who have difficulties in finding jobs of decent quality, are in particular need of high-quality employment services and weak municipal resources should not be an impediment to this.

There are good reasons to enhance the quality of job intermediation in Chile. OECD experience suggests that job intermediation programmes are particularly successful in reducing the time spent in unemployment, while increasing employment rates and earnings (Kluve, 2010; Card *et al.,* 2010), while classroom and on-the-job training programmes yield only small effects in the shorter term, but bigger effects in the long term. In a developing country context Betcherman *et al.* (2004) confirm that job placement services are relatively effective and costs are comparatively low, although they are of limited use by themselves when structural unemployment is high and there is little demand for labour. The government plans to integrate private and public job intermediation with publicly-funded training programmes and that will be welcome.

The government has also started to engage private providers into job intermediation through the *Bono de Intermediación Laboral*, which pays job intermediation agencies for placing jobseekers. OECD experience suggests that partial outsourcing of job intermediation services can be cost effective. However, the public agency must be prepared to monitor private agencies' performance in providing job intermediation services and training, compare with its own results and fight fraud. In Chile this will be particularly important, as the role of private placement agencies is currently limited, with only ½ per cent

of employees stating that they have found their jobs thanks to a private agency. The Ministry of Labour should conduct such evaluations, as this would be beyond the capacity of municipal labour offices. The fees for the private agency have to be designed to reward sustainable job placements and minimise fraud as well as the risk that private agencies cherry pick and choose only the most employable candidates. Chile foresees higher payments for placing hard to place candidates, which is a sensible approach, but agencies can choose freely from a pool of candidates open to all private agencies. Unless fees for the hard to place are high enough, agencies may prefer to concentrate their efforts on workers who are easier to place. Letting agencies bid for predefined pools of candidates, which are diverse in terms of work experience and qualifications, would prevent agencies altogether from cream-skimming and it would allow the government to compare their performance if each of them had a pool with a similar composition. Agencies could be paid depending on the share of candidates that they place with premia for finding jobs for hard to place candidates. The government plans to pay out fees to agencies fully only after the candidate has been retained for three months in the new job. Another possibility to create incentives for agencies to search for longer-term employment would be to withhold part of the fee until candidates have spent a year in their new job.

The government also created an electronic platform for job search, *Bolsa Nacional de Empleo.* The tool has the potential to make it easier for job counselors to place their clients and jobseekers can access the tool directly. In 2009 only 1% of employees stated that they had found their job through this tool. At the time, it was only available for jobseekers visiting an OMIL. Since then the government has made the tool available through the internet, which has increased its use and potentially its effectiveness.

It is not yet clear how the envisaged employment programmes for *Ingreso Ético Familiar* will fit into the structure of municipal labour offices, private placement services and publicly-financed training programmes. The current thinking is that an employment coach will attend to recipient families to help them improve their employability and find a job. Chile should evaluate its different efforts to improve job intermediation services and make sure that they are well coordinated or even integrated. Over time, it should retain only the most effective of the different programmes. Concentrating efforts to train staff at municipal labour offices that is specifically qualified to guide low-skilled workers towards training and employment may well be more efficient than pursuing a patchwork of different structures that could be difficult to administer and monitor.

Training, public employment programmes and wage subsidies in Chile

Training and other active labour market programmes can be useful in raising jobseekers abilities to generate income. However, publicly financed programmes in Chile are insufficiently targeted at those who need training most to overcome barriers towards employment. Around 80% of total public training resources are devoted to *Bono de Franquicia Tributaria para la Capacitación*, a programme that offers tax breaks to employers who decide to send their employees on training with certified institutions. This programme disproportionately benefits higher-income workers with higher education who work in large enterprises with sophisticated human resource management. Less than 5% of the programme's resources go to workers with basic education or less (Castro and Viñaspre, 2011; Larrañaga *et al.*, 2011). Moreover, recent studies commissioned by the government suggest that the programme has no measurable effect on salaries or employment in the long run (Larrañaga *et al.*, 2011). This may be related to institutional problems. As an example, more than 70% of the training programmes financed by *Franquicia Tributaria* lasted less than 18 hours.

There are other training programmes that are of doubtful effectiveness. One example is *Bonificación a la contratación de mano obra*, which combines wage subsidies for a period of four months with training subsidies for companies who hire a previously unemployed worker. The programme has a special arm for *Chile Solidario* recipients with higher subsidies for young workers. A study found no

significant impact of the programme on the probability that beneficiaries remain in employment or receive higher wages (Agrouc, 2009).

On the other hand, several programmes directed at low-skilled workers seem to have significantly positive impacts on employment and wages, especially when they are longer-term and combine classroom training with practical work experience and job intermediation (Larrañaga *et al.* 2011).

The central government created a commission that has evaluated existing training measures. Based on the result the government plans to increase slots for successful training programmes more than threefold in 2012 and it wants to reduce the tax break for *Franquicia Tributaria*. This is welcome. The government should indeed use this opportunity to gradually phase out or reform programmes that show little or no effect on beneficiaries' wages or employability, such as *Franquicia Tributaria*, expand those that have proven useful and develop more effective programmes to help groups with difficulties to find employment, such as the low-skilled and women. Programmes of this type are currently small-scale and they are dispersed across many different institutions. Streamlining and developing Chile's training programmes, to ensure that they are efficient, will be important to help the poor improve their living standards. Chile should consider bundling training and employment programmes at one institution, for example SENCE, to facilitate rigorous evaluations and strategic planning. Better integrating SENCE with the network of local labour offices and training job counselors might promote the flow of information between both institutions and facilitate tailoring programmes to the need of job seekers (OECD, 2009). The plan to integrate job intermediation services and training programmes will be helpful in this respect. The government also considers creating a permanent commission that would regularly review training, job intermediation and other labour market programmes and policies led by SENCE.

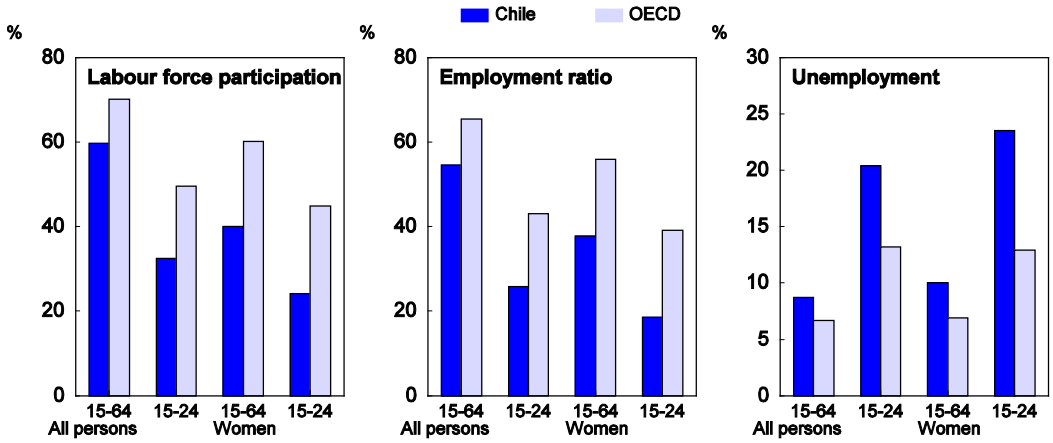
Effective and efficient protection for workers from the effects of unemployment

Should unemployment benefits be extended further?

The unemployment benefit system created in 2002 in Chile is mainly based on savings in individual accounts with small complements from an insurance fund, called *Fondo Solidario*. The system started out with moderate benefits, which allowed the government to assess sustainability first. Until a reform in 2009, access to the insurance fund was very restricted. As a result the fund was involved in only about 6% of the cases of benefit receipt. Account balances for many workers are too low to ensure benefits providing adequate protection. Workers on fixed-term contracts and low-wage workers in particular, who are most likely to experience unemployment, contribute less regularly, owing to frequent movements into and out of formality, and with relatively low average amounts. To this date a large minority of workers has accumulated less than a monthly minimum wage in their accounts, only around 10% of workers have more than 5 monthly minimum wages. The replacement rate of unemployment benefits and the duration is short. In fact, Chile has the lowest average replacement rate over 60 months in the OECD even after a recent reform that extended benefit receipt for many workers (Figure 12) Around 85% of the workforce is affiliated to the system, but only about half of these workers contribute to their accounts every month. Around 20% of private salaried workers, who are obliged by law to contribute to the system, do not.

Figure 12. Unemployment benefit replacement rates (net of taxes), 2009

Average for four family types and two earnings levels[1]



1. Unweighted averages (single and one-earner married couple with no children and lone parent and one earner married couple with two children) for earnings levels of 67% and 100% of average worker income, without social assistance.

2. Initial phase of unemployment but following any waiting period.

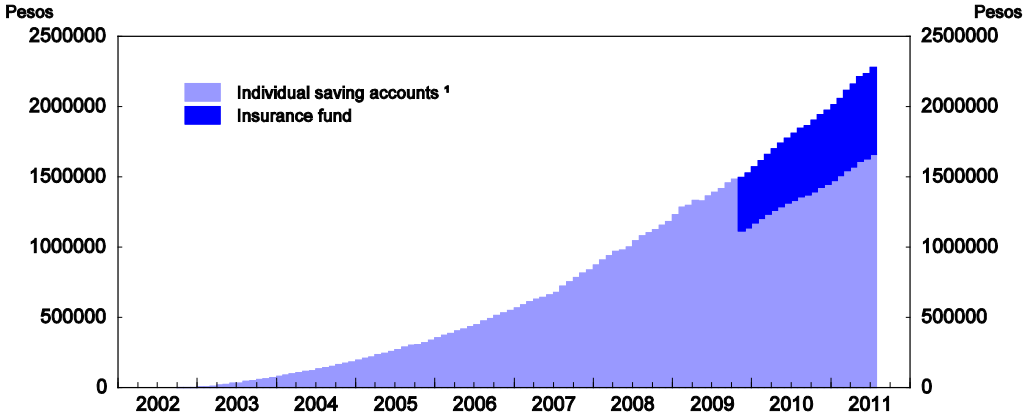
Source: OECD, Tax-Benefits Models.

A reform in 2009 eased access to the insurance fund, making it easier to top up own savings to ensure five monthly payments for dismissed workers with indefinite contracts, with the replacement rate tapering off from 50% to 35%. The government also eased access to the insurance fund for workers on fixed-term contracts, who can now receive two monthly payments with a replacement rate of 35% and 30%. Payments for beneficiaries of the *Fondo Solidario* can be extended for two further months with a replacement rate of 25% each when the unemployment rate is more than a percentage point higher than the average over the last four years. Workers who draw on the *Fondo Solidario* are required to look actively for work and cannot decline a job offer. After the earthquake in 2010 access to unemployment benefits was temporarily eased for workers, who became unemployed or whose work places were seriously damaged as a result of the natural disasters.

However, the large majority of workers with a right to the insurance fund payments, around 85%, never uses it, pointing to a need for better information. Another reason could be that costs of the requirement to visit a local labour office every month during benefit receipt do not match the benefits in terms of effective job search assistance (Comisión de Usuarios del Seguro de Cesantía, 2010). In some cases, workers may be deterred by the provision that they can draw on unemployment insurance fund only twice in five years, or they may expect their unemployment spell is to be short-lived. The government should conduct a survey to find out what the problem. It launched an information campaign about unemployment benefits and pensions in December of 2011 and it will require the private administrator of the unemployment benefit funds to provide its affiliates with better information. This is a welcome initiative.

Despite the recent reforms that extended the access to unemployment benefits and prolonged the duration of benefit receipt, funds accumulated in the individual savings accounts and the *Fondo Solidario* continue growing (Figure 13). This suggests that unemployment benefit contributions could be reduced. However, labour tax wedges are very low in Chile and thus the benefit of reducing contributions in terms of improved employment are likely to be limited (Figure 14). Alternatively benefits could be extended, either through higher transfers and longer benefit receipt or by using parts of the funds to finance better job search assistance and training measures.

Figure 13. Development of funds in the unemployment benefit system



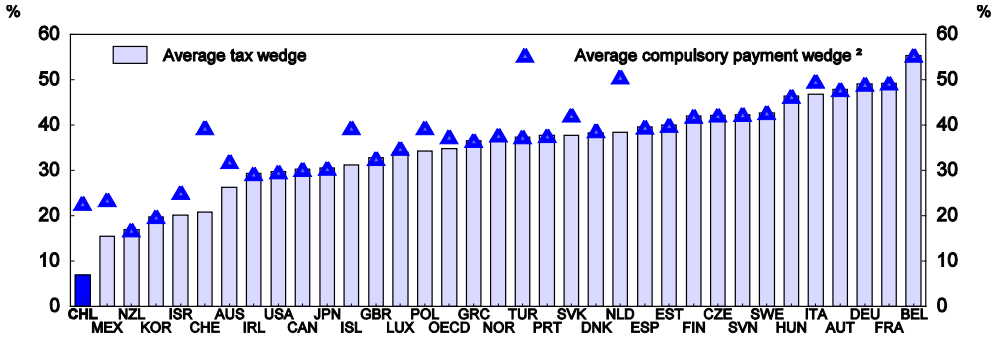
1. Before November 2009, this corresponds to the sum of funds in individual saving accounts and the insurance fund.

Source: Superintendencia de Pensiones.

In theory, unemployment benefits can have negative or positive effects on workers' future employability. They can help workers without savings or access to credit to hold out for a job that better matches their skills, thus increasing their productivity in their next job (Acemoglu and Shimer, 2000), their wages and employment duration. Unemployment benefit extensions also have important benefits for recipients, because they facilitate consumption smoothing (Gruber, 1997). On the other hand, unemployment benefits with long duration and high replacement rates could weaken job search incentives. If this contributes to long-term unemployment it could damage employment prospects permanently, if skills become obsolete because of structural change or because workers lose them to some extent, when not practising their profession over a long period of time. Another risk is that employers take unemployment of long duration as a signal of poor skills or motivation, making it increasingly more difficult over time for the unemployed to find a job.

Figure 14. Average compulsory payment wedge and average tax wedge[1]

As per cent of augmented total labour costs, 2010



1. For a single person at 100% of average earnings, no child.
2. Comprises income tax, social security contributions and compulsory contributions to private social security, such as pensions, healthcare and unemployment benefits.

Source: OECD, Taxing Wages Database

Macroeconometric evidence based on a sample of OECD countries suggests that higher benefit replacement rates and longer duration of benefit receipt are associated with higher average unemployment rates (OECD, 2006). However, recent evidence based on individual data and microeconometric techniques paints a more nuanced picture. Evidence for the US and Germany suggests that extension of the duration of benefit receipt had only modest effects on job search efforts and duration of unemployment (Card and Levine, 2000; Schmieder *et al.,* 2009). This may be different for the level of benefits. Recent research based on data recording individual's use of time suggests that the impact of the unemployment benefit replacement rate on search efforts is large enough to explain the difference in the unemployment rate between the United States and Europe (Krueger and Müller, 2010). On the other hand, a study using administrative audit data of job search efforts finds that 95% of the unemployment maintains an active job search and higher benefits actually produce higher search efforts (Young, 2010).

Even if higher unemployment benefits or longer duration of benefit receipt had an impact on the duration of unemployment, this could be positive if it was because benefits allow workers to hold out for a better job. Indeed, recent evidence suggests that the larger part of the impact of unemployment benefits on the length of unemployment spells is due to liquidity problems of households facing credit constraints rather than moral hazard effects (Chetty, 2008). However, OECD results for Brazil suggest that there may be some form of moral hazard, as some households seem to combine benefit receipt with informal employment (OECD, 2011). On the other hand, other authors found no impact of unemployment benefit duration in Brazil (Cunningham, 2000), and others found that income support reduces the exit probability to the informal sector, while increasing the exit probability to the formal sector (Margolis, 2008). The latter result would indicate a positive effect of unemployment benefits on the quality of job matches. Overall, evidence of such effects across different countries is mixed. Card *et al.* (2007) and Van Ours and Vodopivec (2008) find no effects, while Caliendo *et al.* (2009) for Germany and Tatsiramos (2009) for a number of European countries find positive effects. Gangl's (2004, 2006) results suggest that more generous unemployment benefit systems increase the duration of joblessness, but also the wages in the new job, although this finding is not confirmed by Schmieder *et al.* (2009). Centeno (2004) finds that higher unemployment benefits lead to jobs with longer tenure.

The evidence on the effects of higher benefit replacement rates and longer duration is unclear as to whether positive or negative effects dominate, but this is likely to depend on the starting point, as well. Benefit replacement rates and unemployment benefit duration are much higher in most OECD countries than in Chile and thus work disincentive effects are likely to be less important in Chile.

This suggests that Chile should consider increasing the size and also the duration of its unemployment benefits, but should evaluate the effects carefully. Chile could increase benefits and duration gradually, while collecting the necessary data to gauge the impact of these increases on job search efforts, the length of unemployment spells and the quality of job matches thereafter. One issue that the government needs to take into account is that the assessment of the sustainability of the system may change fundamentally as more workers get informed about the possibility to draw on unemployment benefit.

Chile should consider allowing access to unemployment accounts for workers with temporarily reduced hours during crises. This has helped mitigate the impact of the recent recession on employment in a number of OECD countries and may work better than the programme that allows workers to go on training funded by unemployment benefits.

More generally, Chile could benefit from a more flexible approach to working hours. The reference period for working time is a week. While part-time work is possible, it cannot exceed 30 hours a week. For full-time workers daily working hours cannot exceed 10 hours, weekly working hours cannot exceed 45 hours and workers cannot work less than five or more than six days. One way to make the system more flexible would be to allow social partners to negotiate monthly or annual working time that can be

distributed freely over the reference period, while the law could perhaps impose maximum average working hours per week or a daily maximum that cannot be exceeded. The government recently submitted a draft law to Congress that would allow social partners in the agricultural sector to negotiate longer overtime within a monthly reference period under collective agreements.

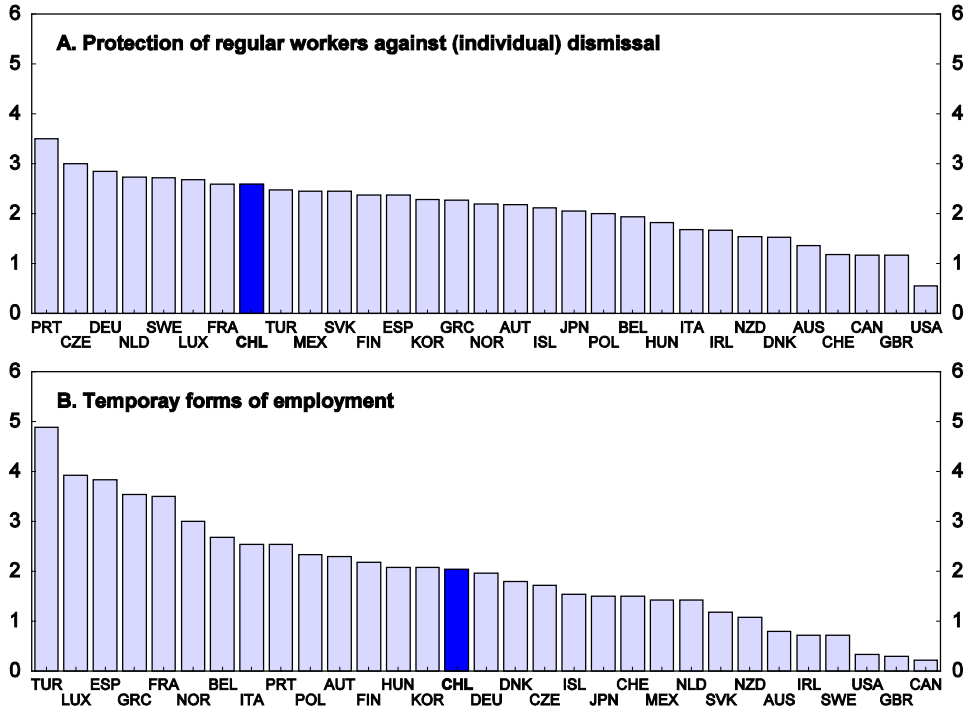
Should severance pay be reduced?

With a stronger protection through unemployment benefits, Chile could reconsider its employment protection legislation. While employment protection for workers on temporary contracts is about average in Chile according to the OECD's employment protection legislation (EPL) indicator (Figure 15), a large share of new jobs recently created is informal or short-term as a result of subcontracting and the use of temporary work agencies, as discussed above. This indicates that employers are reluctant to create longer-term employment relationships. One reason may be that employment protection for workers with indefinite contracts is stronger in Chile than in most other countries, mainly owing to relatively high severance pay that increases with seniority. This is still the main pillar of worker protection against unemployment in Chile, as in many other countries in the region.

OECD experience suggests that high costs of dismissal for permanent workers combined with lax regulation of temporary contracts can lead to a dual labour market (Blanchard and Landier, 2002; Dolado *et al.,* 2002; OECD, 2004) where a part of the workforce can become locked in unstable work relationships with lower chances for training and career progression and a higher risks of paying the cost of crises. Sixty per cent of annual labour turnover is accounted for by workers on contracts with limited duration (Dirección del Trabajo, 2007), although approximately 70% of all dependent jobs are of indefinite duration. This is an indication that employers react strongly to severance pay by terminating job relationships, preferably with workers without entitlements. Only workers with job tenures above 12 months are entitled to severance pay and this group is as small as 6% of all formal and informal employees who become unemployed. Moreover, a significant part of laid-off workers who do have a right to severance pay seem to receive none or less than they are entitled to. Many firms going bankrupt have not provisioned for severance pay, as there is no obligation to do so, and cannot pay (Cowan and Micco, 2005). In that sense, severance pay does not serve as a very effective protection for laid-off workers.

Figure 15. Employment protection legislation (EPL), 2008

Scale from 0 (least restrictions) to 6 (most restrictions)



Source: OECD, OECD Indicators on Employment Protection Database.

There is some evidence that severance pay that increases with job tenure has negative effects on employment and participation rates of young workers in Chile, while favouring prime-aged and older workers, although with no significant effects on aggregate employment and labour participation (Pagés and Montenegro, 2009). This study finds that the adverse effect on youth employment is essentially driven by the link between severance pay and job tenure. Caballero *et al.* (2006) show that in countries with stricter job security regulation the adjustment of employment to its optimum level after shocks is slower, also reducing output and productivity growth. Micco and Pagés (2006) findings suggest that job security legislation reduces employment and output in very volatile sectors, mainly through a reduction in net entry.

Given that severance pay provides protection only for a small fraction of workers, while probably contributing to labour market duality, Chile should reconsider its employment protection. One possibility would be to limit severance pay, by making it flat rather than increasing with seniority. The government should make severance pay available to all workers, by increasing employer contributions to individual savings accounts or the insurance fund. This would make the system more neutral.

Workers consider severance pay an acquired right and reforms are therefore politically difficult to implement. A reform package that strengthens unemployment benefits while limiting severance pay should be more acceptable to workers, while improving their protection and providing them with more equal opportunities to find a high-quality job. If entitled workers start to use the unemployment benefit system more, higher contributions may be needed at some point to strengthen benefits, while maintaining the system's financial sustainability. However, this may still be efficient. García, Gonzalez y Navarro's (2009) research suggests that lowering severance pay while increasing wage taxes to finance better unemployment protection for dismissed workers would have a positive impact on well-being in Chile.

What role for in-work benefits in Chile?

In 2009 Chile introduced an in-work benefit (*subsidio al empleo joven*) for low-wage workers under 25 whose family belongs to the 40% poorest in the country according to their score in the *Ficha de Proteccion Social* (FPS). The subsidy can reach up to 20% of wage income for those workers with the lowest wages and is gradually withdrawn with rising wages, with a third of the subsidy going to the employer and two thirds to the employee.

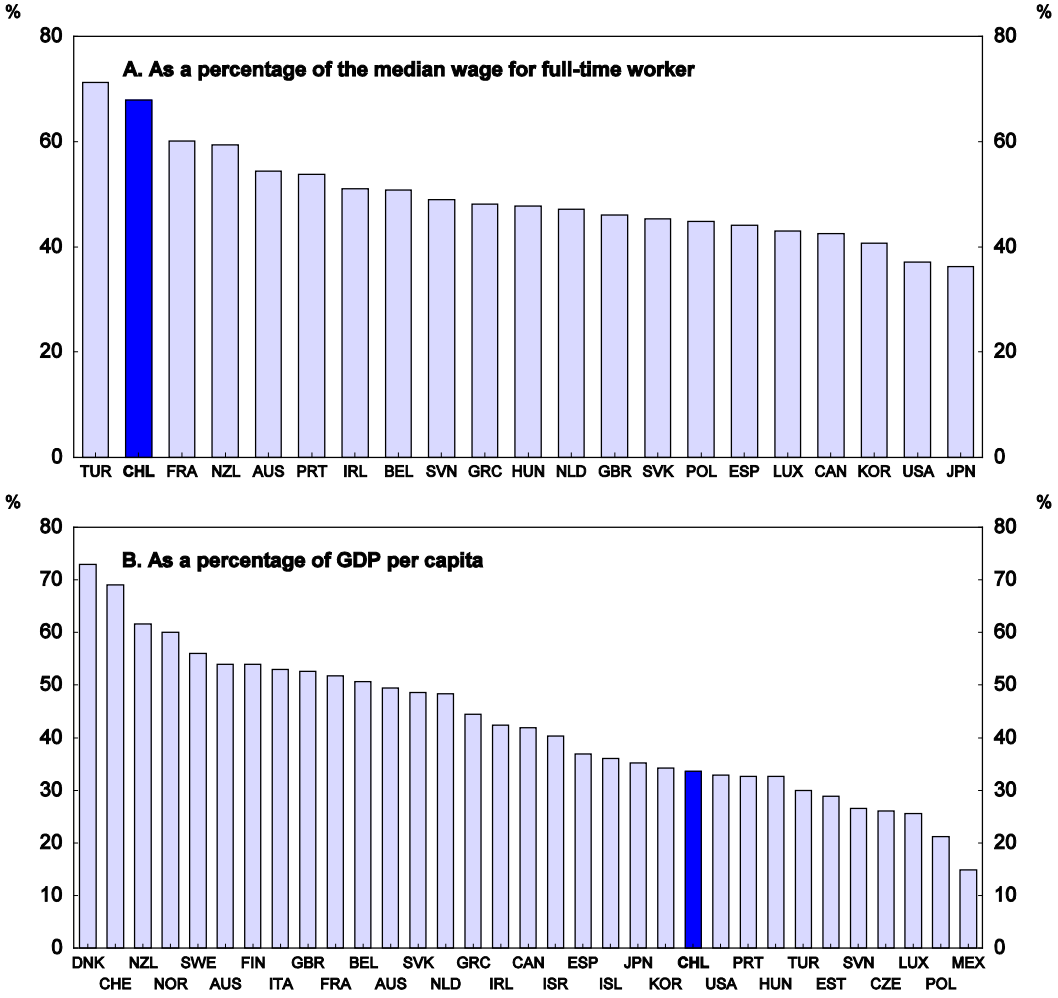
While no thorough evaluation of the Chilean scheme is available, OECD experience with in-work benefits suggests that they are associated with positive, albeit small, employment effects. When targeted on family income, as in Chile, they can also be a cost-effective instrument to reduce income inequality, in particular when the income distribution is wide (Immervoll and Pearson, 2009). In-work benefits can have a negative effect on incentives of second earners when they are targeted on family income. In Chile, there may be an element of this phenomenon, as the benefit is targeted on the wage rate of the young worker, on the one hand, and the *Ficha de Proteccion Social (FPS)* score of her family, on the other. While the subsidy is withdrawn gradually, as the wage increases, the withdrawal with respect to the *Ficha de Protección Social* score is abrupt. This risks limiting the positive effect that the in-work benefit is supposed to have on young people's work incentives for those who live in families with a FPS score close to cut-off point. It might even deter other members in the family to take up employment for fear of losing the wage subsidy.

The government plans to introduce a similar wage subsidy for low-income women as part of *Ingreso Ético Familiar*. However, before extending the benefit to other groups the government should carefully evaluate the impact of the subsidy on young workers' employment and on the income distribution. One way to avoid potential work disincentive effects associated with abrupt benefit withdrawal would be to opt for a gradual phasing out as workers' FPS score increases. This would become easier if the FPS score were to depend mainly on family income, as suggested above. Work incentives of the young and their family members would be enhanced even more if the in-work benefit was targeted at young workers' wages only without considering their family income.

The minimum wage in Chile is relatively high in international comparison as a ratio of the median wage, but this is partly because the wage distribution is so narrow at the lower end. Expressing the minimum wage as a percentage of GDP per capita results in a different picture (Figure 16). Like in-work benefits, minimum wages can enhance labour supply, as they increase take-home pay for workers. Minimum wages can also help to reduce wage inequality (Koeniger *et al*., 2007 and Checchi and García-Peñalosa, 2010), although they are less effective than more targeted measures, as minimum wage earners may live in high-income families. On the other hand, they avoid some of the efficiency problems associated with better targeted measures, such a negative work incentives in the withdrawal range in the case of in-work benefits. In combination with in-work benefits they can be particularly useful, because the size of benefits needed to attain a given income is smaller with a wage floor. The minimum wage also prevents the employer from lowering wages beyond it in response to an in-work benefit, thus ensuring that a larger part of the benefit goes to employees.

Figure 16. Minimum wages across OECD countries[1]

2009



Source: OECD; ILO Wage Report 2011; IMF, World Bank; CASEN.

On the other hand, a minimum wage that is above many workers' productivity can reduce labour demand and thus employment. While evidence on the effect of minimum wages on employment is very inconclusive, with many studies finding no impact on employment and unemployment, including in Chile (see OECD, 2006; Martínez *et al.*, 2001), some studies suggest that minimum wages may have a negative effect on employment prospects of some groups, such as low-skilled or young workers (for an overview over the literature see see Neumark and Wascher, 2007). The OECD therefore recommends differentiated minimum wages with a lower rate for young workers. The part of the Chilean in-work benefit that goes to employers lowers the labour costs for young workers and is thus to some extent a substitute for a lower minimum wage rate for young workers, although associated with fiscal costs. Chile has a reduced minimum wage for workers under 18, but not for young workers above that age.

If a negative impact on employment dominated, minimum wages could actually have a negative impact on income inequality despite compressing the wage distribution. Among the few studies that explore this issue some find that this is indeed the case (Checchi and García-Peñalosa, 2008), while a

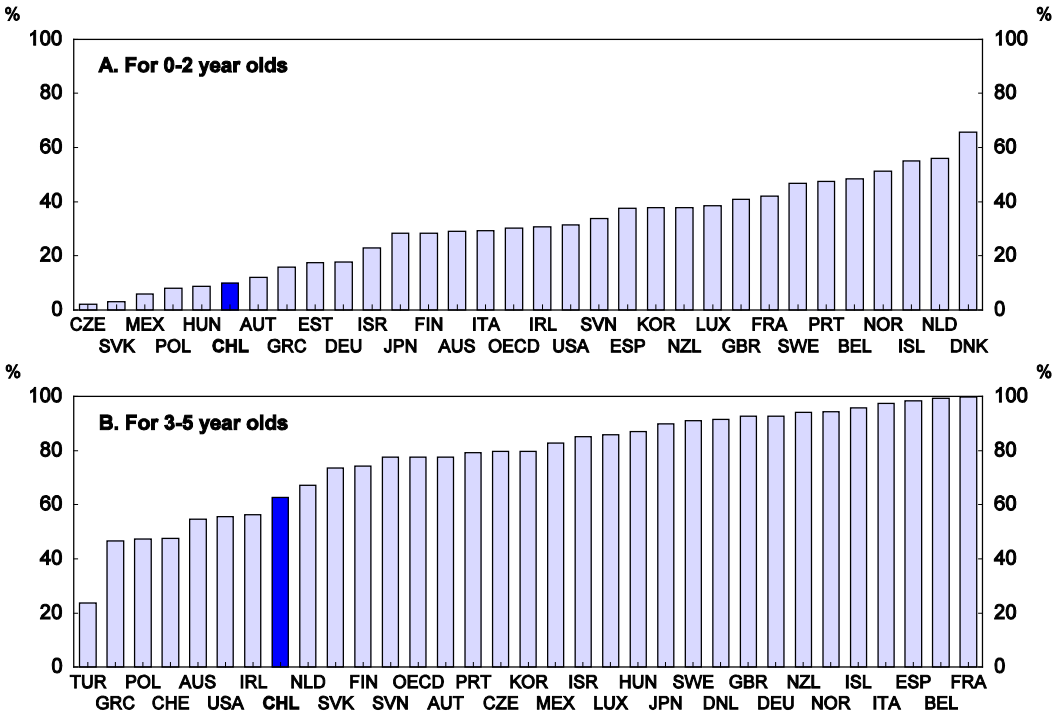
recent OECD study finds no significant effect on employment with the positive impact of minimum wages on the wage distribution dominating (Koske *et al.*, 2012).

Female labour market participation

The relatively weak position of women in the Chilean labour market is likely related to a number of barriers to employment for them, in particular for single mothers with low wages. While Chile has made important efforts to increase the number of nursery and kindergarten places, coverage is still low in international comparison (Figure 17). Moreover, residential segregation is likely to exacerbate the problem, as mothers who have to commute for several hours a day would need childcare for much longer than what is available to accept a full-time job. According to household survey data 10% of inactive women cite difficulties to secure childcare as a reason. The government is making substantial efforts to increase childcare coverage, which has increased from 33% to 40% for children up to age 7. The government wants to increase enrolment of children below 4 by 3% by 2014 and ensure universal coverage for children in the two lowest income deciles for children aged 4 and 5. These important efforts should continue.

Figure 17. Coverage with early childhood education and care across OECD countries

Share of children in formal childcare or in educational pre-school programmes, 2008



Source: OECD, Family Database

Some labour regulations that are meant to favour women actually risk turning against them. As an example, enterprises with more than 19 women have to provide a kindergarten place for the first two years. Since children have both a father and a mother the rationale for this regulation is not quite clear. Moreover, this regulation can deter companies from employing more than 19 women. Chile should consider scrapping this provision or, at a minimum, making it gender neutral by obliging firms with a certain number of employees to provide childcare facilities or financial support for alternative providers. However, aiming to

provide free childcare for the – say - 40% poorest families, while asking for co-payments from richer families is likely to be a more effective way to help families reconcile work and family life.

The government has extended state-funded maternal leave after birth from 12 to 24 weeks. It is capped at a monthly salary subject to social contributions of around 2 800 USD. The extension is longer for children with health problems and those with siblings. The extra 12 weeks can be further increased to 18 weeks if the mother and her employer agree on a part-time arrangement, in which case the mother can opt for 50% of the corresponding benefit. Mothers can transfer their rights to the father for 6 weeks or 12 weeks if the parents take the leave on a part-time basis. At the same time, the government has taken stricter measures to counteract the common practice to extend maternity leave by providing sick certificates that some doctors issue without any medical basis. The government also eased access to paid maternity leave for temporary workers with a minimum record of social charges, regardless of whether they were employed at the time of birth.

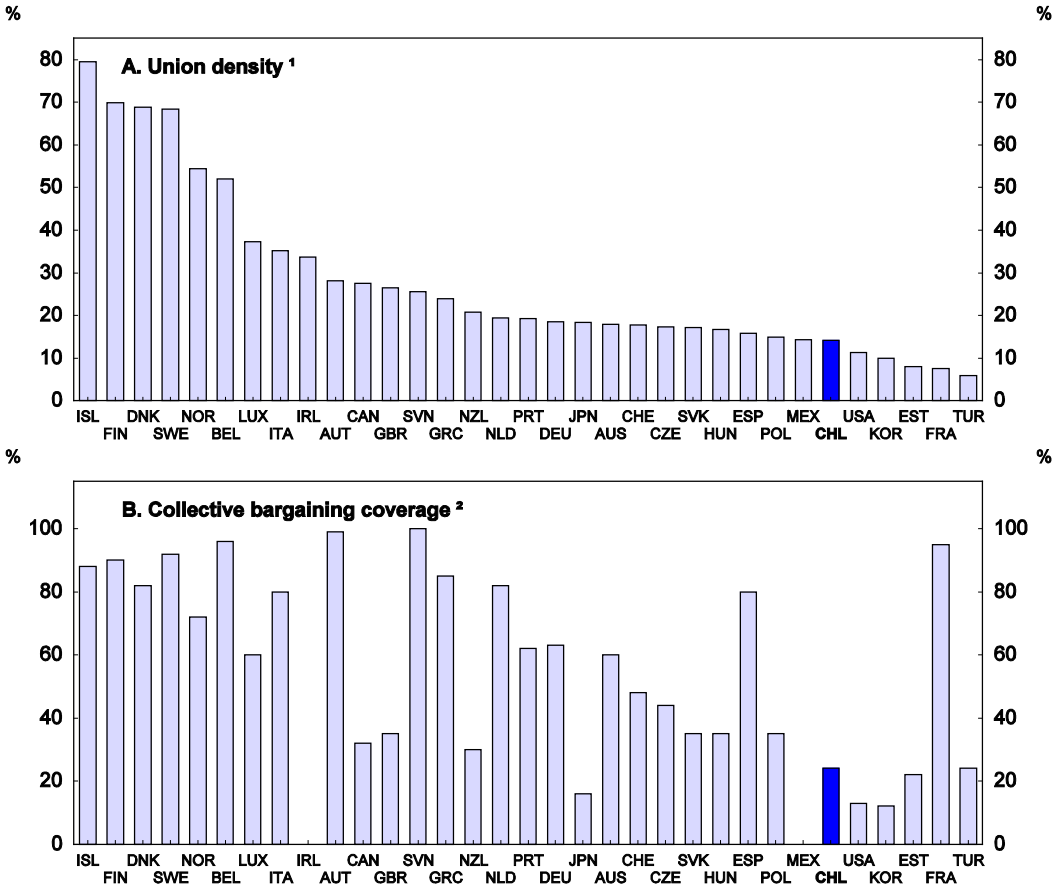
Studies have shown that parental leave can mitigate the negative effect of children on women's wages by shortening the time after which she returns to work (Burgess *et al.*, 2008; Berger and Waldfogel, 2004) and increasing the likelihood that women return to their pre-birth job, thus allowing them to capitalise on the benefits of accumulated tenure with their existing employer, such as seniority, training and access to internal labour markets (Baker and Milligan, 2008). However, this holds true only for relatively short periods of leave, while periods of leave that exceed one year can lead to a substantial loss of human capital and a decrease in wages (Ruhm, 1999). Bassanini and Venn (2008) present some evidence that an increase of maternity leave from short durations can increase productivity, with a stronger effect when the leave is paid rather than unpaid. Plans to increase paid maternity leave after childbirth are thus welcome.

Labour relations

Unionisation density and coverage are relatively low in Chile (Figure 18) and strongly concentrated on the public sector. Chile's legislation allows strikes and wage negotiations only at the firm level, unless firms and unions agree otherwise. The common practice of companies to obtain a tax identification number (RUT) for each of their subsidiaries, at which point these are considered as a separate company, effectively results in wage negotiations at the plant level.

There is little evidence that wage negotiations at the firm level have a negative effect on employment outcomes. At the same time, stronger unions have been found to have beneficial effects on wage equality. Empirical studies based on macro data (Koske *et al.*, 2012) suggest that, on average across countries, a rise in union density or union coverage is associated with lower wage inequality. Calderón and Chong (2009) investigate the relationship between unionisation and the Gini index, thus accounting for both wage and employment effects. They find that unions lower inequality.

Figure 18. Union density and collective bargaining coverage



1. Trade union density corresponds to the ratio of wage and salary earners that are trade union members, divided by the total number of wage and salary earners. Density is calculated using survey data, wherever possible, and administrative data adjusted for non-active and self-employed members otherwise. 2010 or latest year available.

2. Coverage is the share of wage and salary earners who are covered by collective bargaining agreements.

Source: OECD, Labour Force Statistics Database; OECD Social, Employment and Migration Working Papers 89, Danielle Venn (2009), Legislation, collective bargaining and enforcement: Updating the OECD employment protection.

At a minimum, the government should put an end to the practice of breaking up companies for the purposes of wage negotiations to build confidence in labour relations. This might increase the scope for leaving more of the details of work arrangements to collective negotiations, possibly leading to more working time flexibility and enhancing cooperation of social partners in designing training programmes. In fact, the practice of breaking up companies for wage negotiation purposes is illegal and labour courts or the Labour Directorate can fine companies for such a practice. The government has submitted a law to Congress that would force companies to engage in collective wage negotiations together if they produce the same good and share a centralised organisation. This initiative is welcome.

Box 4. Recommendations to improve the functioning of the labour market

- Continue strengthening local labour offices to improve their capacity to help the unemployed. Make sure that private employment agencies have incentives to attend to low-skilled workers.
- Evaluate training programmes, streamline based on results and focus more on low-skilled workers and women. Integrate SENCE better with the local labour offices.
- Extend unemployment benefits further and limit severance pay, while increasing employers' contributions to individual savings accounts or the unemployment insurance fund. Evaluate the effects of longer unemployment benefit duration and/or higher benefit levels to improve the design if needed.
- Evaluate the in-work benefit for poor, young workers and - if found successful - consider extending it to other groups. Consider making it dependent on individual worker's income only or phase it out more gradually with respect to family income.
- Continue efforts to extend the availability of affordable, high-quality nursery and kindergarten places, while lifting the requirement for firms to offer kindergarten places once they employ more than 19 women.
- Work to improve labour relations, including by strengthening union's negotiation power, at a minimum by forcing firms to end the practice to obtain multiple tax identification numbers to artificially break up their company for wage negotiation purposes.

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