

A Comparison of U.S. and Chilean Labor and Employment Law

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I. INTRODUCTION

While the largest corporations have maintained a global presence for many decades, today nearly all businesses, including small and medium-sized enterprises, recognize the importance of international markets. However, many issues arise when the feasibility of globalization is considered; labor and employment laws are one of the primary factors companies need to consider when selecting countries in which to invest or do business. Although economists and legal scholars have extensively researched and discussed the business climate in European and Asian countries, relatively little has been written about the Latin American legal and business environment.

The purpose of this paper is to examine the potential implications of the differing labor and employment laws in Chile for U.S. companies interested in establishing a business presence in Chile. The case of Chile is important because, during the past quarter century, the U.S. has been a major trade partner and source of foreign investment for Chile, and, more recently, Chile became the first country in South America to sign a free trade agreement with the U.S. (effective January 1, 2004). Since the implementation of the free trade agreement, U.S. companies are even more likely to consider entering the Chilean market and, thus, there is a need for additional research to inform prospective investors. This paper partially addresses this need. Section II presents a brief history of recent Chilean economic policy and discusses the increasing economic interdependence between the U.S. and Chile. Section III reviews and compares labor and employment legislation in Chile and the U.S. and its impact on foreign direct investment and international trade. Drawing from the analysis the final section concludes with implications for U.S. investors and Chilean policy makers.

II. ECONOMIC PERSPECTIVES

“If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage.”¹

“I love to hear people use these code words—productivity, efficiency, global competitiveness. Say what you mean. You mean the cheapest possible labor.”²

The concept of globalization of business has become so widely accepted as reality that it has almost become a cliché. Part of the cliché is the stereotypical business position, reflected in Adam Smith’s quote above, that argues businesses must be able to produce goods and services wherever production costs are the lowest in order to allocate resources efficiently, and maximize production, consumption and economic growth. In contrast, the stereotypical position of organized labor, espoused in the Lou Dobbs’ quote, is that workers lose in a “race to the

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¹ ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 185 (1886).

² Interview by Joanne J. Myers with Lou Dobbs, an economics commentator on CNN (Dec. 2, 2004).

bottom”³ when businesses are allowed to move production to wherever costs and wages are lowest. The reality of global labor-management relations is, of course, more complex than these stereotypical positions imply. A comparison of the United States and Chile labor and employment laws reveals some of the complexities of globalization, especially when it involves trade and investment between developed and developing countries.

Chile’s Recent Economic History

Among the countries of the southern hemisphere, Chile was a relatively early adherent to the underlying premises of globalization and, under the direction of the Chicago Boys,⁴ implemented an open-economy policy as part of a broader policy of economic liberalization that began in the mid-1970s.⁵ The economic liberalization policy was implemented under the regime of Augusto Pinochet, who had recently overthrown Salvador Allende’s democratically elected socialist government. While Pinochet’s dictatorship had wide-ranging impacts on many aspects of society, not the least of which are political freedoms and human rights, the focus of this paper is on economic policy. The economic policy components of greatest relevance to this paper are 1) the elimination of non-tariff restrictions on imports, 2) large reductions in import tariff rates, and 3) changes in the legal status of organized labor. In Chile non-tariff trade restrictions, such as import quotas and licenses, were completely removed on most products by 1975. Tariff rates were reduced in three steps from triple digits rates in 1975 to a uniform rate (except for motor vehicles) of 10 percent in 1979.⁶ Tariff rates have fluctuated somewhat since that time, but the general commitment to a uniform tariff rate has continued.⁷ With regard to the status of organized labor, during the late 1970s collective bargaining was temporarily suspended in Chile, and economic liberalization has since reduced the influence of labor unions with the trend toward labor practices being more market-driven. Following the return to democracy, union membership sharply increased to 15.1% in 1991, only to drift downward during the remainder of the decade to 10.7% in 1999. Since the turn of the century union membership has rebounded to reach 13.8% in 2006. This was somewhat higher than the U.S. (12.0%), but still put it in the bottom half of all Latin American countries.⁸

³ ALAN TONELSON, *THE RACE TO THE BOTTOM: WHY A WORLDWIDE WORKER SURPLUS AND UNCONTROLLED FREE TRADE ARE SINKING AMERICAN LIVING STANDARDS* (2004). Tonelson argues that the entry of low-wage countries like Mexico, China and India into the World Trade Organization has accelerated the erosion of wages and labor standards in the industrialized countries of the world.

⁴ The term “Chicago Boys” refers to a group of young economists educated at the Universidad Católica in Santiago, Chile under a collaborative agreement with the Economics faculty of the University of Chicago beginning in 1956. Some of the students subsequently went on to post graduate studies in Economics at the University of Chicago and later returned to Chile to become instrumental in implementing economic reforms during the 1970s and 1980s. Veronica Montecinos, *Economic Policy Making and Parliamentary Accountability in Chile*, Programme Paper Number 11 UNITED NATIONS RESEARCH INSTITUTE FOR SOCIAL DEVELOPMENT, DEMOCRACY, GOVERNANCE AND HUMAN RIGHTS 3, (2003).

⁵ PATRICE FRANKO, *THE PUZZLE OF LATIN AMERICAN DEVELOPMENT* 245-6 (3d ed. 2007).

⁶ James Levinsohn, *Employment Responses to International Liberalization in Chile*, 47 J. INT’L ECON. 321, 323 (1999).

⁷ Julio Nogues & Sunil Gulati, *Economic Policies and Performance under Alternative Trade Regimes: Latin America in the 1980s*, 17(4)WORLD ECON. 467, 471 (1994).

⁸ Ruth Bradley, *Chile’s Trade Unions*, BUS. CHILE, Sept. 1, 2007, <http://businesschile.cl/en/news/reportaje-principal/chile%E2%80%99s-trade-unions> (last visited Dec. 18, 2010).

Two of the most visible symptoms of Chile's economic liberalization are an increased importance of both international trade and foreign direct investment. The importance of international trade is reflected in the increased ratio of international trade to Gross Domestic Product⁹ (GDP) from a range of 30-37 percent in the first half of the 1980s to 58 percent by 1990.¹⁰ By 2004, its international trade to GDP ratio was over 70 percent and, although Chile's GDP ranks as only the 47th largest in the world, it ranked tenth in terms of world trade.¹¹ Historically the primary destination for Chile's exports has been the industrialized countries; in 2008 the top recipients were China (14.2%), the U.S. (11.3%), and Japan (10.4%).¹² From the rest of the world, Chile has traditionally imported capital goods (e.g., machinery, equipment, tools), energy, and consumer goods, with the U.S. (19.1%), China (11.9%) and Brazil (9.3%) becoming its top suppliers in 2008.¹³ Foreign direct investment (FDI)¹⁴ has also become increasingly important to the Chilean economy. FDI has increased from a few hundred million dollars annually in the late 1970s to just under \$7 billion in 2005, and reached approximately \$16.8 billion in 2008.¹⁵ The U.S. was the single largest source of foreign direct investment (FDI) to Chile during 1974-2008, representing approximately 24 percent of Chile's total FDI.¹⁶

While international trade and FDI in Chile have grown significantly since the 1970s, employment in the sectors most affected by trade and FDI has not changed significantly in recent decades. Employment in the mining, energy and transport sectors, as a percent of total employment, has been virtually unchanged.¹⁷ In the sectors least affected by trade (i.e., service, construction, and retail), however, employment percentages have increased noticeably.¹⁸ Thus, the relatively large flows of FDI into the mining and utility sectors, and the growth in trade, have had little apparent effect on employment patterns in Chile. A more extensive analysis of the effects of economic policies on employment patterns during decade following liberalization similarly found some net job creation in the exporting sectors, with minor job losses in the import and non-tradable sectors.¹⁹ The employment shifts, however, were largely complete by

⁹ Gross Domestic Product is the market value of final goods and services produced within a country during a given time period.

¹⁰ Julio Nogues & Sunil Gulati, *Economic Policies and Performance under Alternative Trade Regimes: Latin America in the 1980s*, 17(4) *WORLD ECON.* 467 (1994).

¹¹ *Pocket World in Figures*, *ECONOMIST* 34 (London) 2007.

¹² Central Intelligence Agency, *The World Factbook*, <https://www.cia.gov/library/publications/the-world-factbook/> (last viewed Nov. 9, 2009).

¹³ *Id.*

¹⁴ FDI refers to foreign ownership and control by a parent enterprise of productive assets, such as factories, mines or infrastructure, of a foreign affiliate. Foreign investors are, thus, generally subject to the prevailing laws of the country in which the FDI occurs.

¹⁵ Gobierno de Chile, *Foreign Investment in Chile*, https://www.cinver.cl/english/clima/inversion_reconocido.asp (last viewed Nov. 9, 2009).

¹⁶ *Id.*

¹⁷ Alejandro Foxley, "Hacia una Economía de Libre Mercado: Chile 1974-1979", 21 *DESARROLLO ECONÓMICO*, 29 (1981) and Instituto Nacional de Estadísticas de Chile, *Ocupación, por Rama de Actividad Económica*, http://www.ine.cl/canales/chile_estadistico/home.php. (last viewed Nov. 9, 2009).

¹⁸ *Id.*

¹⁹ Levinsohn, *supra* note 6, at 335.

the end of the 1970s and thereafter employment trends could not be causally related to sector. The analysis indicates that changes in employment were mostly affected by firm size and macroeconomic conditions.²⁰ To gain a better understanding of comparative employment and labor laws and their relationship to FDI and international trade, a brief review of relevant studies on these topics is first presented.

Comparative Labor and Employment Laws

Recent cross-country studies indicate significant differences among countries' labor and employment laws. In 1997, an analysis of the formal legal rules governing labor markets in 85 countries was used to calculate indices and sub-indices for employment law, collective relations law and social security law for each country.²¹ The researchers estimated that the employment law index ranged from a low of .15 to a high of .83 (a higher index number indicates a more rigid law),²² with a mean value of .47 and a median value of .49. The U.S. had an employment law index of .2176 and Chile's was .4735. The collective relations law index estimates range from .19 to .71 (mean value of .45 and median of .46), with the U.S. at .2589 and Chile at .3810. The social security index has the widest range with a low of 0 and high of .87, (mean value of .57 and median of .68), but the U.S. (.6461) and Chile (.6887) indices were closest for this measure.²³ One criticism of this study is that the indices are based on a comparison of the formal legal rules rather than the application of the laws in the countries.

A more recent study addresses this criticism. The researchers began with the original employment law indices, and additionally consulted with labor lawyers and experts in each country to also assess the application of labor and employment laws.²⁴ They then created a single index for each country that takes into account the formal laws as well as the application of the law in each country. The resulting rigidity of employment index varies, in principle, from 0 to 100, where higher numbers imply more labor market rigidity. A higher level of labor market rigidity indicates less freedom for employers to contract with their employees; lower levels correspond to greater freedom to contract. There are five countries (including the U.S.) with an index of 0, but no countries received an index of 100. The highest rigidity of employment index was 79 (Bolivia and Venezuela) and two other countries were evaluated at 70 or above.²⁵ Low income countries generally have higher labor market rigidity than high-income countries, an

²⁰ *Id.*

²¹ Juan Botero et al., *The Regulation of Labor*, 119(3) Q. J. ECON. 1339 (2004). The authors define the categories of law as follows: "In most countries, in addition to some basic civil rights protections, this system encompasses three bodies of law: employment law, collective relations law, and social security law. Employment laws govern the individual employment contract. Collective or industrial relations laws regulate the bargaining, adoption, and enforcement of collective agreements, the organization of trade unions, and the industrial action by workers and employers. Social security laws govern the social response to needs and conditions that have a significant impact on the quality of life, such as old age, disability, death, sickness, and unemployment."

²² More rigid law means a greater degree of specificity in the law and limits how employment issues can be resolved. When there is more protection for employees there is less flexibility for employers.

²³ World Bank, *Doing Business*, <http://www.doingbusiness.org/> (last viewed Nov. 9, 2009). The work originally done for this study has been expanded upon and has been published annually by the World Bank.

²⁴ S. Djankov & R. Ramalho, *Employment Laws in Developing Countries*, 37(1) J. COMP. ECON. 3 (2009).

²⁵ The authors do not report the rigidity of employment index for all countries in their paper, but the comparable index in the *Doing Business* 2010 publication for Chile is 18.

average of 40.4 for the poorest countries versus 31.1 for the richest countries. Thus, it is clear from these studies that countries have taken very different approaches to the issue of regulating labor-management relations. We next turn to the question, how do different approaches to regulating labor-management relations affect foreign direct investment and international trade?

Effects of Labor and Employment Law on FDI and International Trade

Why do companies invest in foreign countries? In basic terms, “international capital movement is created by variation in returns across borders.”²⁶ That is, investors move capital between countries because they seek a higher return than what can be earned domestically. Similarly, international trade in goods is largely driven by which country has the lowest cost of production (i.e., comparative advantage) for a good. The higher return or comparative advantage abroad can be attributable to a number of factors, including relative scarcity of capital abroad (compared to the domestic economy), the location of complementary resources (e.g., minerals), proximity to potential customers, and lower costs for labor.²⁷ The cost of labor is of particular relevance to this paper. Labor costs include wages, salaries, fringe benefits (e.g., vacation pay, health care, maternity or paternity leave), taxation (in some countries this may include contributions to the worker’s pension, unemployment insurance, and possibly severance pay), as well as costs associated with managing human resources (legal expenses, hiring costs and training costs).²⁸ The labor cost components are directly related to a country’s employment and labor laws.

In recent years, numerous studies have been conducted to analyze the economic effects of differing labor and employment law, and the resulting labor regulatory environments in a variety of countries. Studies have analyzed the relationship of labor market rigidity to FDI, domestic investment, output, employment (by age, gender and skill levels), productivity, and firm size in a wide range of countries. Of particular interest to this paper are the studies that focus on the effects of different labor market conditions on FDI and international trade. An early study investigates the effects of employment protection differentials between domestic and foreign locations on the investment decision of multinational corporations in 1989 and 1998.²⁹ The index of employment protection for each country is based on measures of protection affecting the country’s temporary and regular employment. The larger the gap in employment protection between the home and host country, the lower are FDI flows from home to host country, i.e., for a given level of home country employment protection, higher levels of employment protection in the host country discourage home country firms from investing there.³⁰

Another recent empirical study also analyzes the impact of labor law on FDI using a theoretical model that hypothesizes severance payments to workers act as a disincentive for investment by multinational corporations.³¹ A labor market index of hiring and firing restrictions

²⁶ HENRY THOMPSON, INTERNATIONAL ECONOMICS: GLOBAL MARKETS AND COMPETITION 259 (2006).

²⁷ *Id.*

²⁸ T. HYCLAK ET AL., FUNDAMENTALS OF LABOR ECONOMICS (2005).

²⁹ Gerda Dewit et al., *Should I Stay or Should I Go? A Note on Employment Protection, Domestic Anchorage, and FDI*, No. 845 INST. STUD. LAB. DISCUSSION PAPER (2003).

³⁰ *Id.*

³¹ Holger Görg, *Fancy a Stay at the ‘Hotel California’? The Role of Easy Entry and Exit for FDI*, 58 KYKLOS 519 (2005).

is constructed based on extensive surveys of managers conducted by the World Economic Forum in 59 countries. Using data on U.S. FDI to 33 developed and developing countries during 1986-96, the study finds a statistically significant negative relationship between U.S. FDI and labor market restrictions.³²

There are also several recent studies looking at the interactions between labor regulation and international trade policy. In a theoretical analysis, a two-country two-sector model of international trade was developed in which the countries are similar except for rigidities in their labor markets.³³ The model indicates that, in theory, there are economic gains to both countries engaged in international trade, but the country with lower labor market rigidities gains proportionately more. Thus, a less rigid labor market confers comparative advantage; a country benefits by lowering rigidities in its labor market. Furthermore, the model suggests that simultaneous proportional lowering of labor market rigidities in both countries results in benefits to both countries.

A more recent empirical study of the relationship between domestic labor regulations and trade policy uses cross-country data from 126 countries.³⁴ To measure domestic labor regulations in the countries they utilize the World Bank *Doing Business* indices for 2004. The researchers create a labor regulations index as an average of three World Bank indices on flexibility of hiring, conditions of employment, and flexibility of firing. They analyze the impact of labor regulations on the economic benefits from trade policy for 2000-05 and find that countries with less rigidity in hiring and firing have higher incomes. They conclude that the positive effect of economic openness is enhanced when labor market regulation is moderate and reduced when labor market regulation is excessive.

Last, a 2009 empirical study also tests the relationship between domestic labor regulation and trade policy, but uses a different economic model.³⁵ The findings show that the economic growth effects of international trade may be significantly improved if certain complementary reforms are undertaken. More specifically, changes in the areas of labor market rigidity and firm entry/exit flexibility create benefits for most countries (high- or low-income countries) when they open their markets to international trade.

Analysis and Assessment

During the late 1970s Chile implemented a broad policy of economic liberalism that has largely continued to the present. Economic liberalism included changes in employment and labor law that reduced labor market rigidities in Chile. In addition, reduced tariff and non-tariff barriers have resulted in Chile's economy becoming more integrated into the global economy. Economic liberalism and open economy policies that include less rigid labor market regulations

³² One of the most extensive studies of the effects of labor market rigidity is based on firm level data on new investments across 19 Western and Eastern European countries during 1998-2001. The indices of labor market rigidity reflect laws governing individual and collective dismissals, the length of the dismissal notice period, and the required severance payment. The study's findings indicate that less rigidity in the host country's labor market relative to that in the investor's home country is associated with larger FDI inflows. B. Smarzynska & M. Spatareanu, *Do Foreign Investors Care about Labor Market Regulations?*, 3275 THE WORLD BANK (2004).

³³ Elhanan Helpman & Oleg Itskhoki, *Labor Market Rigidities, Trade and Unemployment*, NBER Working Paper 13365, Nat'l. Bureau for Econ. Res. (2007).

³⁴ C. Freund & Bineswaree Bolaky, *Trade, Regulations, and Income*, 87 J. DEV. ECON. 309 (2008).

³⁵ Roberto Chang et al., *Openness Can Be Good for Growth: The Role of Policy Complementarities*, 90 J. DEV. ECON. 33 (2009).

have a positive impact on the flows of foreign direct investment and the economic growth effects of international trade. These effects can be observed in Chile where, since the economic reforms of the late 1970s, international trade as a percentage of GDP has risen dramatically and FDI has consistently increased as well. Throughout this period, trade and FDI ties with the U.S. have been especially strong. Because the recently signed free trade agreement between the U.S. and Chile has created enhanced incentives for trade and investment in Chile, more U.S. companies have a need to understand the implications of Chilean labor and employment law.

III. LEGAL PERSPECTIVES

Background

In Chile, labor and employment laws are codified in the *CÓDIGO DEL TRABAJO* (Labor Code).³⁶ The Code was published in 2002, but has been continuously updated in an appendix that is slightly larger than the Code itself.³⁷ Since Chile is a civil law country there is no case law that is readily accessible.

Labor Law.

Although there are many topics that are not clearly distinguished as labor law or employment discrimination, for ease of discussion in this paper topics will be classified as one or the other.

Employment-at-will.

In the United States all states but one³⁸ follow the principle that, in the absence of an explicit contract, an employment relationship may be terminated for a good reason, a bad reason, or no reason at all.³⁹ The U.S. is unique in this regard; Chile, along with most of the rest of the world, does not permit such terminations. Throughout the Chilean Code it is assumed that an employment contract exists which may only be terminated by the employer for good cause. This is one of the most prominent differences between the law in Chile and the U.S., making Chile more rigid in its labor market. In Chile when employees are terminated they generally are entitled to severance pay, one month for every year's service.⁴⁰ But, the work contract will terminate without the right to any compensation when the employer fires the employee for one or more of the following causes:⁴¹ A lack of integrity in the performance of duties, sexual harassment, violent acts against the employer or any co-worker, defamation of the employer, immoral conduct that affects the company, breach of contract, or excessive absences. Excessive absences is specifically defined as failure of the worker to show up to perform assigned duties without a justified cause for two consecutive days, two Mondays in a month or a total of three days during a month or any unjustified or unplanned absence that creates a serious setback to the

³⁶ The authors express their appreciation to our graduate assistants, Ben Ernst and Diana Osorio Rodriguez, for translating the Code.

³⁷ Citations to the Code will generally reference article numbers, but more recent citations to the appendix will reference law numbers in addition to the article numbers.

³⁸ Wrongful Discharge from Employment Act, Mont. Code Ann. § 39-2-901 *et seq.* (2005).

³⁹ Charles J. Muhl, *The Employment-at-Will Doctrine: Three Major Exceptions*, Jan MONTHLY LAB. REV. 3 (2001).

⁴⁰ CODIGO DEL TRABAJO (Labor Code) art. 159.

⁴¹ COD. TRAB. art. 160.

overall mission of the business. In addition, abandonment of work, negligence and intentional tort are good cause for termination.

Minimum Wage and Overtime.

Although the Chilean Code stipulates that the minimum wage cannot be less than a minimum monthly income,⁴² there is no specific figure set. Similar to the practice in the U.S., the minimum wage is periodically adjusted. In July 2009 the minimum wage was 165,000 pesos per month (approximately \$305) for workers between the ages of 18 - 65. Those younger than 18, or older than 65, must be paid a minimum of 123,176 pesos (approximately \$228). Non-remunerative workers are required to be paid a minimum of 106,435 pesos a month (approximately \$197), and last, domestic workers must be paid 136,000 pesos (approximately \$253), eighty-three percent (83%) of the wages of the 18 - 65 group.⁴³ The average gross annual wage of Chileans is approximately \$5,432, about one third of the average gross annual wage of American workers (\$15,080).⁴⁴ The Chilean wage is about 37% of GDP per capita, while the U.S. wage is only 32%.⁴⁵

Providing that it does not risk the health of the worker, overtime hours can be contracted up to a maximum of two per day.⁴⁶ As in the U.S., overtime hours are calculated as time and a half.⁴⁷ However, in Chile overtime is more closely regulated; overtime must be contracted and can only be used for temporary situations (no longer than three months) in the company.⁴⁸

Unemployment Compensation.

Chile has established an obligatory unemployment insurance plan⁴⁹ that automatically begins with the working relationship and will not permit the employer to negotiate to lower the amount recoverable.⁵⁰ Workers are qualified for unemployment if they were not terminated for good cause (one of the seven reasons listed above).⁵¹ The amount of the compensation received is dependent on the amount of remuneration received when working. There are survivor benefits if the unemployed worker is deceased.⁵² In principle, unemployment compensation appears to be very similar to the system in the U.S.

Workers' Compensation.

⁴² COD. TRAB. art. 42.

⁴³ COD. TRAB. Law 26.359.

⁴⁴ [Http://www.payscale.com/research/CL/Country=Chile/Salary](http://www.payscale.com/research/CL/Country=Chile/Salary) (last visited June 12, 2010).

⁴⁵ *Id.*

⁴⁶ COD. TRAB. art. 31.

⁴⁷ COD. TRAB. art. 32.

⁴⁸ *Id.*

⁴⁹ COD. TRAB. Law 19.728 art. 1.

⁵⁰ COD. TRAB. Law 19.728 art. 2.

⁵¹ COD. TRAB. Law 19.728 art. 15.

⁵² COD. TRAB. Law 19.728 art. 18.

Temporary incapacity of Chilean workers due to accidents or illness gives them the right to receive subsidies.⁵³ The subsidies are paid during the duration of the treatment, starting with the day on which the accident occurred or the illness was diagnosed.⁵⁴ The maximum duration of the subsidy period is fifty-two weeks, but an additional fifty-two weeks can be allowed if necessary for an improved treatment that will allow the worker to be rehabilitated. The subsidy is paid during holidays and is not taxed or subject to social security deductions.⁵⁵ The payment of the subsidy can be suspended if the ill or injured workers refuse treatment or deliberately impede possible cures.⁵⁶

Social Security.

In 1980 the government of Chile replaced the government-run pension system with a privately administered, national system of pension savings accounts.⁵⁷ It is a privatized Chilean version of what the U.S. calls social security and is described as a voluntary pension system for seniors, disability, and survivorship.⁵⁸ Men who are 65 and older and women who are 60 and older have the right to a senior pension.⁵⁹ Persons who do not exercise their rights to obtain the senior's pension are then not permitted to solicit rights to disability or survivorship either.⁶⁰

José Piñera, one of the Chicago Boys and the architect of the pension plan, touts the success of the system in an article published in 1996.⁶¹ Piñera explains that under Chile's Pension Savings Account (PSA) system, workers' pension levels are determined by the amount of money they accumulate during their working years. Since neither the workers, nor the employers, pay a social security tax to the state the workers will not collect government funded pensions. Instead, during their working lives, each month the workers automatically have 10 percent of their wages deposited by their employers into the workers' individual PSA's.⁶² Because the mandatory 10 percent only applies to the first \$22,000 of wages, "as wages go up with economic growth, the 'mandatory savings' content of the pension system goes down."⁶³ Workers may contribute an additional 10 percent of wages each month as a form of voluntary savings. To manage their PSA's workers choose one of the private Pension Fund Administration companies. Piñera explained:

These companies can engage in no other activities and are subject to government regulation intended to guarantee a diversified and low-risk portfolio and to prevent theft or fraud. A separate government entity, a highly technical "AFP Superintendency," provides oversight.⁶⁴

⁵³ COD. TRAB. art. 30.

⁵⁴ COD. TRAB. art. 31.

⁵⁵ COD. TRAB. art. 32.

⁵⁶ COD. TRAB. art. 33.

⁵⁷ COD. TRAB. Law 3.500. This law was published in the Official Journal on November 13, 1980.

⁵⁸ COD. TRAB. Law 3.500 art. 1.

⁵⁹ COD. TRAB. Law 3.500 art. 3.

⁶⁰ *Id.*

⁶¹ José Piñera, *Empowering Workers: The Privatization of Social Security in Chile*, 15 CATO 2 (1996).

⁶² *Id.* at 3.

⁶³ *Id.*

⁶⁴ *Id.* at 4.

Workers' contributions are deductible for income tax purposes; the return on the PSA is tax free. Only when funds are withdrawn upon retirement are taxes paid according to the workers' income tax brackets at the time. Both private and public sector employees are included in the PSA's with the exception of police and armed forces whose pensions are built into their pay and working conditions system. Self employed workers have no mandatory savings, but may voluntarily enter the system.

Some workers may have contributed to the system for the 20 year minimum, but may still not have adequate savings.⁶⁵ In those cases, once their PSA is depleted, they will receive pensions from the state. Those without the minimum of 20 years contribution will receive a reduced amount, a welfare type pension.

As discussed earlier, the legal retirement age for men is 65, for women it is 60. These are the ages when men and women have the right to collect pension funds; it is not a mandatory retirement age. Workers can continue working after retirement; they can receive their pension and no longer have a mandatory contribution to the PSA.⁶⁶ Workers can also take early retirement if their pension funds are sufficient (50 percent of the average salary of the previous 10 years, as long as it is above the "minimum pension").⁶⁷

Piñera lists several advantages of this system over the pay-as-you-go system in the U.S.: 1) the working population does not pay for the retired population, because the PSA system is completely independent of the companies employing the workers, 2) the account is fully portable, 3) the PSA helps create labor market flexibility and neither subsidizes nor penalizes immigrants, and 4) the PSA scheme allows flexible working styles that accommodate part time workers.⁶⁸ In addition, Piñera noted that the success of the Chilean private pension system has led three other South American countries, Argentina, Peru, and Colombia, to adopt similar systems.⁶⁹

Labor Unions.

Without any previous governmental authorization, both private-sector and state employees have the right to create labor unions.⁷⁰ The stated purposes of the unions are nearly identical to those that are created in the U.S. They are to: represent their affiliates in collective bargaining, enter contracts, ensure their fulfillment, and to enforce employee rights; strive to improve risk and accident prevention systems at work and work-related illnesses; create services to aid and advise members regarding investments and other technical, judicial, educational, cultural, health, career and socio-economical advising; and in general, realize all those activities contemplated in the statutes and that are not prohibited by law.⁷¹

⁶⁵ The typical worker should have sufficient money in the PSA to fund a pension that would be 70 percent of the final salary. This calculation is assuming a 4 percent average net yield on the 10 percent mandatory minimum saving level during a working life.

⁶⁶ Piñera, *supra* note 61, at 4.

⁶⁷ *Id.*

⁶⁸ *Id.* at 5.

⁶⁹ *Id.* at 2.

⁷⁰ COD. TRAB. art. 212.

⁷¹ COD. TRAB. art. 220.

In Chile four kinds of unions can be constituted: labor unions that group workers of one company; intercompany unions that group workers of two or more distinct employers; independent workers' labor union that groups worker who are not dependent on any specific employers; and labor unions of occasional or transitory workers that are constituted by workers that perform jobs during cyclical or intermittent periods.⁷² “While the growth of one-company unions has more or less kept pace with the expansion of employment, multi-company unions - although still much smaller in terms of total membership - have been growing faster. This is, perhaps, surprising given that, under Chilean law, companies are not obliged to enter into collective bargaining with a multi-company union.”⁷³

The only condition is that union members remain subject to the existing law. In addition to the right to organize, labor unions have the right to affiliate with federations, confederations, and international labor organizations.⁷⁴ It is interesting to note that minors are explicitly authorized to become affiliates of labor union and to participate in their administration and direction.⁷⁵ Employees are restricted from belonging to more than one labor union at a time and labor unions cannot belong to more than one umbrella organization.⁷⁶

Similar to legislation in many “right-to-work” states in the U.S., the Chilean Code provides that affiliation with labor unions is voluntary, personal, and non-delegable. No one can be obligated to affiliate with a labor organization in order to perform a job or develop an employment activity.⁷⁷ The Code emphasizes that it is impermissible to condition the employment of workers on their affiliation or disaffiliation of labor unions. Equally, it is prohibited to impede or hinder their affiliation, fire, or harm them in any way as a result of their labor union membership or participation in union activities.⁷⁸

Analysis and Assessment.

In Chile workers are well protected by their labor law; their protection equals or exceeds that of American workers. The most significant advantage in Chile is the absence of employment-at-will. Chilean workers may not be fired when good cause is nonexistent. In fact the Labor Code specifically lists what constitutes a good cause firing. An employee who is fired without good cause is entitled to severance pay; one month's salary must be paid for every month the employee worked for that employer. An American employer will incur additional responsibilities (and potential costs) when hiring workers in Chile. Those additional expenses, however, may be balanced by the fact that the comparative wage of Chileans is only about one third that of American workers. Unemployment compensation, workers' compensation, and social security benefits are very similar to those offered in the U.S. and therefore would not benefit an American employer who is seeking to curtail labor costs.

Chile's trade unions don't present a significantly increased risk to employers. Because of the right to work status of all employees in Chile, many workers simply don't see the point of

⁷² COD. TRAB. art. 216.

⁷³ Bradley, *supra* note 8.

⁷⁴ COD. TRAB. art. 213.

⁷⁵ COD. TRAB. art. 214.

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ COD. TRAB. art. 215.

belonging to a union. After all, why run the risk and pay dues when, in any case, they're likely to see the benefits of collective wage agreements? That deprives the labor movement of a broader base of support, particularly in the private sector. However, in August 2007 Chile was in the international headlines when the Central Unitaria de Trabajadores (CUT), one of the country's three national union confederations, organized what it billed as a national day of protest against oppression of the country's workers. However, despite recent stoppages and the attention they attracted, labor disruptions are relatively infrequent in Chile. In 2006, there were 134 strikes, involving just 15,602 workers out of a total labor force of 6.8 million.⁷⁹ Most agree that labor relations are not bad; as in the U.S. only the negative aspects are publicized. Although the situation tends to be less comfortable in smaller businesses, with less margin to absorb union demands, many larger Chilean companies report solid and mutually beneficial relations with their unions.⁸⁰

Employment Discrimination.

Because of the long history of exclusion the U.S. Congress has legislated to protect a number of groups against employment discrimination. Title VII of the 1964 Civil Rights Act prohibits employers from discriminating on the basis of race, color, religion, sex, or national origin.⁸¹ It is unlawful for employers with 15 or more employees to fail or refuse to hire or to discriminate with respect employees' compensation, terms, conditions, or privileges of employment.⁸² The Age Discrimination in Employment Act prohibits employers with 20 or more employees from discrimination against individuals who are 40 years of age or older.⁸³ The Americans with Disabilities Act⁸⁴ protects otherwise qualified individuals with disabilities from discrimination by employers with 15 or more employees.

Chile's Constitution essentially guarantees all groups of people the freedom to work.⁸⁵ Chapter III states that any discrimination that is not based on personal skills or capabilities is prohibited, although the law may require Chilean citizenship or age limits in certain cases.

In contrast to the U.S., Chile has relatively little employment discrimination legislation; probably because they have the constitutional protection. Early in the Code it is stated that acts of discrimination are contrary to the principles of the labor laws.⁸⁶ Acts of discrimination are defined as the distinctions, exclusions or preferences based on motives of race, color, sex, age, marital status, union membership, religion, political opinion, nationality, national ascendancy or social origin. The Code's objective is to prohibit actions that annul or alter equal opportunities or treatment in employment.⁸⁷ Note that Chile specifically prohibits discrimination based on marital status, political opinion, national ascendancy, and social origin, groups that are not

⁷⁹ Bradley, *supra* note 8.

⁸⁰ *Id.*

⁸¹ Civil Rights Act, 42 U.S.C. § 703 (a)(1) (1964).

⁸² *Id.*

⁸³ The Age Discrimination in Employment Act, 42 U.S.C. § 4 (e) (1967).

⁸⁴ The Americans with Disabilities Act, 42. U.S.C. § 102 (1990).

⁸⁵ CONSTITUCION POLITICA DE LA REPUBLICA DE CHILE [C.P.] art. 19.

⁸⁶ COD. TRAB. art. 2.

⁸⁷ *Id.*

protected by U.S. federal law, but Chile does not expressly protect the disabled. However, it could be argued that skilled and capable disabled persons would be protected by the Chilean Constitution.

In addition to the general protection provided by the Chilean Constitution and Code, more specific regulations protect workers based on:

National origin.

Employers who employ more than twenty-five workers are required to maintain a workforce that is at least eighty-five percent (85%) of Chilean nationality.⁸⁸

The impact of this rule is somewhat softened by the methods of computing the 85% proportion.⁸⁹ First, the total number of workers that a business employs within the national territory will be taken into consideration; the numbers in the distinct branches will not be calculated separately. Second, the calculations will exclude specialist technical personnel that cannot be replaced by national personnel. Third, foreigners whose spouse or children are Chilean or who are widow or widowers of Chilean spouses will be treated as though they are Chilean. Fourth, foreigners who have been residents for more than five years in the country will be considered as Chileans, without taking into account incidental absences.

Maternity Protection.

No covered employer may condition the contracting of female workers based on the existence or absence of pregnancy. To this extent the law is similar to that in the U.S.,⁹⁰ but Chile provides a much broader protection for pregnant employees. Conditions of employment include the duration of contracts, renewal of contracts, promotions or mobility. Employers cannot require female employees to produce a certificate or have any type of exam to verify pregnancy or its absence at the time of hiring.⁹¹ Covered companies consist of those in public administration, semi-fiscal services, autonomous administration, municipalities including all services and establishments, cooperatives or industrial companies, quarries, agricultural or commercial businesses, including the branches or dependencies of those establishments, companies or services indicated.⁹² Note that for this protection Chile does not limit the coverage based on the number of employees in the entity. It is difficult to think of an employer who would not fit into any of those classifications, therefore these laws will benefit all female workers who depend on any employer and are part of a pension system, even those who work at home.

Female workers will have the right to a paid maternity leave of six weeks before the delivery of the child and twelve weeks after it.⁹³ During this time the women receive a subsidy equivalent to their regular salaries with only taxes and legal discounts deducted.⁹⁴ These rights cannot be waived and during the periods of leave pregnant women and new mothers are

⁸⁸ COD. TRAB. art. 19.

⁸⁹ COD. TRAB. art. 20.

⁹⁰ Pregnancy Discrimination Act (1978) (part of the Civil Rights Act of 1964, 42 U.S.C. §2000e(k) (2005)).

⁹¹ COD. TRAB. art. 194.

⁹² *Id.*

⁹³ COD. TRAB. art. 195.

⁹⁴ COD. TRAB. art. 198.

prohibited from working. Additionally, regardless of any stipulation to the contrary, the mothers' employment positions must be conserved during the maternity period. To make use of the maternity leave the pregnant employee must only present a medical or midwife's certificate that verifies the pregnancy.⁹⁵

The father will have the right to a paid leave of five days upon the birth of his child. He may use the leave at his discretion after the birth; the five days can be used consecutively or they may be distributed during the first month after the date of birth. This leave is also extended to the parents who have adopted a child;⁹⁶ adoptive mothers will have 12 weeks leave following and adoptive fathers will have 5 days.

Sexual Harassment.

Sexual harassment is defined in the Chilean Code comparable to *quid pro quo* harassment in the U.S. Article 2 first states that labor relations should always be based on treatment consistent with the dignity of the individual.⁹⁷ Second, it expressly defines sexual harassment as improper behavior of a sexual nature, in which employees, without consent, are required to sexually perform in order to protect their employment status or opportunities. Apparently hostile work environment claims are not actionable.

The Code then provides a process for resolving sexual harassment complaints. To start an investigation, the victim must file a written claim with the company.⁹⁸ Within a period of five days from the receipt of the complaint, the employer must undertake an internal investigation of the violation and conclude it within a 30-day time period.⁹⁹ When the complaint is first received, after considering the gravity of imputed acts and the possibilities derived from the work conditions, the employer must immediately adopt necessary preventative measures, such as the physical separation of the parties involved or rescheduling of the work.

Age Discrimination.

Although age is protected by the Chilean Constitution, no additional legislation to protect the aged has been enacted. Note that the Constitution allows age discrimination in two circumstances: 1) men are eligible to receive pension funds at age 65 and woman at age 60,¹⁰⁰ and 2) the highest level of minimum wage is only guaranteed to those 65 and under.¹⁰¹

Analysis and Assessment.

It is interesting to speculate on possible reasons for the paucity of legislation regarding employment discrimination. Since it is generally prohibited in the Constitution, additional legislation may not be necessary to protect workers. Also, it could be attributed to a number of other reasons: 1) Chile does not have the high level of ethnic and cultural diversity as in the U.S., 2) Chile does not have a history of exclusion, or 3) ethnic minorities, women, the aged, and

⁹⁵ COD. TRAB. art. 197.

⁹⁶ COD. TRAB. art. 195.

⁹⁷ COD. TRAB. art. 2.

⁹⁸ COD. TRAB. art. 211.

⁹⁹ *Id.*

¹⁰⁰ Piñera, *supra* note 61.

¹⁰¹ *Id.*

disabled are relatively powerless in Chile.

The first statement appears to be correct; most Chileans are of mixed ancestry and share a high degree of cultural homogeneity.¹⁰² Being quite nationalist and patriotic, they focus on being Chileans, not on their cultural and ancestral European roots; this generally prevents open hostilities between the different ethnic groups. Chileans are not in the habit of discriminating on the basis of race and color because the color variation is very slight. Very few Afro-Americans live in Chile and the most prominent indigenous group, the Mapuche Indians, have relatively light skin. Ethnic differences in Chile focus more on “facial appearance, hair and eye color, body length, and family names.”¹⁰³

Second, Chile does have some history of exclusion. Because the Mapuche Indians are socially and economically segregated in Chile, one commentator stated, “Chile has historically denied its ethnic and cultural diversity.”¹⁰⁴ Even though the 1992 census revealed that one thirteenth of the population identified themselves as member of indigenous cultures, the law did not recognize their culture or language. As late as 1999, the Chilean National Constitution only recognized the existence of one group – the Chilean people. The historical background provides some explanation.

In the mid-sixteenth century when Europeans started to arrive in South America, the Spanish conquistadores started taking control of indigenous territories and imposing their laws and customs, much like the practices of the settlers in the U.S. Only the Mapuche people were able to resist and retain their lands in southern Chile until 1881 when the Chilean army occupied and divided the land. Again, much like the American activity, the Mapuche were dispossessed and resettled on less attractive land (only 6% of their ancestral territory).¹⁰⁵ From 1881 until 1990, the laws and policies applied to indigenous people were designed to assimilate them into the national society. There was little regard for culture and identity. In 1990 the Congress approved The Law on Protection, Promotion and Development of Indigenous Peoples.¹⁰⁶

The third statement, “Ethnic minorities, women, the aged and disabled are relatively powerless in Chile,” appears to be essentially true. Only the Mapuche, who usually work in poorly paid jobs with little or no prestige, have protested against discrimination.

Maternity protection may actually work against the best interests of the Chilean female worker; it certainly makes it more complicated, and significantly more expensive, to employ workers who might become pregnant. In reality fertile women may be kept out of the labor force because it is too expensive to take the risk they may become pregnant. Although women make up 51% of the Chilean population, they form only 37% of the labor force.¹⁰⁷ Women earn about 65% of the income earned by men, and unemployment among women is persistently higher.¹⁰⁸

¹⁰² *Countries and Their Culture*, <http://www.everyculture.com/Bo-Co/Chile.html> (last visited June 1, 2010).

¹⁰³ *Id.*

¹⁰⁴ Jose Alwyn, *Indigenous Rights in Chile: Progress and Contradiction in the Context of Economic Globalisation*, 4(23) INDIGENOUS L. BULL 72 (1999) <http://www.austlii.edu.au/au/journals/ILB/1999/72.html> (last visited June 1, 2010).

¹⁰⁵ Hector Gonzales, *Propiedad Comunitaria o Individual*, 11 LOS LEYES INDIGENAS Y EL PUEBLO MAPUCHE 3,7 (1986).

¹⁰⁶ Decree No 19253 of 1993.

¹⁰⁷ *Countries and Their Culture*, *supra* note 102.

¹⁰⁸ *Id.*

In Chile all groups of people are guaranteed equal employment opportunity; the only legal discrimination must be based on personal skills or capabilities. Therefore, relatively more employees are protected in Chile than in the United States. In addition to race, color, national origin, sex, religion, age and disability, protected groups in the U.S., Chile also protects against employment discrimination based on marital status, political opinion, national ascendency or social origin. Since employers are regulated more in regard to both labor and employment legislation, it appears that the only factor that would entice a cost conscious American employer to create a business presence in Chile would be the relative wages.

IV. CONCLUSION

The historical information on Chile's economic policies indicates that the country has moved away from labor market rigidity and toward a more market oriented approach to labor regulation after the late 1970s. Nonetheless, the comparison of its labor laws with those of the U.S. indicates that Chile currently imposes more labor regulations in some areas (e.g., termination and severance pay, minimum wages and overtime), while other aspects of labor law (i.e., unemployment compensation) seem to be similar to that of the U.S. Only one aspect of labor law (social security) may be considered more market-oriented (less government involvement) than in the U.S. With respect to employment law (i.e., employment discrimination), Chile also seems to take a more market-oriented approach than the U.S. with the exception of maternity protection.

The limited empirical data available indicates that Chile has higher employment law and collective relations indices, and thus, has somewhat greater rigidities in its labor markets than the U.S. When compared with our analysis of labor laws in Chile and the U.S., it would suggest that the indices give a greater weight to the issues of termination, severance pay, minimum wages, and overtime than to the issues of employment discrimination. Or, alternatively, the disparity between the labor market rigidities created by the labor laws governing the former issues in Chile versus the U.S. are greater than the disparity created by U.S. labor laws on employment discrimination. Regardless, what we can say is that our comparison of the labor and employment laws in Chile and the U.S. is at least not inconsistent with the available data.

What implications can be drawn from our analysis? There are lessons for potential U.S. investors in Chile and economic policy planners. For potential U.S. investors in Chile, current labor laws with respect to termination, severance pay, minimum wages, overtime pay, and maternity/paternity leave is more restrictive than U.S. law and they will almost certainly incur higher labor costs for those components. Those labor cost components must be assessed against the lower labor cost components in Chile, such as wages, social security contributions and cost associated with employment discrimination laws. Not only will the cost of these labor components differ from those in the U.S., but business owners and managers will also likely face a less flexible work environment in Chile; the less flexible work environment likely will make it more difficult for businesses to respond to changing market conditions. Thus, investments in sectors that are characterized by market volatility (e.g., luxury and capital goods, real estate) will probably be more risky to undertake in Chile. On the other hand, Chile's labor and employment law will be more conducive to investment in sectors that typically experience less market volatility (e.g., retail sales of consumer necessities, and utilities) and capital-intensive industries that employ relatively little labor (e.g., mining).

From a policy perspective, in light of the studies on labor market rigidity, FDI and economic growth effects of international trade, our analysis suggests that Chile could increase its inflows of FDI from the U.S. and achieve somewhat greater macroeconomic growth effects from

international trade if it were to reform its labor law still further by relaxing its mandates on termination, severance pay, minimum wages, overtime pay, and maternity leave. The macroeconomic benefits of such a policy, however, should be weighed against the individual and social costs of increased terminations and lower income to the workers, not to mention the ethical or human rights issues that such a policy may imply.