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by

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We welcome your comments.

Labor Policy and Structural Adjustment in Latin America

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1. Introduction: Stabilization and Structural Adjustment

During the 1980s, the so-called "lost decade," the Latin American countries suffered an economic crisis of large proportion. The causes of the severe recession were both external and internal. External shocks to the Latin American economies came from adverse commodity prices, and the regional debt crisis and resulting scarcity of commercial external financing. Internally, economic policy mismanagement and, in some cases, destabilizing political events aggravated economic problems.

By the end of the decade, most Latin American countries had taken important steps to put their economic policy houses in order, including currency devaluation, liberalization of foreign exchange markets, reduction of the public sector deficit, and control of monetary growth. This class of policy reform is referred to as "stabilization" and is implemented with the objective of reducing balance of payments and public sector financing gaps. Macroeconomic imbalances, until resolved by stabilization policies, generated rounds of inflation and devaluation that were major contributors to real wage declines throughout Latin America. Hence, the economic disequilibria that prevailed prior to the adoption of reform were the true causes of the economic pain felt during the eighties, not the reforms themselves, which have taken an unfair blame.

"Structural adjustment" has been another objective of policy reform, in addition to stabilization. Structural adjustment refers to policy actions taken to improve economic efficiency and the allocation of resources. In Latin America, prior to the early 1980s, countries had adopted policies such as high tariffs protecting domestic industry, below market-rate pricing of energy and utilities, and public sector monopolies, in order to attract investment and achieve social welfare objectives. As elsewhere in the world, national policymakers believed that the benefits of having, say, a national airline or a newly engendered pharmaceutical industry outweighed the costs of distorting market signals and forcing resources into sectors where there was little comparative advantage.

Latin American reform programs have combined stabilization with structural adjustment measures. As long as economies were

growing and external borrowing on reasonable terms was relatively easy, the cost of inefficiencies arising from import substitution and excessive government involvement in the economy was not an issue with policymakers or the public. The high price of inefficiency in terms of output and employment foregone did not become fully apparent - and, indeed, intolerable - until the fiscal and foreign exchange squeeze forced a hard look at how scarce resources were being allocated. In the face of stagnant or declining GDP, the potential increases in production that could result from a greater free-market orientation enticed national leaders to consider politically difficult adjustment measures.

These winds of change in economic thinking, now referred to as Latin America's "quiet revolution," had several additional influences. A greater global recognition of the benefits of free trade and free markets, intensified by the collapse of many of the world's centrally planned economies, certainly created an atmosphere conducive to economic liberalization in Latin America. At the same time, restoration of democracy in many countries stimulated public debate that questioned the benefits to the population at large of the special protected relationships afforded to certain industries and certain public enterprises.

The Latin American countries that have taken heroic measures to stabilize their economies and improve internal efficiency - Mexico, Chile, Bolivia, and El Salvador, to name just a few - have seen renewed growth, lower inflation, and greater private investment. Nonetheless, a growing credence is being given to the largely unsubstantiated hypothesis that "structural adjustment hurts the poor." This belief reflects dissatisfaction and impatience with the pace of recuperation of the incomes of the region's poorest households, despite reform programs designed to enable economies to employ their labor forces more productively.

In this context, the question of the proper role of labor policy within an adjustment program merits our attention. Improvements to labor policy can be highly complementary to other adjustment efforts, and may accelerate delivery of adjustment's benefits to lowest-income groups. The absence of labor policy improvements as part of an adjustment program may diminish the benefits of reform, or contribute to its eventual failure.

In addition to serving as a tool of poverty alleviation, labor policy is important from a variety of perspectives. Labor issues are closely linked with concern for a healthy business and investment environment, democratic participation, and human development. In the broadest economic sense, the single most important asset a developing country offers in the international marketplace is its labor force, and the productivity of this

labor force in turn determines the well-being of the national population.

2. Labor Markets and Policy in Latin America

Latin American economies have been characterized by dualism. Modern industrial and export sectors have traditionally coexisted with low-productivity small-farm and informal sectors. The barriers between modern and traditional segments of the economy have included policies (such as import substitution) that protected and cultivated chosen sectors at the expense of all others.

Labor markets in the region mirror the tendency toward dualism. While each country is different, what one generally finds throughout Latin America are progressive labor codes that provide for a standard workweek, minimum wage, severance pay, and other standards for the work force. In many countries, the labor code gives a strong voice to the public sector in regulating how companies manage labor resources. For example, in some countries public sector permission is necessary for a firm to reduce the size of its work force.

Labor codes typically, by design or by accident, only cover a portion of the national work force. (The same is usually true for the "national" pension plan, and the "national" health care system.) Generally, smaller firms are exempted from many labor code provisions, and labor ministries do not have the resources to enforce codes, particularly in the informal sector. A large portion of the population may be "self-employed" as microentrepreneurs or small farmers. Laborers outside of the labor code live in a world where work conditions are determined by supply and demand for labor, the benevolence (or not) of their particular employers, and the sheer necessity of producing an income.

An analogous situation exists for labor unions. Unionization tends to cluster in larger firms, particularly in manufacturing, public enterprises, and large-scale agroexport concerns. The public sector has tended to take a strong role in regulating union behavior. In some countries, for example, formation of a union must be approved by government, allowing for political interests to intervene. Where the public sector role is sufficiently strong that it serves as the official arbiter of all differences between management and labor, the development of free and democratic labor unions is impeded. In this situation, management and labor do not view the negotiation process as one of resolving their differences, but rather as an exercise in calling upon "friends in high places" in government to rule in their respective side's favor.

Hence, labor market regulation by the public sector has contributed to dualistic labor markets in Latin America. The modern formal sector, including the public sector, is generally subject to rigid labor codes and to health and pension insurance schemes that are financed by payroll taxes. For this reason, the sector has per-hour labor costs that are, all else equal, higher than those elsewhere in the economy. As a result, there is less potential for employment creation in the modern sector.

Not coincidentally, those sectors which have had to bear higher labor costs and less flexible labor regulations are the same sectors of the economy that have traditionally looked to government to create stability and preserve profitability on the output side. Tariffs and special tax provisions guaranteed domestic markets to manufacturing concerns, while public enterprises could count on state subsidies in difficult times. Indeed, in some countries, the system was one of de facto contracts between the state and enterprises. The state guaranteed profitability and markets, and in return the enterprise provided good jobs with socially progressive benefits to its work force. The costs of these benefits could easily be passed on to consumers by manufacturers protected against external competition, and to society at large by the public sector.

The tripartite collaboration - management, labor, government - has sometimes worked without much friction. In other cases, tensions frequently have arisen in which shifting alliances form, pitting two sides against the third, generally with the public sector as the swing vote. At the heart of the system, however, is a public sector that disrupts market signals that should be the basis for business decisions, both on the input and output sides. Labor policy is just one source of market signal distortion.

In contrast, workers in the small business, rural, and informal markets have enjoyed few of the benefits received by their colleagues in the public and formal private sectors. Some sort of work is available to anyone who wants it, but productivity and returns for some endeavors (such as shoe-shining or selling oranges on the street corner) may fall very far short of the minimum necessary to cover basic household expenses. Informal and rural labor markets enjoy freedom from the more onerous labor market measures imposed by the public sector, because enforcement capabilities preclude going after any but the largest companies. Hence, these markets offer more flexibility to workers and entrepreneurs.

Toleration of dual labor markets has occurred because policymakers expected that the process of development would eventually pull most employment into the formal sector, extending its benefits to the broad population. The lessons of the recent past suggest that the opposite took place: policies (like import substitution) that helped create a small, distinct formal sector actually retarded growth and constricted formal-sector employment opportunities.

3. Structural Adjustment and Labor Policy

Labor policy has typically fallen to the bottom of the list of priorities for structural adjustment reforms. Privatization, trade liberalization, financial sector reform and public sector reduction all seem to take precedence in timing and scope over labor market issues. In some countries (Panama and Ecuador are examples), labor policy distortions are substantial contributors to inefficiency, but political constraints prevent their being addressed. In these countries, the potential success of the overall adjustment effort is called into question when major labor reforms are not undertaken.

In other countries (El Salvador, for example), the problems of labor policy are less severe, and delays in action may reflect a reasonable prioritization of efforts. Nonetheless, revision of the labor policy framework offers opportunity for improving labor conditions, and may be a worthy component of the structural adjustment process.

Whether urgent or moderate needs for reform exist, the failure to fully incorporate labor policy measures in structural adjustment programs seems to stem from the belief that these measures are the most divisive politically. Urban, formal sector work forces tend to be more organized and vocal in opposing change than their counterparts among the informal sector, rural labor force or the unemployed. This phenomenon is unfortunate, as the absence of labor policy reform may well impede improvements in competitiveness.

In the Latin America of the nineties, where import duties are low, inefficiencies caused by labor policy problems may mean the difference between being competitive with imports (or other countries' exporters) or not. Protecting the existing set of labor policies may be at odds with the objective of creating more and better jobs. There may also be a conflict between protecting the status quo as regards conditions of employment for a relatively small, privileged group in the formal sector, and improving labor market conditions (and income) for households at the bottom of the income distribution.

Political sensitivities arise in part from the common misconception that structural adjustment is a code phrase for lowering wages and benefits to the working class. (Remember that adverse commodity prices, the debt crisis, and domestic macroeconomic mismanagement corrected by stabilization policies, were the primary contributors to the reduction in real wages during the eighties, not structural adjustment.) When the entire labor force - formal, informal, rural, and unemployed - is taken into account, structural adjustments to labor policy offer clear opportunities to improve living standards. Even when labor reform issues are considered looking only at the urban formal sector, the issues are broad and complex, and should not be construed as a simple question of which worker benefits to eliminate.

A review of labor policy concerns related to structural adjustment illustrates this complexity.

(a) Removing the bias against labor-intensive production

The Latin American countries, with few exceptions, are labor-abundant economies. National policy, then, should avoid introducing biases against production that uses labor, especially unskilled labor, intensively. This has generally not been the case.

Many countries, to stimulate investment, adopted policies encouraging entrepreneurs to use capital relatively more intensively. Tax codes, for example, provided relief for firms engaging in purchase of equipment, while use of labor was taxed. Overvalued exchange rates and subsidized credit also biased production away from creating jobs, in providing incentives for the use of capital.

Elimination of the bias against the use of labor is one area where the policies normally associated with structural adjustment programs will have an important effect. Trade reform, for instance, will push domestic industry in the direction of national comparative advantage, which in a labor-abundant country means labor-intensive production, or in plainer language, more jobs. Financial sector reform which decreases the concentration of credit may facilitate expansion of credit to smaller firms. These firms have generally not been subject to protection and regulation, and hence employ labor relatively more intensively. Indeed, most structural adjustment measures fall into two general classes. They either redress the subsidy or bias toward use of capital implicit in the policy framework, or they remove barriers to entry or access to resources that worked against firms in more labor-intensive sectors.

A third class of measure can be highly complementary: looking for those direct reductions in the cost of labor to formal sector firms which have minimal or no impact on the value of wages and benefits to the worker. A few countries have experimented with providing relief from the corporate income tax for creation of new work places, arguing that this provision is analogous to the breaks offered for capital equipment. Making overly restrictive work rules more flexible (e.g., reducing prohibitions on overtime) can also reduce labor costs to the firm.

(b) Controlling costs and expanding coverage of national health and pension insurance schemes

Health, disability and old-age insurance schemes are generally financed through payroll taxes, with contributions from both employer and employee. While important social benefits are conferred through access to such programs, the payroll taxes associated with them do raise the cost of labor relative to other inputs to production. Such programs are normally mandatory for formal sector workers, but unavailable, prohibitively expensive or marginal in terms of benefits for other members of the labor force.

Several countries have implemented reforms of their insurance schemes. The least ambitious reforms have attempted to control costs so that payroll tax increases could be avoided and deficits of the insurance schemes could be reduced and eliminated. More fundamental reforms (e.g., Chile and Peru) have tried to privatize insurance, in an effort to provide better benefits at a lower cost to a larger population.

(c) Labor code reform

Most Latin American countries have labor codes which provide mandatory standards for work conditions, work schedules, severance pay, overtime, vacations, termination of employment and other workplace norms. While regulation of the workplace is important in preventing abuses (such as child labor), at least some of the labor standards contained in Latin American labor codes excessively restrict allocation of labor by the firm, at the expense of employment. The Panamanian labor code provides some interesting examples.

In Panama, in many cases, a firm in financial distress must seek Ministry of Labor approval for laying off workers. Provisions for overtime payment are extraordinarily expensive. A rigid provision that work conditions and terms for an employee can never be reduced makes redeployment of labor within a firm difficult, as well as payment by piecework rates. Requirements

also exist for firms to finance training programs selected by the employee, and allow the employee to spend up to two months per year away from the job while drawing full salary. Panama's severance pay requirements are front-loaded (on a pro-rata basis, payments are relatively more generous to workers with little time on the job), an effective disincentive to job creation. While such regulations may be workable in firms in highly protected environments, for firms trying to compete in global markets, they are severe handicaps. Of course, the ultimate losers are the individuals whose employment opportunities are much scarcer as a result.

Many labor code provisions try to protect the worker against normal labor market risks, such as unemployment, a changing job description, or a changing work schedule. In some cases, the labor force may be better off if work rules are more flexible, and protection now afforded by the labor code comes from another source or is eliminated. For example, rather than prohibiting layoffs or making them excessively expensive, both employers and workers may be happier with an unemployment insurance scheme to which employers contribute. If reforms are seen to lead to more abundant and better work opportunities, workers may not oppose elimination of government-imposed rules controlling work assignments within the plant, as the option to seek an alternative job is a more viable form of leverage in dealing with an employer.

(d) Minimum wages

The justification for establishment of a minimum wage is to set a standard for employers, and to provide a minimum standard of living for workers. Economists, however, view minimum wages set above the market-clearing wage as deterrents to employment. In other words, when society chooses a higher minimum wage, some individuals will benefit because they will earn more, while others will be hurt because employment opportunities will be fewer.

Rampant inflation in many Latin American countries has left the minimum wage well below the market-clearing wage, so that the minimum has no real role in determining the allocation of labor. In other countries, the minimum wage is set above the market-clearing wage, and does depress employment creation in those sectors within which it is enforced. If enforcement is uniformly weak, then the minimum wage has little effect on labor markets.

(e) Redefining the role of the public sector

A structural adjustment issue for labor policy is how best to narrow the scope of government activity and direct it into those areas where public sector involvement most effectively contributes to national well-being.

Governments tend to reinforce dualism by intervening intensively in the labor-management relationship in the formal sector. By contrast, governments do little or nothing for the informal sector and unemployed work force. Public sector intervention takes numerous forms. For example,

- The public sector appropriates to itself decisions on many of the details of work conditions, that could be just as well negotiated between management and labor. These include rules for hiring and firing, work schedules, overtime provisions, noncash benefits and others.

- The public sector may establish itself as the arbiter of first recourse in labor-management disputes, rather than of last recourse.

- The public sector may attempt to supplant markets in determining "fair" levels of remuneration across occupations, geographic areas and types of firms. For example, some countries have multiple minimum wages by sector and occupation.

- The public sector may require or encourage professional licensing beyond what is needed to protect the consumer.

These interventions raise the cost of labor to the firm, and require establishment of a bureaucracy for enforcement. They also distract from what should be the most important domain of the public sector in labor policy, namely to protect public interests by intervening in areas of market failure. Market failure occurs where private markets, if left to themselves, will not produce desirable outcomes from society's perspective. For example, actions to discourage child labor, maintain adequate work place health standards, and prevent discriminatory practices are more appropriate areas for public sector involvement. Latin American governments have substantial room for progress in providing these protections. Progress might come more easily if government's role were more narrowly defined.

(f) Collective bargaining

Labor policy is frequently presumed to involve only those workers who belong to, or who potentially belong to, a union. In many Latin American countries, this is considerably less than a

majority of the labor force. A broader and more equitable perspective might view the maximization of benefit to workers in the formal, informal and unemployed work forces as the objective of labor policy.

Nevertheless, there are issues of labor policy relating to collective bargaining that merit attention in the region, with the objective of raising economic prosperity. Latin America's often turbulent past has witnessed attempts to circumvent formation of unions, as well as politicization of union activities to the point of undermining their ability to represent their members' interests.

Proposals for reform have stressed that labor unions must become more democratic and responsive to membership needs. In addition, the role of the public sector in overseeing labor relations issues needs to be reconsidered in many countries. Excessive public sector control over formation of unions and resolution of labor-management disputes impedes the development of mature, productive bargaining relationships. Moreover, it also contributes to excessive political intervention in labor relations. The uncertainty of having a public sector "swing vote" at play in labor-management issues, or a weak and politicized labor movement, discourages investment in sectors likely to have a unionized labor force.

(g) Education and training

The scope of this paper prohibits a full discussion of the relationship between education and labor markets. Suffice it to say that improved productivity of the labor force depends greatly on effective national education systems that function at all levels.

Specific structural adjustment issues that relate to labor policy include vocational and management training, apprenticeship and other informal training arrangements, and retraining of dislocated workers from sectors that are adversely affected by economic policy revisions (for example, parastatals or import-substituting firms). For each of these questions, the appropriate role of government and the private sector is part of the equation.

A promising area of attention is management training in industrial relations, particularly for smaller firms. Often, difficulties in dealing with a labor code or unionized work force can be relieved if management is trained in, for example, proper documentation of employee performance. Union representatives could also benefit from labor relations training emphasizing nonconflictive techniques (i.e., negotiation and conciliation) to

facilitate transition away from the confrontational style affected by traditional labor unions.

(h) Gender discrimination

"Progressive" labor policy in Latin America often differentiates between men and women in its treatment. Two common examples are labor codes which have special provisions for women (such as prohibiting more onerous work schedules or barring them from traditionally "male" occupations, which tend to be better paid) and old age insurance that allows women to retire earlier then men. Gender differentiation in labor policy may make employing women costlier than employing men, thus creating a disincentive to female employment. Moreover, it creates an atmosphere less conducive to equal treatment in the work force. Making labor policy more uniform in its treatment of male and female employees will facilitate women's participation in the work force.

4. Conclusions: The need for reform

A review of structural adjustment programs in Latin America reveals little attention given to improvements in labor policy. Neglect of labor issues is surprising, given that labor costs are a key determinant of competitiveness. In many cases, public policy inflates labor costs with no real benefit to the worker, for example, when inefficient health and pension insurance schemes are financed by payroll taxes that might otherwise be lower. In other cases, policy creates an unsustainable level of benefits to one small subset of the labor force (e.g., workers in parastatals) to the detriment of employment in the rest of the economy.

A holistic approach to labor market issues is called for, one that considers how best to improve working conditions for the entire labor force - public and private sector, formal and informal markets, employed and unemployed. By correcting biases against use of labor, structural adjustment programs will create jobs. Greater labor demand is essential to improved wages and working conditions, as it forces employers to compete for workers. Measures to reduce inefficiency in labor markets, as described in previous sections, will also help increase demand for labor.

Lower import duties and other structural reforms are permitting Latin American countries to effectively compete in the global marketplace. The cost to society of leaving labor policy

problems untouched will become increasingly evident. Employment creation and poverty alleviation can be fruits of a serious effort to improve labor policy. If structural labor policy problems are not corrected, countries may be tempted to adopt alternative measures such as devaluation to bring labor costs down, to compensate for the costs of bad policy. Such an outcome would be unfortunate, as there are many opportunities to adjust labor policy where the beneficiaries will be the working class.

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