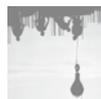




# Labour Markets, Worker Protection, and Lifelong Learning in a Global Economy:

EXPERIENCES AND PERSPECTIVES  
OF LATIN AMERICA AND THE CARIBBEAN



UNITED NATIONS

ECLAC



SIXTY YEARS WITH LATIN AMERICA AND THE CARIBBEAN

MINISTRY OF FOREIGN  
AFFAIRS OF DENMARK



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## Presentation

Despite the expansion of the world economy in recent years, the employment situation remains uncertain, with a high percentage of the labour force unemployed or engaged in occupations that do not enable workers to escape from poverty. Recent growth rates in Latin America and the Caribbean, which have been relatively high compared with historical levels —albeit lower than those recorded in other regions— have had a favourable impact on job creation, employment rates and poverty; however, serious problems still persist, in our region as well, in terms of high unemployment, underemployment and job insecurity, and these situations are compounded by barriers to access to productive employment affecting specific sectors of the population, especially the least skilled, including youth and women.

Sustained economic growth is known to be necessary, albeit insufficient, for generating high-quality employment and this, in turn, is recognized as the material base needed to ensure a decent life for the vast majority of the population and to build social cohesion in Latin America and the Caribbean.

Labour-market trends reflect economic growth, which, according to its characteristics alters the extent and composition of labour demand. However, work must be considered as an input in the productive process, so that its features and the way in which it fits into this process have an impact on the characteristics of the latter.

The nature of both links, between work and employment, on the one hand, and between the productive process and economic growth, on the other, is determined to a great extent by labour-market institutions, whose purpose, ultimately, is to generate quality employment. To this end, the two-fold objective of ensuring the efficient operation of the labour market and protecting the more vulnerable actors must be pursued.

Like all institutions, labour-market institutions are products of history, the result of social, political, economic and cultural interactions in a given place and at a given time. The fulfilment of the above-mentioned objectives hinges mainly on the responses developed to meet the challenges posed by a particular economic, social, political and cultural context.

As pointed out in this document, the current challenges stem from open, volatile economies which are radically different from the growth and development models that were current in the post-war era. In the face of stiff competition and constant technological change, the economies of the region are under pressure to increase their capacity for adjustment in many areas, among them labour-market institutions. They must also work out a long-term development strategy to stimulate systemic competitiveness, and this calls for on-going education and training of the labour force. The former mechanisms for the protection of workers —centred on job security— and the old ways of consolidating their position in the labour market over time, precisely through seniority in a stable job position, have been declining. This brings to the fore the challenge to create worker protection mechanisms and promote career advancement in the context of present-day labour markets. Lastly, efforts must be made to expand the coverage of labour-market institutions in order to encompass broad segments of the labour force that do not enjoy their benefits or comply with their obligations.

ECLAC, with support from the Government of Denmark, has prepared the study “Labour markets, worker protection and life-long learning in a global economy: experience and perspectives from Latin America and the Caribbean”, which seeks to contribute to the debate in the countries of the region in the search for creative solutions to the problems —whether old or new— currently being faced in the region.

This document, which consists of nine sections, gives a brief outline of the main findings of the study. Following a short introduction, section 2 describes the situation and recent labour-market trends in the region, which reflect the favourable macroeconomic context of recent years, although serious problems persist for a large proportion of the workforce. Section 3 looks at the characteristics of labour-market institutions and the three following sections sum up the changes introduced in recent years in the three pillars of labour-market institutionality: labour market regulation, unemployment protection and active labour-market policies. It

should be noted that no single approach has been used to improve these institutions in the face of the above-mentioned challenges and that major deficiencies persist in all three areas. Section 7 discusses *flexicurity*, the approach used by the countries of the European Union, in a context that bears little resemblance to that of our region, to confront the challenges emerging in the current phase of world economic development. Section 8 analyses the hurdles that Latin American and Caribbean countries will need to overcome in order to change their institutions, bearing in mind the basic tenets of *flexicurity*, and puts forward proposals for reforming the three areas of labour institutionalality. The final section presents some considerations relating to strategic aspects of a process of reforms negotiated in order to strengthen labour institutions in the countries of the region.

One of the findings of the study is that, while countries face similar challenges, the solutions must be varied according to each country's peculiar characteristics, in order to reach a sufficiently broad consensus to give labour-market institutions legitimacy and, consequently, social sustainability. To that end, social dialogue—however complex and difficult, given the historical background of our countries—remains the most suitable avenue. In view of the region's past experience, this dialogue will only be successful if it is part of a process that generates mutual respect, recognition and trust. Consequently, while the reforms in the three areas of labour institutionalality should be considered as complementary, the approach that promises to yield the greatest successes in terms of legitimacy and social sustainability is a gradual one. Lastly, labour-market institutions must be part of a more comprehensive effort to devise a development strategy for the countries of the region, including the definition of objectives relating to job creation and job quality. Labour-market institutions must contribute to the objectives thus defined.

**José Luis Machinea**  
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# 1

## **Introduction: the global economy and labour-market challenges**

The changes that the global economy has experienced in recent years have generated new challenges for societies and economies all over the world. Growing trade in goods, services and information, heavy capital flows, and massive international migration are producing what has been called a second wave of globalization. While benefiting from the positive aspects of market integration, the more open economies are faced with the cost of adapting continuously to a volatile and unpredictable economic environment.

To take maximum advantage of the potential benefits, countries must try to improve their systemic competitiveness, but at the same time they need to establish efficient adjustment mechanisms and social security systems to protect those affected by these adjustments, in order to limit the costs inherent in a volatile environment and to distribute them as fairly as possible.

In this context, firms are demanding flexibility in market regulations so that they can adapt promptly to shifts in demand, and so that they can reduce economic transaction costs (World Bank 2007). Yet if they are to remain competitive over the long run, firms will also need to adopt strategies for increasing productivity, and the key elements here are process and product innovation and a skilled labour force.

The changes noted above have had an enormous impact on labour markets. Factors such as technological change, which makes productive

processes more flexible, the growing mobility of capital and technology, and the adoption of business strategies in response to the shifting context tend to diversify and polarize occupational patterns. Moreover, the integration of the economies of Asia and of countries of the former Soviet Union into the world market has in effect doubled the global labour force (Freeman 2005a). The labour force in Latin America and the Caribbean, in particular, faces competition both from skilled workers in highly industrialized countries and from less-skilled workers who compete by accepting low wages. In this setting, workers are demanding more protection and greater opportunities for promotion and advancement. When it comes to meeting these demands, the protection mechanisms of the past, which focused on employment stability, are losing their relevance. Because a great proportion of the Latin American and the Caribbean workforce is excluded from institutionalized labour relations, there is an additional demand to make labour-market institutions increasingly inclusive of this segment of the population.

The ultimate purpose of labour-market institutions is to generate high-quality employment. Employers and workers alike are insisting that, to reflect socioeconomic changes, there must be adjustments to the three pillars of the system of labour-market institutions: labour-market regulation, unemployment protection systems, and active labour-market policies. In recent decades, many countries in Latin America and the Caribbean have undertaken reforms in these three areas. However, many of these reforms have lacked coherence and consistency over time, due primarily to the lack of an underlying consensus on how labour institutions as a whole should be revamped.

Some European countries have responded to the challenge of adapting their labour-market institutions (challenges which, while similar, have to be faced in a very different socioeconomic context) by combining flexible labour regulation with solid mechanisms for protecting the unemployed, including direct financial subsidies and active labour-market policies. This response is based on the concept of “flexicurity”. For many reasons, experiments in other parts of the world do not offer much of a model for the changes that are needed in the Latin American and Caribbean region. Nevertheless, there are some lessons to be drawn from these experiments. They include the need to adapt labour institutions to a new economic and social context, one that is more dynamic and changeable, the importance of

negotiated adaptation to make sure that the new institutions are sustainable over time, the need for a comprehensive approach that treats the different components of these institutions as complementary, and the need to consider labour-market institutions within a long-term development strategy.



## 2

### **Labour markets in Latin America and the Caribbean: current situation and trends**

Historically, demographic growth has exerted heavy pressure on Latin America and the Caribbean labour markets, with the ranks of new jobseekers swelling year by year. Yet the demographic transition of recent decades has tended to mitigate this pressure, and indeed, in recent years, has helped to reduce it. While the region's working-age population (defined as all persons aged 15 years and older) was growing annually by 2.9% in the early 1970s, this indicator will drop to 1.8% over the five-year period 2005-2010. In the decade 2000-2010, the increase in the working age population will have declined even in absolute terms, from a maximum of 37.7 million in 2000-2005 to a projected 37.0 million in 2006-2010 (ECLAC 2004a).

This tendency is even more pronounced in urban areas. Sharp migratory flows caused the urban working-age population to grow by 4.2% a year in the first half of the 1970s; 30 years later, the figure stood at 2.4% and, according to projections, will fall to 2.1% in 2005-2010.

Alongside these demographic trends, growth in the labour force is also influenced by changes in participation rates (the percentage of the working age population that is actually in the labour market). The following tendencies have had important medium and long-term effects:

- In recent decades there has been a steep increase in the female participation rate, although it is still well below that for men.
- The fact that young men remain longer in school has tended to slow the increase in the male participation rate. While in many

countries young women have achieved higher education levels than men, this has not slowed the female participation rate, which was already lower than that for men: what declined was the percentage of women engaged in domestic work.

- Workforce participation tends to drop when people reach retirement age, especially if there are broad social protection systems in place. The increase in the number of persons older than 65 years tends to dampen labour participation rates, especially in urban areas.

Because it was the first of these tendencies that dominated in most countries, the overall participation rate has risen, despite short-term fluctuations in the supply of labour in reaction to the macroeconomic situation.<sup>1</sup>

Notwithstanding the reduced labour supply pressures resulting from demographic trends, unemployment increased during the 1990s and the beginnings of this decade. As figure 1 shows, job generation was insufficient, until 2003, to offset the increase in the labour force: as a consequence unemployment, which appears in the figure as the difference between the participation rate and the employment rate, rose throughout this period. This trend was especially marked following 1995, when successive economic crises had an extraordinary impact on unemployment, which remained at historically high levels because of the lack of sustained economic growth. The region's unemployment began to decline in 2004, thanks primarily to an upsurge in job creation, and by 2007 the jobless rate dropped to below 8.0%, from a peak of 11.0% in 2002-2003 (ECLAC 2007a).

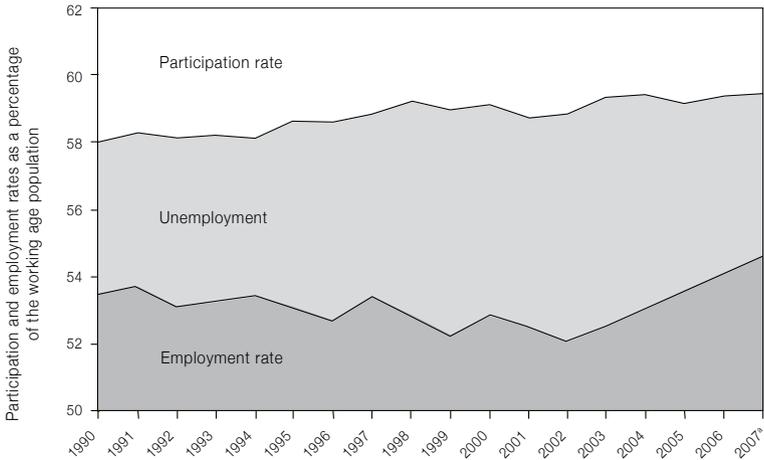
The high and persistent level of open unemployment recorded after 1995 was in fact without precedent in the region, for while previous economic crises sparked a jump in unemployment, this always dropped back fairly quickly, even at times of weak economic growth, as in the 1980s. In those circumstances, open unemployment was followed by a period when jobs were more available in low-productivity sectors, a process that was not so apparent after 1995.<sup>2</sup>

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<sup>1</sup> The labour supply response to the business cycle varies among countries: see Machinea, Kacef and Weller (2007).

<sup>2</sup> The low-productivity sector is measured on the basis of household surveys, and covers employers and wage-workers in microenterprises, domestic service, and self-employed workers with no professional or technical qualifications.

Figure 1  
**LATIN AMERICA AND THE CARIBBEAN (16 COUNTRIES):**  
**LABOUR PARTICIPATION AND EMPLOYMENT TRENDS, 1990-2007**  
*(Weighted average rates)*



**Source:** Economic Commission for Latin America and the Caribbean (ECLAC) based on official country data.

<sup>a</sup> Preliminary data.

More recently, employment trends in low-, medium- and high-productivity sectors have varied. Between 1990 and 2002, the medium- and high-productivity sectors showed a slight increase in their share of urban employment (from 58.9% to 59.6%). This increase was not generalized, however, and in 12 of 17 countries the share of these sectors declined, while that of the low-productivity sector rose (ECLAC 2007c, p. 133).<sup>3</sup> Between 2002 and 2005, the composition of employment improved: the proportion of the medium- and high-productivity sectors increased in 8 of 15 countries, rising from 59.6% to 62.6% for the region as a whole.

Another important factor has been heavy outward migration from the region. In addition to the long-standing emigration of Mexican, Central

<sup>3</sup> Brazil was one of the countries in which the low-productivity sector share declined, and this explains most of the decline in the weighted regional average.

American and Caribbean workers to the United States, there has been a sharp increase in persons leaving the region because of severe economic crises. Because of differences in welfare levels between neighbouring countries, these crises have also sparked intra-regional migrations. According to ECLAC estimates, 11 countries in the region have net annual migration rates of two persons per thousand or more.<sup>4</sup>

A further labour-market problem is the declining quality of employment. A major component of this phenomenon is the reduced coverage of social security programs, reflecting greater job instability. The proportion of employed people contributing to social security systems dropped from 63.3% in 1990 to 55.5% in 2002, increasing slightly in subsequent years to 56.7% in 2005 (ECLAC 2007c, p. 136). It should be noted that this reduction in protection levels also affected those with wage jobs, among whom the percentage of contributors declined from 72.4% in 1990 to 68.2% in 2005. Another indicator reflecting the deterioration in job quality in the 1990s was the significant proportion of wage earners who had no formal contract, or only a short-term contract (ECLAC 2007c, p. 135), possibly reflecting the increase in outsourcing. Generally speaking, employment has become increasingly precarious.

Within the region, the trend in average real wages in the formal sector has varied, depending on the method of calculation used. The index based on median annual wage growth rates shows that wages rose by 30% over the period 1990-2007 (1.5% a year), more than offsetting the 11% loss in the 1980s. By contrast, using an index that represents the weighted average of wage growth rates, the cumulative increase over the last 17 years was only 12%, or an average annual growth of 0.6%. From this perspective, wage increases lagged slightly behind output per worker, which grew by around 0.8% annually between 1990 and 2006.

Figure 2 shows that, after a drastic drop in average labour productivity in the 1980s, output per worker resumed a gently upward path until 1997, although it did not regain its 1980 level. This trend can be attributed to a significant increase in productivity in the primary and secondary sectors, in the context of freer trade. Average productivity in the tertiary sector

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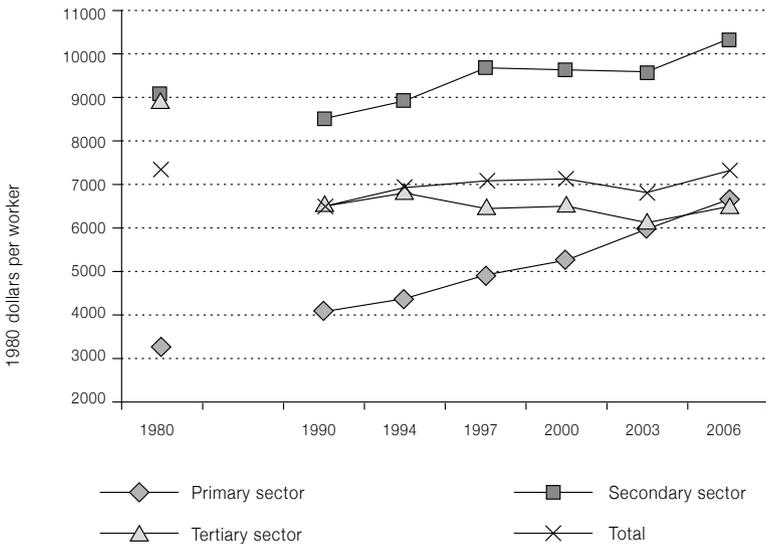
<sup>4</sup> Those countries are, in descending order: Guyana, Suriname, Saint Lucia, Jamaica, Guatemala, Ecuador, Nicaragua, Mexico, Trinidad and Tobago, Haiti, and Peru (ECLAC 2004a).

(a variable that is more difficult to measure) appears to have increased in only certain years, and it retreated at the end of the “tequila crisis”, with the expansion of the informal urban economy that characterizes many branches of the tertiary sector.

Between 1997 and 2003, average labour productivity stagnated. Only in the primary sector was there an increase in labour productivity, due primarily to the modernization of capital-intensive commercial agriculture, the shedding of labour in certain sectors of the small farm economy, and the expansion of mining. Since 2004, with the improvement in macroeconomic conditions, all sectors have seen a rise in productivity, although in 2006 productivity had yet to regain its 1980 level.

In fact, the problems that Latin America and the Caribbean countries have encountered in boosting their productivity, and hence their competitiveness and economic growth, are key factors for explaining why labour conditions

Figure 2  
**LATIN AMERICA AND THE CARIBBEAN:  
LABOUR PRODUCTIVITY TRENDS, 1980-2006**



Source: Economic Commission for Latin America and the Caribbean (ECLAC) based on official country data.

have not improved much in the region. This weakness is also reflected in the sharp drop in total factor productivity that many countries suffered in recent decades, although some performed better in the 1990s (ECLAC 2004c, Chapter V).

Lower labour productivity translates into a high incidence of poverty among workers. Naturally, poverty is less prevalent among the working population than in the population as a whole, yet it is noteworthy that 27% of urban workers and 48% of rural workers earn too little to raise their per capita household incomes above the poverty line.<sup>5</sup>

Finally, labour-market trends do not affect all groups equally. The causes of this inequality lie in factors outside the labour market, such as unequal education opportunities, the weaknesses of labour-market institutions, and patterns of discrimination or bias in favour of certain segments of the labour force. Various indicators, such as a rising unemployment rate, or longer job-seeking periods, difficulties in landing certain jobs, pay differentials for the same type of work, and the wide and growing wage gap among sectors, demonstrate the need for specific measures to promote employment opportunities for the most affected groups. Those groups include, in particular, women and young people, especially those with little schooling, and ethnic minorities. At the same time, inequality is ingrained in the structural heterogeneity of the region, which expresses itself in great productivity differences and in the concentration of poor workers in the low-productivity sector.

As noted above, the economic dynamism recorded in the region since 2004, with annual growth rates of 5.5% between 2004 and 2007, has helped to boost labour performance. Following are some of the most noteworthy developments in this period:<sup>6</sup>

- The employment rate rose steadily, and in 2007 it was 1.5 percentage points above the average for the 1990s.
- The unemployment rate fell by three percentage points between 2003 and 2007 and, at 8.0%, stood at early 1990s levels.

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<sup>5</sup> Simple average of 18 countries for urban workers and 15 countries for rural workers, based on ECLAC calculations (2007c).

<sup>6</sup> See ECLAC (2007a, 2007b, 2007c) and Machinea, Kacef and Weller (2007).

- Job creation was heaviest in wage-paying employment, reflecting strong labour demand and a growth-employment elasticity of around 0.7 between 2004 and 2007.
- Formal employment expanded as measured both by the structure of the labour market and by enrolment in social security systems and contributions to those systems.
- There was also an increase in more unstable contractual relationships.
- The impact of higher labour demand was felt primarily in job creation, while wages in the formal sector increased only slightly in most countries.
- Labour productivity improved after a period of stagnation that lasted for about 10 years from the mid-1990s.
- Poverty levels declined, thanks to higher employment levels, demographic changes that reduced dependency ratios and, to a lesser degree, higher wages.

In summary, the relatively high economic growth of recent years, supported by a very favourable external environment, has had a positive impact on labour performance. Yet unemployment and underemployment rates in the region remain high, and many people are unable to escape from poverty even if they have jobs. Despite the relatively solid labour performance of recent years, then, the region cannot afford to overlook questions such as the following:

- Are existing labour-market institutions helping to create high-quality jobs, or are they an obstacle to better performance?
- Are existing labour-market institutions contributing to the systemic competitiveness of Latin American and Caribbean countries?
- Do labour-market institutions promote the efficient functioning of labour markets?
- Do labour-market institutions protect and strengthen the weakest players in a market with structural inequalities among participants?
- Do labour-market institutions foster the inclusion of persons working in the informal and low-productivity sectors?



# 3

## Labour-market institutions

Labour-market institutions are mechanisms with differing degrees of formality that establish the rules of behaviour for participants in the labour market. Examples of such institutions include legislation governing individual and collective labour relationships, active labour-market policies, unemployment protection systems, and also informal agreements, regarding labour relations. The ultimate goal of labour-market institutions is to generate high-quality employment. To achieve this goal, institutions must meet two objectives: they must ensure an efficiently functioning labour market, i.e. the optimal allocation of resources, and they must guarantee protection and support for the weakest players in a market characterized by structural inequalities among participants. In this way, properly designed labour institutions stimulate economic growth, competitiveness, employment, and social cohesion.

When these objectives come into conflict, it is up to labour policy to find the appropriate balance. For this there is no “best” solution, however, and the response will always depend on temporal and spatial factors. On one hand, shifting conditions in other markets may spark modifications in labour-market institutions. On the other hand, labour institutions are the result of historic processes specific to each country. This means that, while a given institutional rule may be broadly accepted in one country because of its social history, and may contribute to achieving objectives there, in another society that same rule may be controversial and its implementation can upset the functioning of other institutions.

In the context of Latin America's "inward-oriented" development, labour institutions similar to those in more industrialized countries were created.<sup>7</sup> The intent was to establish a comprehensive framework that would take account of the sharp increase in wage employment in the industrial and tertiary sectors, and respond to the demands of emerging social sectors. As happened in more developed countries, Latin America and the Caribbean created institutions to regulate labour relationships, both directly through the State and through collective bargaining. Yet there are a number of features that distinguish Latin American experience from that in industrialized countries:

- The coverage of labour institutions was confined to a much smaller sector of the labour force.
- Within that sector, there was less observance of existing rules.
- In many countries, relations among the principal socioeconomic agents (public sector, employers, unions) were determined by a populist State that proposed a social covenant under its leadership. In this context, the unions came to depend heavily on certain political forces or the State, favouring political over labour negotiations, and legal regulation over arrangements negotiated between employers and unions.
- In some cases, social and political instability sparked a cycle in which, at some point, integrative institutions were replaced by authoritarian regulations that dismantled or undermined union organization, after which those institutions were re-established.
- In countries with a weak productive base and exclusive social and political systems, the predominant form of collective labour relations was authoritarian and repressive, while individual labour relations were frequently geared to protection of workers, even though the coverage of labour institutions was narrower than in more developed countries.

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<sup>7</sup> The two principal regulatory mechanisms in industrial countries were labour and social legislation, and collective bargaining. In the context of a broad national covenant, whether tacit or explicit, between firms, workers and the State, these regulations improved working conditions (with higher real wages, shorter working hours, provisions against unemployment, sickness and disability, and regulation of workplace safety and hygiene, among other improvements), and they contributed to increasing labour productivity (through training and organization of work).

It is reasonable to conclude that, while the basic features of labour institutions in more industrialized countries were repeated in Latin American and Caribbean countries, they embraced there a much smaller portion of the productive, social and political structure. Moreover, large segments of the population, the weight of which varied from one country to another, remained excluded from these processes and benefited only indirectly from the progress that was made (for example, social policies, “trickle-down” income effects, or they suffered economic dislocation and social marginalization. Thus, labour institutions generally failed to achieve the stability typical of social covenants in industrialized countries, and they did not produce the desired social cohesion. It may be noted that the situation was slightly different in Caribbean countries, where labour institutions followed Anglo-Saxon models, meaning that there was less State intervention in labour-market regulation.

In economies that were much more closed than those of highly industrialized countries, some elements of Latin American economic regulation had an adverse impact on economic efficiency.<sup>8</sup> Yet during the 1970s and a large portion of the 1980s, most analysts were convinced that Latin American labour markets were functioning reasonably well (Squire 1981, Gregory 1986).

Nevertheless, the technical and economic changes that have occurred at the global, regional and national levels in recent decades have modified the functioning of other markets, and have exerted renewed pressure on the labour market. In particular:

- market opening increased the competitive pressure on national economies and on firms, obliging them to make better use of the factors of production and to strive for steadily rising productivity; and
- recent technological progress has allowed production processes to adapt more swiftly, and has forced firms to make greater adjustments to shifting patterns of demand. Elements such as quality, innovation, diversity and creativity have gained importance in comparison with

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<sup>8</sup> For example, wage increases and high earnings expectations tended to be passed on in higher prices.

the standardized, large-scale production lines that characterized the Taylorist system.<sup>9</sup>

As a consequence, labour demand has become more heterogeneous and requires swifter adjustment. When it comes to the labour supply, a more heterogeneous workforce (in which there is growing female participation, and where young people have specific preferences with respect to working conditions) requires labour relations that are different from those that predominated in previous stages, designed to fit the “typical worker”, i.e. the adult male (Cortázar 2004). This greater heterogeneity of both supply and demand implies less direct State intervention, which would now be limited to establishing a ‘floor’ for labour rights and mechanisms for protecting specific groups. In general terms, labour relations are increasingly being negotiated between firms and workers, and at different levels, for example within a specific branch of activity, and complementarity at the level of the firm. In short, while there is no single regulatory system that can best fulfil these objectives, more adaptable internal and external labour markets could play an important role in making the productive process more flexible.

In this setting of more volatile markets, workers tend to demand more stability and protection. The traditional response of labour legislation to these demands has been to discourage layoffs through a system of compensation for “dismissal without just cause”, in an effort to avoid high turnover rates. In the current context, where economic volatility tends to reduce employment stability, the focus should be on another kind of stability, relating in particular to incomes (ILO 2004a). It must also be recalled that (to differing degrees among countries) a high proportion of the labour force is not covered by labour institutions, a fact that tends to undermine social cohesion. Consequently, further attention needs to be paid to two instruments:

- systems for protecting the unemployed; and
- active labour-market policies that will help the unemployed rejoin the labour market promptly, and will improve the employability of those excluded from labour institutions.

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<sup>9</sup> Because technological change is less generalized in Latin America and the Caribbean than in the more industrialized countries, these factors are less widespread in the region. In any case, they are becoming more important as Latin America and the Caribbean countries attempt to bolster their productive structure through technological change, innovations, and upgrading of the labour force.

Finally, labour-market institutions must be appreciated in the context of a long-term development strategy. The question is this: what is the basis for building systemic competitiveness in Latin America and the Caribbean countries? If the answer is that growth and development must increasingly be based on innovation and knowledge, on the production of higher value-added goods, and on rising productivity (ECLAC 2004b), then it is obvious that labour institutions must be such as to promote the accumulation of human capital and to foster labour relations and business organization schemes that will stimulate cooperation, at the level of the firm, the sector, and the economy as a whole.



# 4

## Labour-market regulation

The profound crisis that marked the 1980s, and caused it to be known as “the lost decade”, had severe repercussions (*de facto* if not *de jure*) on labour-market regulation. As the informal economy spread, the scope for enforcing formal regulations shrank even further and, in many cases, rising inflation caused real wages to fall, a situation that was unavoidable, since labour unions were weakened and minimum wage policies were subordinated to anti-inflation strategies.

The situation provoked calls for structural reforms, and these were subsequently compiled into the “Washington Consensus” (Williamson 1990), the basic idea of which was that less market regulation would generate higher rates of economic growth, while macroeconomic policy would be designed to avoid the imbalances that hampered the efficient allocation of resources. Among other things, this consensus championed freer trade in goods and services, fewer restrictions on foreign investment, the privatization of public enterprises, less government intervention in financial and other markets, and measures to control fiscal deficits.

Labour reforms had little place in this framework, probably because it was expected that other reforms would have a more significant effect on economic growth and the labour market, particularly if existing labour-market institutions functioned properly. Moreover, the risk that wide-ranging labour-market reforms would spark social conflict was probably another dissuasive consideration.

Consequently, during the 1980s only a few countries—Chile in particular, and Panama to a lesser extent— took any significant steps to make labour relations more flexible. In other countries, for example Argentina, Brazil and Uruguay, priority was given to re-establishing collective labour rights that had been suppressed by military dictatorships, and to expanding individual labour rights. Brazil took the lead in this regard, through a constitutional reform (Chahad 2008).

In part because of the disappointing results of the “first generation” reforms, a series of supplementary reforms were proposed in the 1990s, including labour reforms (IDB 1997). Over the past decade, many countries have reformed their labour legislation, in most cases in order to bring greater flexibility to specific aspects of the labour market, with the emphasis on expanding the available range of contractual arrangements. The intent was to supplement contracts of indeterminate duration with a series of fixed-term contracts, to expand the use of probationary periods, and to facilitate subcontracting. The second tendency was to make it easier to fire or lay off workers: chief among these measures were a broadening of the definition of “dismissal for just cause” and the introduction of unemployment protection systems based on individual accounts. Other flexibility-oriented reforms included the de-indexing of wages, more flexible working hours, and a reduction in non-wage labour costs.

According to detailed ILO studies (Vega Ruiz 2005), it was in Argentina and Peru that the most wide-ranging reforms took place following 1990. Brazil, Colombia, Ecuador and Panama also introduced changes to the key institutions of labour relations, while efforts to achieve greater flexibility were of lesser scope in Chile, Guatemala, Nicaragua, Venezuela and the Dominican Republic. Other countries, including Mexico, made no significant changes in their labour legislation (Ruiz Durán 2008).

It should be noted that these legal changes did not represent a general move towards greater flexibility, either at the regional level or within the model adopted by individual countries. A number of countries extended vacation periods and adopted laws to improve protection for specific groups. For example, measures were taken to protect working mothers and to eradicate the worst forms of child labour. As well, during the first half of the 1990s, legal changes led to a strengthening of labour unions in Brazil, Chile, Colombia and Costa Rica, while they were weakened in

Argentina and Peru. In Chile, some of the deregulation measures from the 1980s were reversed.

In the present decade, Chile and Peru, among other countries, have introduced new, “atypical” labour contracts. Chile, for example, developed contracts covering part-time work, the promotion of youth employment, and teleworking (Ministry of Labour and Social Welfare, 2003), while Peru designed new, atypical contracts to encourage youth employment, especially in conjunction with various training instruments (Toyama 2008).<sup>10</sup> In a switch from the prevailing trend of the previous decade, other countries restricted the use of “atypical” contracts. Taking the Spanish example from the late 1990s, Argentina replaced the strategy of making contractual relationships more flexible via atypical contracts, nullifying some of those agreements through amendments to standard contracts (Tokman 2007a).

Since 2000, generally speaking, there have been no further wide-ranging reforms for greater flexibility, and such measures as have been adopted have focused on small businesses and micro-enterprise, or on specific sectors, such as agricultural exports in Peru. On the other hand, some of the more recent reforms have stressed the overhaul of collective labour relations in order to bring them into line with ILO standards and to strengthen collective bargaining (Vega Ruiz 2005). Some countries have also broadened somewhat the spectrum of issues covered by collective bargaining (Vega Ruiz 2005, p. 13), while extending this to new groups such as seasonal workers (Ministry of Labour and Social Welfare 2003, p. 97). In general, these reforms have improved the conditions for labour union organization, and in some cases have succeeded in halting or reversing the downward trend in unionization.

As well, a number of countries have reformed individual labour relations to make them more protective. For example, Chile has reduced the number of hours in the workweek and increased the scale of compensation for unjustified dismissal (Ministry of Labour and Social Welfare 2003). Argentina has also increased compensation, especially for workers with little seniority (Golden 2008). Some countries have placed restrictions on overtime, or raised overtime pay rates (Vega Ruiz 2005, p. 45). In some

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<sup>10</sup> Nicaragua and Paraguay also saw the emergence of new types of contracts to help young people land a formal “first job” (Vega Ruiz 2005, p. 30). Peru also tried to encourage the hiring of persons 45 years and older.

cases, such as Chile, Colombia and Peru, the abuses detected in the use of personnel subcontracting has led to limits on this contractual instrument (Toyama 2008; Velazquez 2008; and Puyo Posada 2007). In Argentina and Venezuela, temporary measures have been taken to prevent the layoff of workers during an economic crisis.

Given the disparity between existing legislation and levels of compliance, several countries have significantly bolstered the resources available for labour inspections.<sup>11</sup> One obstacle to the proper functioning of labour institutions is the ineffectiveness of the labour courts, as reflected in the length of proceedings. A number of countries have introduced reforms to improve this aspect of labour institutions (Vega Ruiz 2005, p. 25; Bensusán 2006).<sup>12</sup>

Although this has not been the dominant trend, labour reforms in some countries have resulted from a process of social dialogue.<sup>13</sup> The most wide-ranging reforms in general have been applied under exceptional circumstances that precluded adequate participation by the parties. This rendered the reforms unsustainable, and they were subsequently amended, sometimes in the opposite direction. International commitments today play an increasingly important role in the debate. Those commitments include the ILO conventions as well as proposals relating to labour legislation and its enforcement that have emerged in the course of trade negotiations, especially with the United States. While the emphasis in the first free trade treaties between the United States and Latin America and the Caribbean countries was on the enforcement of national legislation, some countries in recent years, including Colombia and Peru, have committed themselves to amend their laws in order to win approval of these treaties.

Generally speaking, the main changes have been to individual labour rights, while collective bargaining rights have been weakened for various reasons, including the following (Weller 2000):

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<sup>11</sup> Argentina, Brazil, Chile and Peru, among others; see the consulting reports.

<sup>12</sup> It has been argued that in some countries labour court jurisprudence has had an important impact on the functioning of labour institutions, particularly as a result of inconsistencies between constitutional rights and legal provisions (Ermida 2007; Toyama 2008).

<sup>13</sup> For example, in El Salvador and the Dominican Republic tripartite pacts were negotiated (Vega Ruiz 2005, p. 21). Other countries as well undertook exercises at social dialogue, of varying thematic coverage and final scope.

- The productive structure has been reorganized, increasing the weight of SMEs and making union organization more difficult (particularly in many tertiary fields), as well as reinforcing the role of occupations that do not fit the traditional pattern of union affiliation (professionals, technicians, administrative and other careers).
- Technological change has reduced the tendency of large groups of workers to gravitate towards homogeneous occupations.
- The union movement has faced repression, especially under military dictatorships and during the economic crisis of the 1980s.
- Legislative changes have restricted the scope of union action.
- Some unions have lost their legitimacy because of their close ties to political parties, or because of non-transparent practices.
- The tendency of unions to look to the State to address their demands, and not to employers, is out of touch with the new development modality.
- Employment has declined in the public sector, where unionization rates were frequently high.

As noted above, some countries have taken steps since the 1990s to strengthen collective bargaining, but their intent was not necessarily to negotiate flexibility as a strategic component of institutional reform.

In conclusion, labour regulation has undergone various changes in recent decades. First, during the 1980s and part of the 1990s, the employment structure became more informal and the coverage of formal labour institutions narrowed. This reflected not only the growth of the informal sector (comprising primarily micro-enterprises and unskilled own-account workers) but also “moonlighting”, and a growing tendency to “delaborization”, i.e. concealing the relationship of dependency between worker and employer by giving it the gloss of a business relationship (Morgado 1999; Goldin 2008).

Second, during the 1990s, and even earlier in some cases, labour reforms were clearly (but not exclusively) aimed at achieving greater flexibility. While deep reforms were implemented in some countries (Argentina, Peru and Chile in the late 1970s and throughout the 1980s), in other countries the changes were much more gradual and lacked a clear strategic direction.

Third, during the present decade, efforts to make labour relations more flexible have been more modest in scope, and in some countries the main thrust has been to provide greater protection for workers in both

their individual and their collective labour relations.<sup>14</sup> Countries that had introduced greater flexibility, such as Argentina, Chile and Peru, often within an “exceptional” institutional context, have recently amended those reforms and have refocused attention on certain aspects of protection.<sup>15</sup>

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<sup>14</sup> This coincided with the international debate from which there emerged a greater degree of caution with respect to radical deregulation measures (Freeman 2005b).

<sup>15</sup> Chile began this gradual process in the 1990s.

# 5

## Unemployment protection

The traditional approach to worker protection starts from the assumption that workers' incomes, and the welfare of their families, depend on their job. On this basis, the principal risk to workers' well-being is the loss of employment, not only because unemployment means no income, but also because any subsequent job they find is likely to be of lower quality (Herrera and Hidalgo 2003).

The traditional instrument for reducing the risk of unemployment has been to make employers pay compensation to workers dismissed "without just cause", and this discourages firings and layoffs.<sup>16</sup> Because the amount of this severance payment rises with the length of time on the job, this protection is greater for older workers, although there are generally ceilings on the amount a worker can receive.

There are important inter-country differences in the amount of compensation and its ceiling, in the definition of "unjust" dismissal, and in the prospect that a worker will find another job. While there is general agreement that a worker's bad behaviour, such as absenteeism, justifies dismissal without compensation, there is less consensus when he is laid off because of the firm's needs. While some countries tolerate this rationale

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<sup>16</sup> The employer is usually required as well to give advance notice of layoff, or to pay the corresponding wages.

for dismissal (with appropriate compensation), in Peru it is valid only for mass layoffs, and in some countries it is not accepted at all.<sup>17</sup>

The severance payment tool has been criticized for discouraging labour mobility and hindering productivity growth by preventing workers from moving out of low-into high-productivity activities. It is also seen as a stabilizing employment for older workers and impeding job access for excluded groups, particularly youth and women.

Beyond severance payments as a mechanism for protecting workers from unfair dismissal, some countries have introduced other instruments (generally as a supplement to layoff compensation) to provide income support for the unemployed while they are looking for a new job. One approach is to have employers make regular deposits, defined by law, into individual worker accounts.<sup>18</sup> If he is laid off, or (sometimes) if he quits his job, the worker will have built up an amount of capital plus interest. In terms of compensation, these accounts have the advantage of offering greater security, since the deposits are made regularly and payout in case of unemployment does not depend on the employer's financial situation. In some cases, this instrument can lift the restriction on voluntary mobility by giving the worker access to savings regardless of the reason for ending the contractual relationship. A certain portion of these funds has been used on occasion for purposes other than protecting the unemployed worker, and this undermines their original function.

Some countries have unemployment insurance systems funded by contributions from employers and (in most cases) from workers.<sup>19</sup> In some cases the State may also contribute. Insurance of this kind provides a subsidy to the laid-off worker, for a specified period of time (and sometimes after a waiting period), the amount of which will depend on the contributions made. Generally, for a worker to be eligible for insurance benefits, he must have made a certain minimum amount of contributions, and he must be available to accept a new job.

In a few countries, for example Brazil and Ecuador, unemployment insurance coexists with individual accounts. Chile's unemployment

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<sup>17</sup> There are other provisions that make layoffs difficult, such as the so-called Bustos law in Chile, which bans dismissals until social security contributions are paid (Velasquez 2008).

<sup>18</sup> For example, in Brazil, Colombia, Ecuador, Panama, Peru and Venezuela (Velásquez 2005).

<sup>19</sup> For example, Argentina, Brazil, Chile, Ecuador, Venezuela and Uruguay (Velásquez 2005).

insurance represents the most recent experiment: it combines individual accounts (funded by employer and worker contributions and accessible if the worker is laid off or quits) with an unemployment fund (*fondo solidario*) to which firms and the State contribute. The fund guarantees payment of a minimum amount to laid-off workers who have exhausted all the money available in their individual accounts before the end of the statutory period (up to five months, depending on time in the job). If a worker is laid off, the severance payment will be reduced by the amount of previous employer contributions to his individual account. It should be noted that some aspects of this insurance are being reviewed, as the conditions for accessing the funds have been found too restrictive.

Certain aspects of the Latin America and the Caribbean social security systems have traditionally been tightly linked to holding a formal job. Few countries have specific provisions for the unemployed, and the benefits are very limited:

- In Argentina, an unemployed worker is covered by health insurance for as long as he receives unemployment insurance benefits or, in the case of a laid-off worker who has no unemployment insurance, for up to three months, through the contributory social welfare system.
- In Chile, unemployment insurance beneficiaries receive health insurance cover.
- In Peru, voluntary insurance is being introduced to ensure continuity in contributions to the national pension system during periods of unemployment.

Generally speaking, the unemployed have access to the universal health system or, depending on the features of a country's system, to its non-contributory component. This coverage is usually of lower quality, and not everyone outside the contributory health system is protected by it.<sup>20</sup>

The various instruments of unemployment protection have some shortcomings in common, and others that are specific. The main problem is that their coverage is restricted because they are tightly linked to formal employment systems. In fact, some instruments are valid only for private wage earners with formal, indefinite-term contracts. Unemployment insurance coverage tends to be low in countries where the informal economy is large

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<sup>20</sup> See Mesa-Lego (2005) for an analysis of health systems in Latin America and the Caribbean, recent reforms, and their impact.

and the turnover rate is high, with a growing proportion of fixed-term contracts.<sup>21</sup> Under these circumstances, only a small proportion of workers laid off “without just cause” will receive severance payments, even though they are entitled to it.

Given the low average level of wages, the different models have two alternatives: to try to provide the unemployed with income levels not too far below their previous wage, which would pose serious financing problems, or to try to contain the cost of the system by limiting benefits to amounts that fall short of family subsistence needs. It is quite possible that the severance payment system is attractive to workers because, depending on their seniority, they could receive a lot of money if they are laid-off, even if it is only a one-time payment. This could hinder voluntary mobility for formal workers.

Given the shortcomings of the instruments reviewed above, Latin America and the Caribbean countries have frequently resorted to substitute mechanisms, especially at times of economic crisis, such as emergency job creation programs in the public sector, as described in the following section.

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<sup>21</sup> In Chile, all workers with fixed-term contracts are in principle covered by unemployment insurance but, in this case, high turnover means that only a limited proportion of unemployed persons enrolled in the insurance system actually benefit from it, especially in the case of the *Fondo Solidario*. In Argentina, there is also a special regime for seasonal workers.

# 6

## Active labour-market policies

Active labour-market policies refer to interventions in the labour market designed to combat unemployment and raise workers' incomes. The main instruments are programs for direct or indirect job creation, occupational training, employment services (mainly intermediation), and encouragement of self-employment and micro-enterprises. Beginning in the 1990s, these policies underwent significant changes in reaction to the critical labour situation in many countries. They tend to be less controversial than labour reforms, as they do not affect the interests of the main participants in the labour market and can have a positive effect on the functioning of the labour market, for example through encouraging productivity and reducing transaction costs. Another factor that must be borne in mind is that these policies, the efficiency of which is disputed by a number of evaluations (Weller 2004), must be financed from general government revenues. Following is a brief analysis of the most significant changes to these policies in the region in recent times (Samaniego, 2004; Velásquez, 2005; Chahad, 2008; Goldín, 2008; Ruiz-Durán, 2008; Toyama, 2008 and Velásquez, 2008).

### **a) Direct and indirect generation of wage employment**

Direct job creation programs are normally launched in response to an emergency situation when there are no broadly available unemployment

protection systems. This generally occurs at times of sharp contraction in labour demand, sparked by an economic crisis, natural disaster, or seasonal factors. These programs offer temporary jobs at a rate of pay close to the minimum wage, where low pay serves as a self-selection mechanism and where the stress is on generating employment so that members of poor families can earn incomes, a possibility often confined to the head of the household. While the design and implementation of such programs have traditionally been in the hands of government agencies, non-governmental institutions may also offer and execute such projects in some countries since the 1990s. The activities involved are generally labour-intensive, such as cleaning, construction and maintenance of physical infrastructure. A frequent secondary objective of these programs is to improve living conditions in areas with high poverty indices.

One of the weaknesses of these programs is that they do little to help workers rejoin the labour market, because they do not generate skills or know-how recognized by the market. Moreover—and this relates to the previous point—even when the emergency is over, it is often difficult to cancel programs of this kind because many of the beneficiaries will have few alternatives for employment. This generates political pressure to maintain the program. Another frequent criticism points to the unequal distribution of funding because of political factors or because of differing management capacities among participating institutions. To deal with all these issues Argentina, for example, has introduced measures such as economic incentives for people to seek work and enrol in training programs.

Another alternative is indirect job creation through incentives for private businesses to hire workers. The incentive is typically a subsidy to reduce non-wage labour costs or to cover a portion of worker pay, always for a limited period of time and with the expectation that the contractual relationship will survive after the subsidy ends. To improve the chances of such survival and of future job opportunities, Chile has added a training grant. In some cases, the subsidies vary according to the size of the firm.

Yet there are doubts about the efficiency of these instruments, relating for example to possible “dead weight” effects (hiring people who would have been hired anyway) and the displacement existing workers by persons under subsidized contact. One important element here is the close linkage between the program and the economic cycle: at the peak of the cycle the “dead weight” effect could prevail, while in the trough the program

could lose its efficiency through the substitution effect, or simply become ineffectual because firms, seeing no need for further hiring with its attendant costs, will not take up the incentives.

While this instrument has been little used in the region, countries including Argentina, Brazil, Mexico and Panama have recently applied it in the context of “first job” programs, where it serves not so much to facilitate employment during an economic downturn as to overcome the structural barriers facing young labour-market entrants.

## **b) Training**

Among the labour-market policies that have seen the biggest changes in recent years is the policy with respect to training. One of the reasons for attempting to improve the effectiveness, efficiency and fairness of training systems is the recognition that a qualified workforce is needed to enhance the systemic competitiveness of Latin America and the Caribbean countries. At the same time, the acquisition of useful knowledge and skills is recognized as a key component of employability, especially for people with little schooling. Training is a factor of equal interest to all parties, for its positive impact can be seen both in productivity and in labour stability, as it enables workers to climb the occupational ladder and to earn higher wages.

During the 1950s and 1960s, Latin America and the Caribbean countries set up vocational training systems to promote industrialization and the expansion of formal commerce and services. Despite some subsequent amendments, concerns over their functioning began to emerge in the 1980s. The high costs of those systems, the rigidity in the training offered, and the limits on beneficiary groups gave rise to new approaches to training. The main changes introduced to address these problems were the following:

- Diversification of training providers, with greater reliance on private institutions. In the public sector, the functions of delivery and regulation were institutionally separated and programs were decentralized, leading to greater participation by local entities (provinces and municipalities).
- Interest in the certification of skills, sparked by a greater variety in the offer of training and the recognition of informal learning (Schkolnik, Araos and Machado, 2005).

- Attempts to make training more demand-oriented through greater involvement of private enterprise, and in some cases, the unions, in identifying unmet needs.
- Diversification of target groups. On one hand there was a move from one-time training to continuous training for personnel who were of strategic importance for the firm's competitiveness. On the other hand, training programs were developed to encourage reintegration of the unemployed. In this context, special programs were designed for groups with specific employability problems (youth and women with low education levels) or working in low-productivity, low-income activities (specific occupations, own-account workers, micro-entrepreneurs).
- New instruments for the public funding of training, in particular tax incentives.

Despite these recent changes, training systems still fall short of the required effectiveness, efficiency and fairness. Following are some of the indicators that back up this assertion:

- Training systems are not conceived as part of a long-term development strategy focused on continuous improvements in systemic competitiveness. If they were, they would serve a key function in raising labour productivity.
- The coverage of training systems is generally limited, both in terms of training for first-time jobseekers and in terms of ongoing training or retraining for persons already employed or workers who have lost their job.
- Evaluations of the employability impact of training have produced mixed results.
- Many firms face problems in finding suitable personnel, particularly persons with higher qualifications.
- It is common to see persons who are underemployed in terms of their education and skills. This exerts downward pressure on the labour supply.
- In several countries, training expenditure has declined or program coverage has retreated, reflecting management difficulties and problems in matching supply and demand.<sup>22</sup>

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<sup>22</sup> See for example Chahad (2008), Toyama (2008) and Velásquez (2008).

- A contributing factor here may be that, while the importance of demand-driven training is recognized, it is not always easy to determine the exact nature of future demand and to adjust training curricula accordingly. There is seldom any capacity for forward-looking analysis in this respect.
- The take-up of incentives is often unequal: they tend to be used more by large firms than by small ones, and their benefits flow to higher-ranking or administrative personnel rather than to production workers.

### **c) Employment services**

The main purposes of employment services are: to provide general information on the labour market, to intermediate by publicizing information on vacancies and jobseekers, and to help prepare labour-market entry strategies. These employment services do not in themselves create work, but rather facilitate entry into the labour market, thereby helping to reduce unemployment and enhance productivity.

Latin America and the Caribbean countries have made significant efforts to decentralize the delivery of employment services and to expand their coverage by incorporating new technologies, in an attempt to make these services more effective and reduce their cost (Mazza 2003). Various forms of public-private partnership have also been established (sometimes involving NGOs and labour unions) to replace the former, exclusively public structure, and by offering services to portions of the informal sector (micro-enterprises), intermediation is no longer confined exclusively to the formal sector. To take full advantage of their potential, intermediation services are now being integrated with active and, where they exist, passive labour-market policies. In some countries, employment services are also used to deal with international migration.

Employment services are but one of many instruments available for matching labour supply and demand. Another instrument is the individual job search through direct inquiries, newspaper advertisements and, increasingly, the Internet. Despite the progress described, which has certainly made employment services more efficient, a great proportion of job placements are still arranged through personal contact and recommendations, and this tends to undermine the efficiency of matching and to reinforce

segmentation in the labour market. This is because workers with more highly developed networks of contacts (social capital) have an advantage, implying a bias in favour of persons from middle- and upper-income households. Consequently, those most likely to turn to employment services are people with special employability problems, whether because of their low qualification levels, their inexperience, or their lack of social capital: this poses a special challenge to the services and makes it more difficult to measure and evaluate results.

#### **d) Support for self-employment and micro-enterprise**

Given the shortage of demand for labour and the consequent scarcity of wage employment, many countries have taken steps to encourage people to work independently, either as own-account workers or as micro-entrepreneurs. Those measures are designed to help create new businesses, but they also support existing ones, with a view to enhancing their productivity and output by increasing wages and generating new positions.

To this end, programs have been established with training and financing as their chief components, along with technical assistance and networking help. Another policy is to facilitate or reduce the cost of registering micro-enterprises, to encourage them to formalize their status.

As with training, there are two different but complementary approaches here. From the enterprise development perspective, small-scale businesses are seen as needing special support to integrate them more effectively into the productive structure. From the social development perspective, the emphasis is on analyzing the employment problems facing broad sectors of the population in need of alternative income sources. On the basis of these contrasting perspectives, there are great differences between the programs' target groups, their methods and their instruments.

In every part of the world it is common for micro-enterprise start-ups to fail, and this poses a special problem for programs designed to encourage such initiatives. When it comes to nurturing existing small businesses and micro-enterprises, programs have more information available for assessing their viability and their new plans. In the case of new initiatives for independent work, these are unlikely to offer productive alternatives on a large scale at times when few wage jobs are being created, for an

adverse economic setting not only affects labour demand as a whole but also diminishes business opportunities for new initiatives, because of low aggregate demand. Independent employment opportunities that emerge in times of low economic growth must be considered, above all, as survival jobs.



# 7

## Flexicurity and lifelong learning

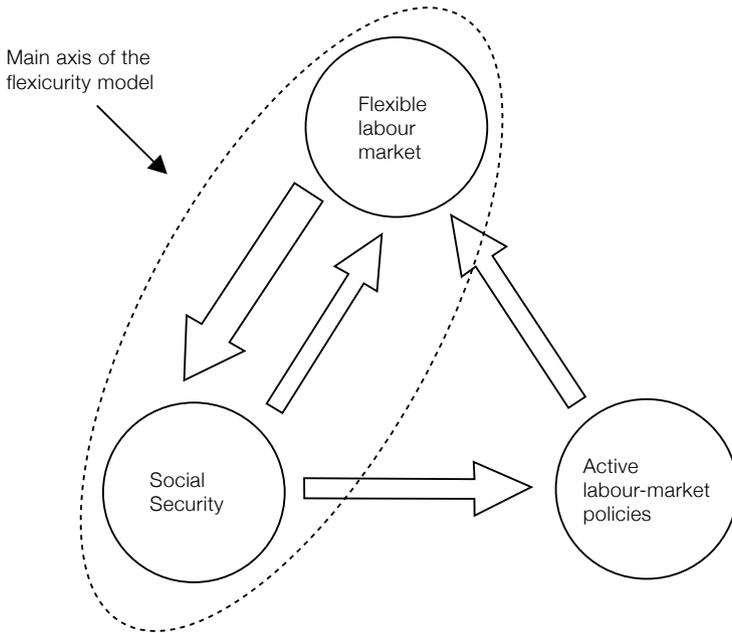
The three elements discussed in the previous sections —labour-market regulation, protection for the unemployed, and active labour-market policies— also enter into the debate on reforming labour-market institutions in the European Union. Facing relatively high unemployment levels and other labour problems, the EU has designed a strategy to improve labour performance, and the European Commission has recommended that member countries put special emphasis on combining flexible labour markets with high levels of social security for the unemployed (European Commission 2007).

Denmark's experience constitutes a significant point of reference for the European debate. After a lengthy historical process, the 1990s saw establishment of a combination of policies that has been described as the “flexicurity” model. This model is characterized by a “golden triangle” (Madsen 2006; Jørgensen 2008) that consists of regulations for a flexible labour market, an unemployment protection system with generous benefits, and active labour-market policies to facilitate prompt and productive reemployment of those who lose their jobs (see figure 3).<sup>23</sup>

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<sup>23</sup> While these three components already existed, they underwent major reforms in the 1990s. The model has been further adjusted during the present decade, and there is debate today as to how far the most recent changes might affect the key elements of the model (Jørgensen 2008).

Figure 3  
THE "GOLDEN TRIANGLE" OF THE FLEXICURITY MODEL



**Source:** Per Kongshøj Madsen, "Flexicurity – a new perspective on labour markets and welfare states in Europe", document presented at the Directorate-General for Employment seminar on flexicurity, Brussels, 18 May 2006.

### a) A flexible labour market

Flexibility in the labour market refers to the high mobility of workers, fostered by the ease with which firms can hire and fire staff, and also to the options available to these workers in a dynamic labour market. The legislation offers ample room for collective bargaining, which is regarded as an efficient and flexible instrument of labour regulation (Trade Unions Confederation/Employers' Confederation/Ministry of Employment, Denmark 2007).

Another important aspect of flexibility is the existence of a broad network of public institutions that provide care for children, seniors and the sick, and in this way make it easier for women to enter the labour market. While in many societies the gender division of labour assigns women the responsibility for these tasks, in this scheme that responsibility falls to society as a whole, and women who want to join the labour market face fewer obstacles in doing so. Consequently, the female participation rate in Denmark is one of the highest in the world.

## **b) Social security**

The social security system provides a high level of income protection for the unemployed. Financed primarily from taxes, it encourages high turnover rates, especially among low-income groups. While the entitlement period for benefits has been shortened in recent years, it remains fairly long, at four years.

The unemployment protection system predates the introduction of flexicurity, and embraces the traditional model of the welfare state that prevailed throughout the 20th century. In that historic tradition, it is regarded not only as a component of the “golden triangle” of flexicurity, but also as a key mechanism for achieving the welfare and fairness goals set by Danish society. All of this presupposes that society is prepared to assume the economic costs implied. This basis of protection, and Danish society’s steadfast commitment to it despite the change of context, may be regarded as key elements for the social viability of flexicurity.

The system for protecting the incomes of unemployed persons can be said to improve the functioning of the labour market, for it gives the unemployed the opportunity to seek a new job free of short-term pressures, and it tends to improve the matching of supply and demand (Acemoglu and Shimer 1999). It may be that, as a result, income losses are lower than they would generally be when a change of employment is caused by a layoff.

## **c) Active labour-market policies**

Passive labour-market policies, and in particular unemployment insurance, are closely linked to active policies that offer various instruments of support to people unable to find a new job immediately. Among these are the

intermediation system and, above all, the retraining system for workers who have few prospects of returning to their former occupation or who lack the know-how and skills to find long-term productive employment.

Active labour-market policies begin from the premise that opportunities and obligations go hand in hand. It will be recalled that the training activities identified for an unemployed person are not merely an option: under certain circumstances, the person is obliged to take training in order to remain eligible for benefits. To some extent, the same is true with intermediation, for there is an obligation to accept the vacancies identified by the placement service.

The close connection between passive policies and active policies makes the above-mentioned matching even more efficient. The main factor behind the lower labour incomes that are usually received in a new job following a layoff may be that a portion of the person's human capital is no longer useful because it was relevant specifically to the firm for which he previously worked. Retraining can counter this effect, if only partially, by enabling the accumulation of human capital, whether general or case-specific. This not only mitigates the income loss of the person affected, but also helps to enhance the productivity of the firm hiring that person and, consequently, that of the economy as a whole.

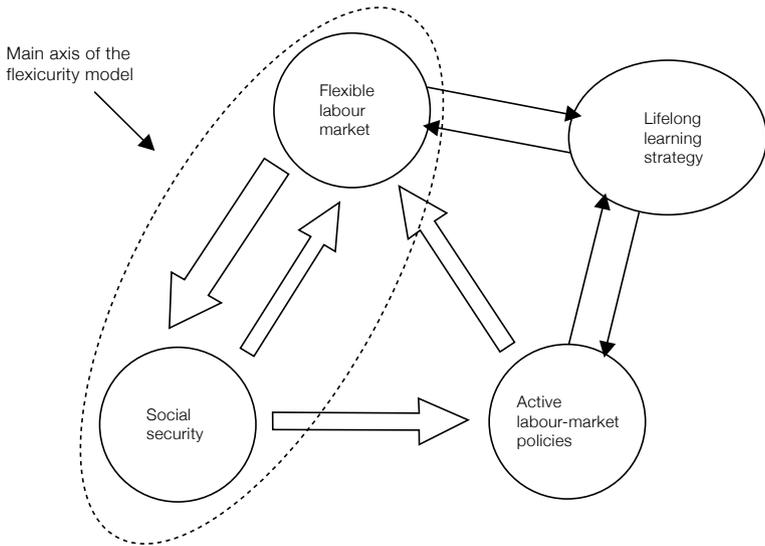
There are two essential elements in the functioning of the institutions described as the "golden triangle":

- i) They are closely linked to a long-term competitiveness strategy with innovation and human capital accumulation as its main pillars

Danish society recognizes that, in the current context of globalization and market integration, the country's competitiveness, economic growth and social welfare will depend on the development and production of knowledge-intensive goods and services. In this context, education and training play a key role, for continuous innovation in processes and products requires highly skilled people, and high-quality production is based on high levels of education and training in all areas of the productive process. This poses a great challenge to all stakeholders, and especially to people with little schooling, who could find themselves excluded if they do not upgrade their skills to current requirements.

In this context, the lifelong learning system constitutes a key component, beyond the education system itself and the training of children and youth (from preschool through to universities that are globally competitive).

Figure 4:  
**THE EXPANDED GOLDEN TRIANGLE**



**Source:** Authors' conception, based on Per Kongshøj Madsen, "Flexicurity – a new perspective on labour markets and welfare states in Europe", document presented at the Directorate-General for Employment seminar on flexicurity, Brussels, 18 May 2006, and Henning Jørgensen, "Flexible labour markets, workers' protection and 'the security of the wings': A Danish "flexicurity" solution to the unemployment and social problems in globalized economies?", unpublished, 2008.

At a time when markets are undergoing continuous adjustment, it is not enough to acquire knowledge and skills that are useful only once, at the beginning of one's working career. In order to achieve continuous productive integration, that knowledge and those skills must be frequently upgraded and expanded. With this in mind, Denmark has opted to improve the recognition of skills acquired outside the formal education and training system, to encourage the demand for training by helping to define the skills required, above all in small and medium-sized enterprises where a mix of training in basic and specific skills is needed, to design short courses at new levels, for example at the university level, and to diversify the offer of training through a more highly differentiated system of fees (Government

of Denmark 2006). In this respect, the “golden triangle” is being expanded with an additional component, which is continuous upgrading of the labour force. This requires a broader vision of the training system than merely helping the unemployed to find new jobs, and makes it part of a long-term competitiveness strategy.

The intent is, first, to foster productivity by having a labour force that can adapt readily enough to the new demands of the labour market; second, to facilitate the functional labour flexibility that firms operating in an open economy must have so that they can devote their workers to various tasks as the productive process demands; third, to raise working incomes, which would benefit from this higher productivity; and fourth, to facilitate productive employment for persons with relatively low education levels.

ii) Social dialogue as a mechanism not only for the design and application of institutionalized flexicurity but also as an instrument for continuous adaptation and progress

The Danish flexicurity model has its origins in a long history of social dialogue based on the recognition of differing but legitimate interests and on negotiation as the principal instrument for achieving sustainable results over the long term. Consequently, legal regulation is relatively limited and leaves considerable room for employer and union representatives to negotiate major aspects of how the labour market functions. This negotiation takes place at both the centralized and decentralized levels (Jørgensen, 2008).

It is clear that the functioning of the system, which confers considerable decision-making powers to these organized social partners, depends on a high degree of organization and representation. Only in this way will the negotiated outcomes win wide acceptance and general legitimacy, and only in this way can the exclusion of broad sectors of the unorganized population be avoided.

The empirical results show that the Danish model has a positive impact on various labour-market variables such as participation rates and unemployment. These results are clearly better than for the average of OECD countries (Jørgensen, 2008). Beyond this “objective” performance, it has been noted that the Danes —like other societies with a similar institutional structure— enjoy greater employment security than exists in countries with similar protection systems but with more rigid labour regulations; or in those that have rigid labour regulations and weak protection systems; or in those that have flexible labour regulations but weak protection systems

(ILO 2004b). This is due to the combination of high benefits during periods of unemployment and a rapid return to the labour force.

Yet any model can be improved, and mechanisms for analysis and constant adjustment are needed to make the available instruments work better. In this respect, the debate over the Danish model has identified the following challenges:

- The model implies heavy fiscal outlays that contribute to the high tax burden. Is it feasible to reduce that burden without upsetting the system's functioning?
- Generous unemployment security provisions usually pose the issue of moral hazard (disincentives to work, abuse of the protection system). How can that hazard be controlled?
- As in other economies, some specific groups such as the unskilled, young people who have not completed their studies, older people and immigrants, face greater problems in finding productive employment in the labour market. How can the system be tweaked to give these groups additional support and incentives that will enhance their employment possibilities?
- How would the model function if unionization rates declined?

As noted above, the features of the Danish model depend a great deal on the fact that it is rooted in the country's history. This means that it cannot readily be transferred with all its features to other countries. The European Commission has concluded that, while the national strategies of member countries must consider the components of flexicurity, the political strategy for moving in that direction, as well as the final design, would have to be adapted to the specific circumstances of each country. Depending on those circumstances, a given country would have to opt for specific pathways in preparing its own model of flexicurity, and they would have to be designed with due regard to the major bottlenecks identified in that country.



# 8

## **Flexicurity and the challenges facing the Latin America and the Caribbean region**

The transformations in economies and labour markets, the need to protect workers, and the need to foster productivity, systemic competitiveness and social integration for workers, all underscore the importance of analyzing, improving and integrating the workings of the three labour-market institutions reviewed above: labour-market regulation, unemployment security systems, and active labour-market policies.

The Danish model of flexicurity is an interesting approach to integrating these components, especially because of the process by which it was created, rooted in socioeconomic and political elements that are peculiar to Danish society and that are adapted to the current context. It thus appears sustainable over time, with an adaptation capacity generated by broad social consensus on the basic features of the model.

Yet some characteristics of Latin America and the Caribbean societies and economies are likely to frustrate any attempt to copy this model:

- Latin America and the Caribbean countries have an informal sector, varying in scope from one society to another, that accounts for a significant proportion of the labour market. Despite measures taken in recent years, formal labour-market regulation is of very limited relevance for workers in the informal sector, as protection systems do not cover them, and active labour-market policies do not reach them. For these workers, the labour market is very flexible indeed, and as they have no tools to protect themselves from the

harmful consequences of that flexibility, they tend not to remain unemployed for very long when they lose their job or source of income. Consequently, in this case the indicators of labour-market entry problems are underemployment, stagnating productivity, and the lack of social and labour protection, rather than unemployment. The instruments of the flexicurity model do not fit with this reality. Yet informality is a heterogeneous and dynamic phenomenon, and there are options for formalization in each of the three components of labour institutions.

- The flexicurity model is costly in terms of public expenditure, both because of the protection component and because of labour-market policies. While the situation varies greatly, Latin America and the Caribbean countries generally lack the resources to prepare similar programs and policies in terms of coverage and per capita outlays.<sup>24</sup>
- For the design and continuous adjustment of the flexicurity model there must be ongoing social dialogue among the main stakeholders, who must recognize each other as legitimate interlocutors. The history of many Latin America and the Caribbean countries is not only marked by conflict but in many cases the opposing parties have viewed this conflict as not amenable to negotiated solution, with the result that the search for solutions frequently turned violent. Moreover, governments have not always accepted or encouraged the various stakeholders to organize themselves and adopt independent positions. This remains true today, and it impedes the search for negotiated solutions, despite the widespread prevalence of democratic political systems.
- Models that offer a high degree of income protection and significant subsidies for reemployment often pose a moral hazard that results in the abuse of these facilities. While a proper combination of incentives, disincentives and control mechanisms can help to limit such abuse, the results will vary depending on the attitudes and values prevailing in specific societies.<sup>25</sup>

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<sup>24</sup> The average level of tax pressure in Latin America is 18% of GDP, while in the European Union (15 countries) it is 40%.

<sup>25</sup> Indeed, it has been argued that for a flexicurity system to work there must be a high degree of "public-spiritedness" (Algan and Cahuc, 2006).

- In Latin America and the Caribbean, the short-term view tends to predominate, because the debate over reforming labour-market institutions is not part of a broader debate about long-term growth and development strategy.
- Given the heterogeneity among countries of the region, it is not surprising that the conditions favourable to labour-market institutions of this kind are present to varying degrees. Factors such as a low rate of urbanization, a low percentage of wage workers, and a low degree of formalization represent structural constraints in achieving such institutions (Tokman 2007b).

As the European Commission itself has recognized, there is no one model of flexicurity nor any one road for achieving it. The countries of Latin America and the Caribbean need to find their own path to the efficient and equitable integration of the three labour institution components, adapted to their social, economic, political and cultural reality. Those components must be regarded as mutually complementary and they must be related to non-labour policy instruments for promoting systemic competitiveness and for integrating that portion of the population not covered by social and labour institutions.

### **i) Active labour-market policies**

As noted in section 6, recent years have seen some promising advances in improving the effectiveness, efficiency and fairness of active labour-market policies. Yet shortcomings against these three criteria still persist, especially when it comes to training, which is a key component both for achieving systemic competitiveness in open markets and for giving workers opportunities for productive and stable employment and advancement.

The strategic advantage of labour-market policies is that the coincidence of interests is greater in this area than in others. Firms and workers alike show great interest in training and in effective, efficient and fair employment services. Both parties are interested as well, although to a lesser degree, in employment creation programs and the encouragement of self-employment and micro-enterprises. This can lay the basis for striking bilateral alliances to promote these policies, especially in a context where most of the financing must come from government, which will be seeking a social return on the investment. The State, then, must foster debate on

the role of training as part of a strategy for growth and development based on continuous improvement of systemic competitiveness. Following are some specific points that must be taken into account:

- A training system will produce better results if the education system is successful in broadening people's general skills and knowledge. It is essential, then, to enhance the coverage and quality of education in Latin America and the Caribbean, on a more permanent and equitable basis.<sup>26</sup> Without these four elements, training systems are unlikely to do much to increase employment opportunities either in the short or the long term.
- Training systems need to be reviewed and adapted to the varying needs of the different segments of the productive economy and the different sectors of the labour force, i.e. new entrants to the labour market (young people in particular), the unemployed, and the different categories of people working.
- It would be useful to design systems of permanent ("lifelong") training to help workers adapt to new technologies, to increase their productivity, and to enhance their employment possibilities. This will need a major effort to produce a forward-looking analysis of demand, involving labour-market players and academics.
- Special attention must be paid to adapting training to the needs and prospects of disadvantaged groups (people with little schooling, in particular women, ethnic minorities and the disabled).
- Diversified institutional arrangements may be the answer for dealing with the great variety of demand for training and frequent changes in that demand. Yet if abuses are to be avoided, the offer of training must be transparent and its results must be controlled, for example through recognized systems for certifying skills and knowledge.
- Fostering small business and micro-enterprise remains a challenge that will require a combination of instruments to improve access to financing, technology, training and information as a means of simplifying the formalization process and reducing its costs. Given the limited size of the formal sector in many Latin America and the Caribbean countries, this is an important task for increasing access to the formal labour market.

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<sup>26</sup> See for example ECLAC/UNESCO (2004).

- Employment services must pursue policies such as decentralization, bringing the various players into the labour market, creating incentives to make intermediation more effective, technological and organizational modernization, personnel training, the integration of intermediation with the different programs of active and passive policies, and helping establish individual labour strategies.
- Direct job creation programs are an inadequate substitute for generating employment through the labour market, and they should be confined to special situations (economic crisis, low seasonal demand for labour, specific local problems). Direct employment programs and subsidies for creating new jobs must both include training components to enhance the employability of beneficiaries over the longer term.
- At a time when fiscal constraints make it difficult to expand and improve active labour-market policies, it is essential to improve the ways those programs are evaluated, so that policymakers can take informed decisions on priorities in this field.

## **ii) Protecting the unemployed**

Protection for the unemployed in Latin America and the Caribbean is the weakest component of the “golden triangle” of the flexicurity model. Few countries have protection systems that go beyond severance payments, and coverage and benefits are generally limited. Yet there is basic agreement on the need to improve protection for the unemployed, for social and economic reasons alike. The principal challenge is to design protection systems where:

- the focus is on income protection rather than job protection;
- they can be funded by workers and employers without raising non-wage labour costs;
- their coverage can be steadily increased;
- moral hazard is limited;
- they are related to active employment policies; and
- they include a follow-up mechanism with respect to social security coverage (particularly health and pensions).

An interesting proposal in this regard that was developed in Argentina (Goldin 2008) raises the possibility of transforming the severance payment mechanism by converting part of it into unemployment insurance, which would have greater coverage, would be more efficient, and would provide reasonable benefits. The portion of compensation that the firm would have to pay in case of a contractual rupture that is not attributable either to the employer or the worker is replaced by periodic contributions to an individual account. This increases flexibility in case of layoff (although the cost is greater in case of dismissal “without just cause”), without boosting labour costs significantly. In addition, thought could be given to a scheme with additional contributions from workers and the State, as with Chile’s unemployment insurance, which combines individual accounts with a contributory fund.

In some countries the portability of social security benefits is an important instrument for helping the labour market to work more effectively without diminishing protection for workers. Sometimes these benefits are linked to length of employment in a given firm, and this impedes voluntary mobility, because workers would lose their accumulated rights. Making benefits portable means that workers can take advantage of better opportunities without losing this component of their social protection. At a time of high intraregional migration, another important issue on which there has been some progress already is to make benefits internationally portable.

### **iii) Labour-market regulation**

The regulation of individual and collective labour relations is no doubt the most complex aspect of the debate over how to redesign labour-market institutions. Many measures are seen as creating one-sided benefits or risks, and it seems to be more difficult to find solutions that are favourable to all parties, as, for example, in active labour-market policies. This situation is expressed in a lack of consensus in many areas. There is even disagreement about the diagnosis itself: the actors on the labour market are unable to reach a common interpretation of the current situation, which must serve as the point of departure for the debate over pending reforms. Points at issue include the costs and benefits of integration into the global economy, and the characteristics of labour regulation and the functioning of the labour market. Labour flexibility is often confused with low labour costs,

or it is identified with only certain aspects (such as the ease of hiring and firing), but in addition to flexibility in labour costs and external numerical flexibility, internal numerical flexibility and functional flexibility must also be considered. From a broader perspective, this concept embraces not only flexibility in the labour market (flexibility of employment and wages) but also flexibility in the labour input (flexibility of human capital, mechanisms for promoting productivity) (Amadeo and Camargo 1993). This covers, specifically, the generation of opportunities for workers to advance along a career path. In short, it is a complicated matter to describe labour institutions as flexible or rigid, because there are so many variables involved,<sup>27</sup> and each side is likely to make selective use of research data, rendering dialogue difficult.

Moreover, the debate is generally conducted at different levels of abstraction, such as when an analysis of regulatory rules and their potential repercussions on the labour market is contrasted with another that stresses how those rules and that market really work, for example by comparing mechanisms to limit layoffs and high turnover. What happens, in effect, is that the debate takes place “in different markets”, and some studies refer to the workings of the formal labour market while others include the informal sector in the analysis. Consequently, while from one perspective labour institutions may be stagnating in the absence of reforms, from another perspective the labour market may be undergoing profound changes because of the shifting occupational structure, different uses of existing institutions, and *de facto* modifications at a “lower” level than labour legislation (Bensusán 2006).

Another point relating to the foregoing discussion is that the debate often lacks specificity, for example when the labour market is claimed to be rigid without specifying the origins of this lack of flexibility, or explaining which specific regulation is causing what damage (Weller 2007). Rigidity may be due not only to labour regulations but also to the functioning of other markets and to the behaviour of participants in the labour market who might, for example, prefer stable relations to high turnover.

This lack of consensus on the diagnosis makes it difficult to reach agreement on how to improve labour regulations. While these discrepancies

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<sup>27</sup> Consequently, a country's ranking in the classifications can change greatly, depending on the variables considered.

are not likely to be overcome in a short period of time, it would be well to clarify the terms of the debate in order to address the challenges in this area. Among those challenges (with significant differences from one country to another) are the following:

- Labour-market participants must recognize each other as legitimate stakeholders. Meeting this essential condition is complicated by the long history of conflict described above, which means that gradualist strategies are needed to build mutual trust. This process differs greatly among societies, because of the great variety of historic experience.
- In many cases, unions need to strengthen their standing as valid and effective interlocutors for representing workers. To do so, they will have to set aside corporatist practices, overcome their lack of internal autonomy and democracy, and enhance their negotiating capacity by upgrading their research and analysis capabilities.
- The legal apparatus is sometimes incoherent. For example, in some countries there are discrepancies between constitutional rights and labour legislation. This means that issues relating to the real functioning of labour institutions are removed from the political sphere, and also from collective bargaining, and are relegated to the courts, with sometimes unpredictable consequences.
- In many countries, enforcement of existing standards is low, and experience has shown that lower costs and greater flexibility are not sufficient to raise compliance levels. This can undermine the credibility of political decisions and encourage people to seek ways to evade the rules rather than make the effort to comply with them. On the other hand, it is essential that regulatory compliance be objectively feasible.
- In order to make labour institutions efficient and fair, the new economic context tends to demand greater room for collective bargaining as opposed to detailed legal regulation. It is important therefore to define the levels of bargaining and the issues to be bargained. Yet legal regulation will remain essential for setting the “floor”, given those broad segments that lack the degree of organization and the negotiating ability required.

While the design of labour institutions, as has been argued throughout this paper, can only be the result of processes specific to each country, we

offer below some suggestions for specific aspects, based on experience in the region:

- Experience within and beyond the region suggests that the introduction of “atypical” contracts has done nothing to create more jobs, but that it has fostered greater segmentation in the labour market. Reforms, then, might focus on “typical” contracts, making them more flexible and combining them with better protection mechanisms (Tokman 2007a). “Atypical” contracts should be reserved for special situations, such as seasonal or part-time work, and for specific tasks or training. Moreover, care must be taken to ensure that “atypical” contracts enshrine the same rights as “standard” contracts, in the corresponding proportion.
- Because the main argument against open-ended contracts is the rigidity produced by layoff compensation systems, thought should be given to transforming a portion of compensation outlays into periodic contributions to an unemployment insurance system based on individual accounts. This would not reduce financial protection against unemployment and, depending on the monthly contributions, the total non-wage labour cost might not decline, but the cost of laying off workers would drop. This raises two considerations: first, the conditions governing layoffs and dismissals must not be allowed to “petrify” existing labour relations, but neither should they encourage high turnover. The positive linkage between labour stability and human capital formation and higher productivity is a key factor.<sup>28</sup> Moreover, it is frequently the case that firms do not use all the legal instruments available to them for achieving greater flexibility in their personnel management. This suggests that, from the firm’s perspective, maximum flexibility is not necessarily the best option.<sup>29</sup> Rather, it would appear that in a scenario with great and frequent

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<sup>28</sup> Chacaltana and Garcia (2001) demonstrate this positive linkage in the case of Peru. Perry et al. (2006) highlight the negative impact of labour instability on human capital formation, while Auer, Berg and Coulibali (2005) emphasize that the relationship between labour stability and productivity is positive but not linear.

<sup>29</sup> In Colombia a discrepancy has been noted between certain economists, who favour flexible labour markets, and employers, who are more cautious about this (Universidad Externado de Colombia 2003). In Mexico there is a divergence between statements by business leadership and the behaviour of firms, which do not apply all the available instruments of flexibility (de la Garza and Bouzas 1998).

changes, the ideal solution for meeting both the immediate and long-term objectives is not obvious for many firms, which are always looking for workable solutions.<sup>30</sup> Second, there must be a clear distinction between labour costs and flexibility. If inflexibility caused by a specific regulation constitutes a bottleneck to the efficient working of the labour market, it should probably be amended, even if that implies greater costs. The situation would be different if the obstacle were related to the amount of labour costs.

- In many countries there is debate over labour institutions as they relate to micro-enterprises and small businesses. Experience has shown that in these cases cutting labour costs is not enough to foster wholesale formalization (Chacaltana 2007). However, because these costs tend to be too high for firms of this kind, a gradual formalization strategy that would improve labour conditions in this segment could include special provisions that would lower them temporarily.
- Encouraging internal flexibility, in terms of functions, wages and working hours, is an increasingly important issue that requires a common legal framework and intense collective bargaining. While this aspect of flexibility may yield immediate productivity and wage benefits, as employment stability does, it also brings with it undeniable risks and burdens, and ongoing dialogue is therefore needed to produce the necessary adjustments.
- On the supply side, the lack of flexibility may be an obstacle to labour-market entry, especially for women seeking opportunities to earn income for themselves and their family. This is not a minor issue, as having more family members employed is one of the main ways of lifting a household out of poverty. At that time when cultural attitudes to the division of labour that exclude broad segments of women from the labour market are weakening, some restrictions persist, especially for women with preschool and school-age children. For this reason, by opening the range of options for these women, policies whereby society assumes part of the responsibility for tasks

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<sup>30</sup> For example, in the first stages of the economic downturn that marked the beginning of this decade, many US firms showed greater caution with respect to layoffs, compared to the similar situation in 1990-91, recalling the trouble they had during the subsequent recovery in recruiting back the skilled workers they let go during the crisis (*The Economist*, 2001 p. 56).

related to reproduction can help to make the labour supply more flexible.

- Given the widespread flouting of many rules, workplace inspection will have to be stepped up. Inspection strategies should help firms to comply, rather than punish them for non-compliance, especially in the case of small and medium-sized enterprises (Schrank and Piore 2007). Other sound initiatives include government awards of “good employer” certification to firms that observe the rules, and voluntary adherence by firms in the name of social responsibility or global commitment.



# 9

## **Improving labour institutions: some strategic considerations**

There is broad consensus that, while Latin America and the Caribbean countries face similar challenges, their responses cannot be the same. The historic evolution of labour institutions to their current shape, resulting from socioeconomic and political processes specific to each country, and the nature of the relations between the main participants in the labour market, as well as the degree of labour-market development, all have a marked influence on the strategic options available for improving labour policies, unemployment protection policies, and active labour-market policies.

In this respect, each country has to find its own way of responding successfully to the challenges posed by the global economy, in order to offer the greatest possible welfare to its people. Labour institutions must make their contribution here: their ultimate purpose is to generate high-quality jobs by fostering labour markets that work efficiently and by protecting and supporting those who are disadvantaged by a market with structural inequalities among participants.

One important lesson from the flexicurity model is that the various components of labour institutions must be recognized as complementary and mutually reinforcing. Yet, because the issue is so politically sensitive in every country, it is unlikely that all these institutional arrangements can be reformed simultaneously. The key point, then, is to identify the main shortcomings in the current institutional structure.

The long history of labour conflict in many countries is a great obstacle to achieving sustainable agreements and reforms in this area, where so much mistrust has been generated among the parties. Following are some strategic elements for making progress on this issue:

- Social dialogue. When reforms are imposed by certain specific stakeholders who seize upon a favourable political juncture to advance their interests, they will lack legitimacy and will usually spark pressure for counter reforms once the political setting has shifted. This is why labour institutions in many Latin America and the Caribbean countries are in constant flux. By contrast, negotiated reforms have broader legitimacy and are likely to be more stable over time.
- The need to devote more resources to reorienting labour institutions. To avoid boosting labour costs, with potentially adverse fallout on labour demand, these resources will have to come from tax revenues. On various occasions<sup>31</sup> ECLAC has proposed a fiscal and social covenant that would set out consensus-based social objectives for the long term and would contribute to their financing and their macroeconomic sustainability through responsible fiscal management.
- Gradualism. While it may seem attractive to negotiate a comprehensive package of reforms covering all areas, such an approach is unfeasible in many countries because of the mistrust that prevails among the parties. Consequently, what is needed is a process of building confidence as the basis for gradual reforms that, if successful, could pave the way for new accords.
- Incorporating labour reforms into a long-term development strategy. Such a strategy, with its corresponding objectives, would define some of the requirements for sound labour institutions and would relate them to non-labour aspects (for example in education and technological innovation).

Voluntary commitments relating to certain issues are another mechanism for building confidence. Such commitments might be given concrete form through adherence to codes of conduct, or through greater consideration of labour aspects in policies for corporate social responsibility.

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<sup>31</sup> See for example ECLAC (2004b).

A significant transformation of labour institutions could spark concerns about workers' rights, especially if one component of that transformation were the elimination of regulations that are seen by workers as offering protection and by employers as causing rigidity. Merely promising that such a reform would yield benefits for workers by stimulating job creation will clearly not be enough to make such a reform feasible. It would seem essential, then, to give priority to designing or improving a system of unemployment protection. That system would focus not on preserving jobs but on protecting incomes. The features of the system would depend on the specific situation in each country and on its success in promoting a social covenant for reaching consensus on the complex variables of financing, coverage, rights, obligations and supplementary services, among others.

Active labour-market policies help to build confidence. While there will no doubt be disagreements, for example over the financing, management and control of programs, the fundamental interests of the main stakeholders are similar, and this should facilitate agreement on specific instruments. Given the great pending challenges, in the area of training for example, a broad dialogue on ways to improve active labour-market policies could be very helpful in opening room for debate in other areas,

Labour-market regulation is no doubt the most complex area, where specific interests clash most openly. It is important to remember that the ultimate purpose of regulation is to generate high-quality employment, and it must therefore fulfil the dual objective of fostering an efficiently functioning labour market and protecting the weakest participants in that market. In light of this dual objective, it is clear that it will not always be easy to find solutions where all players come out winners, even if there are some aspects of flexibility and stability ("rigidity") that suit both employers and workers. As noted earlier, arriving at a common diagnosis would seem to be an essential condition for reaching agreement on ways to improve labour institutions.

As was argued in section 3, there is no one recipe for this that is independent of space and time. What is needed is to analyze matters case-by-case and identify the obstacles that prevent labour institutions from meeting their goals in a specific situation. For that analysis we have adapted the proposal of Hausmann, Rodrik and Velasco (2005) for promoting economic growth, which consists essentially in identifying the bottlenecks in each country that constrain more dynamic growth. This strategy stands

in contrast to those that offer common recipes for all countries, and it takes account of the great diversity that exists among societies in the region, where there are different ways of combining employment protection with social protection (Tokman, 2007b, p. 51).

To identify the constraints on the generation of high quality jobs we may use the “inverted tree” shown in figure 5.<sup>32</sup> If there is a dearth of high-quality jobs—as there is in all Latin American and Caribbean countries if we consider unemployment rates, low incomes, scanty social security coverage and other factors—we should first examine whether formal job creation is low, or if it is significant but low-quality jobs prevail.<sup>33</sup>

If formal employment generation is low, the second step would be to discern whether the problems are due primarily to weak economic growth, or to the fact that growth does not have a sufficiently positive impact on the labour market, which could be the consequence of either the low output elasticity of formal employment or the limited size of the formal sector in the country’s economic structure. If low economic growth is identified as the principal reason for weak employment generation, causes related to the labour market must be differentiated from those not related to it. Among the former there are qualitative aspects that have to do with human capital accumulation, and aspects that impede greater labour-market participation, based on demographic or cultural factors, or on institutional factors that constrain labour supply and hiring.

If economic growth is reasonably high but formal employment generation remains low, it could be that certain macroeconomic prices, such as the exchange rate, are biasing investment against the hiring of employees, or that growth is led by sectors that make little use of labour. It may also be that institutional factors provoke rigidities or high labour costs to the detriment of formal employment. As well, there may be cases where the formal employment elasticity of economic growth is reasonably

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<sup>32</sup> Weller (2007, pp. 59-64) provides some examples for identifying bottlenecks and possible solutions.

<sup>33</sup> For the sake of simplicity, we assume that good-quality jobs are concentrated in the formal sector, and so the main intermediate objective is to generate formal employment. This is not to deny that there may be good-quality jobs in the informal sector, where improving labour conditions is an important challenge, or that there may be low-quality jobs in the formal sector. The concept of the informal economy, which is broader than the sectoral perspective, embraces these aspects in part (see Hussmanns 2004).



high, but the absolute number of new formal jobs created is low because of the small size of the sector.

Finally, even if formal employment generation is reasonable, there may be problems in generating high-quality jobs, as indicated by low and stagnant wages or problems with social protection. In these cases as well, the nature of the difficulties can be identified and specific solutions proposed.

The purpose of the “inverted tree” is not to identify a single key element for resolving labour problems. Besides indicating bottlenecks, it can help differentiate between priority and secondary aspects. The former represent a major constraint on quality employment generation, and eliminating them could have an important impact. Eliminating obstacles in the second category will have a lesser and sometimes doubtful impact, and will frequently carry high political costs in relation to the expected benefit. If politically feasible, reforming these secondary aspects could be part of a negotiated package, where the consensus would relate to the package as a whole and not to each of its individual components.

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