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CONTENTS

Health care markets: their morphology, behaviour and regulation	7
<i>Jorge Katz and Ernesto Miranda</i>	

Liberalization or financial development?	27
<i>Günther Held</i>	

Fiscal adjustment and social spending	47
<i>Rossella Cominetti</i>	

Women's formal education: achievements and obstacles	61
<i>Diane Alméras</i>	

Labour market flexibility: what does it really mean?	81
<i>Ricardo A. Lagos</i>	

The modernization of bank supervision	97
<i>Christian Larraín</i>	

Central American integration: its costs and benefits	111
<i>Luis Cáceres</i>	

Some lessons of the Argentine privatization process	129
<i>Daniel Azpiazu and Adolfo Vispo</i>	

Extraordinary comparative advantage and long-run growth: the case of Ecuador	149
<i>André A. Hofman and Rudolf Buitelaar</i>	

The cultural industry and new codes of modernity	167
<i>Martín Hopenhayn</i>	

Guidelines for contributors to <i>CEPAL Review</i>	181
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Recent ECLAC publications	183
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Labour market *flexibility:* what does it *really mean?*

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The 1980s witnessed the emergence of the concept "labour market flexibility" (LMF) in industrialized countries as well as in some developing countries. As a consequence of poor economic performance in the early 1980s, the view that the way in which labour markets operated constituted a significant obstacle to economic growth gained support at the level of policy makers, employers in general and, not least, in part of the academic establishment. The problems with the labour market were blamed on its "rigidity" in terms of the price of labour, conditions of employment and the quantity and quality of manpower, and this rigidity was blamed in turn on institutional constraints, social policies, legislation and collective agreements, centralized bargaining, trade union action and/or governmental guidelines. The focus, then, was on eliminating a variety of rules and regulations which were felt to make the labour market rigid and thus prevent it on the one hand from absorbing the labour supply, and on the other from adapting to the requirements imposed by technological change and external competition. This paper therefore reviews the meaning of the concept "labour market flexibility" and identifies the various forms which it may assume and their rationale, noting that labour markets in Latin America have undergone substantial flexibilization but there have not been any substantial changes on the institutional side.

I

Introduction

The 1980s witnessed the emergence of the concept "labour market flexibility" (LMF), in industrialized countries as well as in some developing countries, together with the accompanying debate. As a consequence of poor economic performance in the early 1980s –marked by stagnation of growth, rising levels of unemployment and inflation– the view that the way in which labour markets operated constituted a significant obstacle to economic growth gained support among policy makers, employers in general and, not least, part of the academic establishment. The perception that traditional means of controlling unemployment and resuming economic growth had failed (i.e., the breakdown of the Keynesian consensus), the contrast between the economic performance of the United States and Japan in terms of employment creation and the mediocre showing of Western Europe in that respect, and the pressure of external competition both from other developed countries and from the newly-industrialized Asian countries (NICs), led to the belief that the problems lay at least partly in the functioning of the labour market: specifically, in its "rigidity" in terms of the price of labour, conditions of employment and the quantity and quality of manpower.

This rigidity or lack of flexibility was seen as a consequence of institutional constraints, social policies, legislation and collective agreements, centralized bargaining, trade union action and/or governmental guidelines. The focus, then, was on eliminating a variety of rules and regulations which made the labour market rigid, on the grounds that

such rules prevented the labour market from, on the one hand, absorbing the labour supply, and, on the other, adapting to the requirements imposed by technological change and adjusting to external competition. From this viewpoint, labour markets not only became part of the diagnosis of the economic difficulties but also of the remedies for overcoming them.

Starting from this basic and simple diagnosis that there was a need for less rigid employment relations, the conceptualization of what is understood by LMF has led to various and more complex forms of flexibility –forms which reflect the different types of flexibility demanded or required in certain economies and the different approaches or views on flexibility itself.

The purpose of this paper, then, is to review the meaning of the concept "labour market flexibility" and to identify the various forms it can assume and their rationale. In order to do this, section II discusses the concept of flexibility. Section II goes on to analyse the different forms of LMF, while section IV deals with the issue of LMF in Latin America, noting that labour markets have undergone substantial flexibilization but there have not been any substantial changes on the institutional side. Finally, section V presents some concluding remarks. It must be pointed out that this article does not discuss whether (greater) flexibility is desirable or whether it is a welcome contribution to labour economics. Though the interest of these latter topics cannot be denied, the scope of this paper is much narrower (and, certainly, less exciting).

□ This study is based substantially on an earlier paper completed in March 1992 at the Faculty of Economics and Politics, University of Cambridge, United Kingdom. The author wishes to acknowledge the valuable comments made on an earlier draft by Dr. Gabriel Palma and Dr. Paul Ryan. The usual disclaimers apply.

II

The concept of flexibility

As often happens with widely and extensively used terms, LMF has proved to be difficult to define. Economists have traditionally applied the word flexibility to the "capacity of [nominal] wages to rise and fall with the state of the labour market" (Piore, 1986, p. 146). However, as the debate on LMF has progressed, the concept of flexibility has been extended to the point that nowadays it implies the idea of a capacity for adaptation.

In fact, nowadays it is this latter aspect which has become more relevant when referring to the issue of LMF. For example, according to the Organization for Economic Cooperation and Development (OECD), flexibility refers to "...the ability of individuals and institutions to abandon established ways and adapt to new circumstances..." (OECD, 1986a and 1986b, p. 7). For Michon, "flexibility becomes imperative in a context of rapid change: it signifies an aptitude for change" (Michon, 1987, p. 154). Atkinson maintains that flexibility alludes to "...changes to institutional, cultural and other social or economic regulations and practices which permanently increase the capacity to respond to change..." (Atkinson, 1987, p. 88). Standing argues that at an abstract level "flexibility... means responsiveness to pressure" and that "to be flexible is to be responsive to pressures and incentives and to be able to adapt to them" (Standing, 1986a, p. 6). For Boyer, flexibility refers to "the ability of a system or subsystem to react to various disturbances" (Boyer, 1987, p. 113).

The above definitions have the characteristic of being uncommitted with regard to the actual content of LMF, for they do not specify the means through which the adaptation to the new circumstances should be made –which is precisely *the* contested issue concerning LMF. Besides, this neutrality not only does not prejudice on the means but also leaves the door open to the possibility that "the same need to adapt may be satisfied by very different forms of flexibility" (Meulders and Wilkin, 1987, p. 5).

Nevertheless, the discussion on LMF rarely takes place on the basis of these general concepts. In more specific and narrow terms LMF expresses the notion that employment practices should be adaptable to

changes in the economic cycle and technological change. For instance, the International Labour Office (ILO) views LMF as "the capacity of the labour market to be adapted to economic, social and technological circumstances" (ILO, 1986a, pp. 4-7). The OECD understands LMF as an adjustment of all real costs of labour to variations in economic conditions (OECD, 1986a). For the International Organisation of Employers, LMF means the capacity to adapt relative labour costs between enterprises and occupations or adaptation of the costs of factors of production to market conditions (International Organisation of Employers, 1985). Lastly, for American businessmen flexibility is associated with "efforts to convert the traditional highly integrated, hierarchical corporate structure into a more supple organizational form capable of responding quickly to shifting market conditions and product demand" (Piore, 1986, p. 146).

It is at this more specific and narrow level that the concept of flexibility becomes both more diverse and more loaded, since the definitions tend to concentrate on the specific means for achieving the adaptability of employment practices to particular conditions.

The diversity is seen in different emphasis. For instance, despite the common emphasis in both the United States and Europe on seeking less rigid employment relations, the concept of LMF has progressively taken on different meanings as a consequence of the different systems of industrial relations prevailing in each country, and thus different employer's needs. Thus, in the United States the flexibility debate has been mainly related to the freedom to deploy labour within the enterprise, whereas in European countries the main concern in the first half of the 1980s was with the freedom of employers to lay off and discharge workers in response to economic conditions, while by the second half of the decade the debate also centered on making flexibility more compatible with employment security. Moreover, the flexibility issue has also been present in some developing countries, where emphasis has been on the reform of labour laws which affect job security and lower indirect labour costs (Tokman, 1989, p. 39).

Moreover, on looking more closely at the different views on LMF one notices that the concept has become loaded or biased in certain directions. One view maintains that flexibility is merely the rational response, at the labour market level, to changes in the economic environment. Flexibility, it is held, consists of adjustments of the labour force and hours of work and/or the wage structure to unstable and fluctuating economic conditions. It is argued that adjustment to changes is slow and insufficient due to institutional rigidities—a circumstance that calls for the introduction of more flexible employment relationships (OECD, 1986b).

Another view maintains that flexibility is a euphemism for changing power relationships in the production process and for growing labour insecurity: it is only a fashionable catchword disguising attempts to reverse the gains made by workers during the post-war years.¹ Flexibility conceals the employers' desire to become more competitive by making conditions of employment less secure rather than by introducing advanced technology or promoting a

better-trained workforce. It is argued that flexibility has the hidden purpose of depressing real wages, ending the protection of workers, and speeding up the pace of work (European Trade Union Institute, 1985).

Without entering into the above discussion, suffice it to say that both views stress meaningful aspects of the debate. On the one hand, the need to introduce changes in labour institutions does seem to be necessary as a consequence of changes in economic conditions, expressed in greater trade liberalization and the globalization of markets, technological change, changes in the organization of production, and new patterns of international labour flows. On the other hand, the introduction of greater flexibility has been associated with negative effects for workers: income inequality, loss of jobs, and the various ways in which workers' conditions became more precarious (Harrison and Bluestone, 1987; De Bandt, 1991). These two aspects require the construction of formal mechanisms (i.e., new regulations) which reduce the costs of flexibility and at the same time promote changes in labour institutions.

III

Different forms of labour market flexibility

As mentioned above, the conceptualization of LMF assumes different forms, depending on the particular aspects which are emphasized as ways of achieving greater degrees of flexibility. In the following pages, an attempt is made to identify these forms and explain their rationale. With this in mind, three different types of flexibility are reviewed: labour cost flexibility, numerical flexibility and functional flexibility.

1. Labour cost flexibility

Of the many forms of rigidities likely to impede the smooth working of labour markets, rigidity of labour costs is the most debated. "Labour cost flexibility" is understood to mean the degree of responsiveness of nominal wage and non-wage costs to changes in economic conditions in general (e.g., inflation, productivity, terms of trade, demand) and/or the performance of individual firms. Labour cost flexibility, therefore, involves two elements: wage and non-wage costs. The first refers to the gross remuneration paid to the wage earners. Non-wage or indirect costs refer to mandatory costs and charges paid by the employer (e.g., fringe benefits, payroll taxes, workers' compensation insurance, etc.).

The claim made by advocates of this form of flexibility is that an important element—though not the only one—behind high levels of unemployment is

¹ It is argued that the expression "labour flexibility" is in itself a loaded term. The term "flexibility" bears a positive connotation, the ability to adapt to circumstances, whereas its opposites "inflexibility" or "rigidity" have clear pejorative connotations. In this context, if labour or labour markets are becoming more flexible, then that must be socially and economically desirable (Standing, 1986a, p. 2).

the downward rigidity of wage costs.² In fact, a widely disseminated view argues that the absence of this type of flexibility explains to a large extent the different employment performance of the United States and Europe after the two oil shocks. It is argued that in many European countries, unlike the United States, real labour cost inertia caused the main adjustment to the oil shock and the productivity slowdown to take the form of quantity adjustments (i.e., declines in employment) rather than price adjustments (i.e., wage adjustments) (OECD, 1986b, pp. 9-10; Sachs, 1983).

Moreover, non-wage costs—which have increased faster than wages themselves—also bear some responsibility for the high levels of unemployment. Since their contribution to total labour costs is significant, they provide an incentive to replace labour by capital (Sarfati and Kobrin, 1988, p. 8).³

In this analysis, one way of reducing unemployment and introducing wage flexibility is to remove or relax the various barriers that prevent wages from adapting. The most frequently cited barriers include wage-indexing, guaranteed minimum wages, high levels of unemployment benefits, and high non-wage costs. It is maintained that the type of flexibility thus obtained constitutes a source of job creation and reduces unemployment. The rationale is that the drop in wage cost should increase profits and stimulate investments, resulting in more jobs. Moreover, as the cost of labour falls relative to the cost of other factors of production the capital/labour substitution ratio should be modified in favour of labour.

The view favouring the removal or relaxation of minimum wages relates to two aspects. Firstly, to the extent that wages reflect individual productivity more accurately (due to the reduction or removal of minimum statutory wages), some potential low-wage jobs may be generated and thus employment opportunities will increase for those priced out of the labour market by high and rigid wages.

Secondly, by abolishing or relaxing statutory minimum wage requirements it is believed that unemployment of young people could be reduced (Clarke, 1985). It is argued that in general young workers have few skills directly of value to an employer; that they are unused to work discipline; and that they have little firm commitment to a particular occupation or industry, thus giving rise to high turnover rates. Under these circumstances, young workers present higher recruitment, screening and training costs for employers and, it is argued, their wages should reflect these differences in costs and productive value in relation to those of adult workers. If not, employers will prefer to hire adults.

The above reasoning has been questioned on several grounds. Firstly, it is often disputed that greater degrees of wage flexibility will lead to lower levels of unemployment. Some studies indicate that a sharp general fall in wages would do little to reduce unemployment (Boyer, 1988, pp. 237-239).

Secondly, it is pointed out that the theoretical framework underlying the call for greater wage flexibility (i.e., the neoclassical analysis of labour demand) is open to question (Rosenberg, 1989b, p. 396). Rosenberg refers to a study by Bowles and Boyer where a macroeconomic model is developed “that takes account of the influence of the wage on both aggregate demand and the endogenous determination of output per labour hour, and finds that the level of employment may respond either positively or negatively to particular changes in the real wage rate”.⁴ Moreover, Rosenberg states that empirical work on the behaviour of real wages over the business cycle also does not support the neoclassical theory of labour demand. Research by Michon on “...cyclical movements in real wages over 1950-1982 for the United States, Canada, Japan, France, the [former] Federal Republic of Germany and the United Kingdom... demonstrates that there is no necessary cyclical wage behaviour common to these six countries”.⁵

Thirdly, it has been pointed out that, in some cases, in spite of the introduction of greater flexibility wages may not fall according to supply and demand, and different wage levels may prevail for what appears to be the same occupational category. What

² Freeman finds, for a given output performance, a significant real wage/employment trade-off across OECD countries and across industries within countries (Freeman, 1988, p. 77).

³ These authors also noted that high non-wage costs “discourage the recruitment of certain categories of workers in respect of which they are relatively high (young workers in particular)”.

⁴ Rosenberg (1989b), p. 396, based on Bowles and Boyer (1988).

⁵ Rosenberg (1989b), p. 396, based on Michon (1987).

may be seen as a distortion of the labour market may be considered perfectly rational by those involved in employment relationships, however. This is the case, for example, when employers incur labour costs in hiring, testing and training workers and wish to retain the trained workers so that they can recover their investment in them, for which purpose they are prepared to pay the workers higher wages than they could obtain elsewhere. The greater the extent of firm-specific skills, the more difficult it is to expand employment through reduction of wages (ILO, 1989, pp. 7-8). In this case it is in the employers' own interest to pay wages above the market clearing level.

There are two other cases where labour market distortions may prove beneficial for employers. Since relatively higher wages may very likely increase the choice of applicants for jobs the quality of the workforce is improved. Besides, higher wages provide an incentive for higher productivity from the existing workforce, thus lowering unit labour costs (ILO, 1989, pp. 7-8).

Fourthly, it has been argued that the removal of minimum wage mechanisms would impede technical progress by reducing pressure to modernize factory machinery. This could contribute to reduced competitiveness, the closure of firms, and thus more unemployment (Standing, 1986b, p. 14).

Fifthly, the claim that unemployment benefits in some countries are a factor in preventing wages from falling sufficiently to generate additional employment is not conclusive. Research on the effects of unemployment benefits on unemployment shows that cross-country differences in unemployment compensation cannot explain the "large rise in unemployment duration in Europe, or the enormous rise of unemployment levels in the United Kingdom, France, and the [former] Federal Republic of Germany compared with those in Sweden and the United States".⁶

Though the discussion on wage flexibility is far from settled, some trends towards finding ways to overcome wage rigidity can be detected. One such trend is the bypassing of minimum wage regulations and other statutory wage agreements, either through legislative reform, non-implementation of laws or through the use of work arrangements that escape their jurisdictions (e.g., home work and subcontracting) (Standing, 1986a, p. 31).

⁶ Burtless (1987), p. 155. Quoted by Rosenberg (1989b).

The tendency towards wage control is also seen in the efforts of several countries to secure agreements providing for wage moderation and deindexation.⁷ The main goal of these efforts is that wage increases must depend on productivity gains.

There seems to be a strengthening of trends towards "two-tier" or "multiple-tier" wages structures. In Australia a two-tier wage fixing system was introduced in 1987 in which wage increases up to a ceiling of 4% could be gained if industry productivity and efficiency are enhanced (Rimmer and Zappala, 1988). Various forms of two-tier pay structures have emerged in Canada and the United States in which new employees are taken on at lower wages or benefits than established employees doing the same work (Walker, 1987).

Furthermore, experimental forms of "participation wages" are becoming more popular. They include schemes of payments by results, shifts towards the use of bonus systems instead of part of the money wage, or conversion of part of the total remuneration into a flexible component linked to the performance and characteristics of firms.⁸

In some cases the payment system has become more flexible through wage reductions or freezes (nominal wage reductions), in return for some increase in employment security ("concession bargaining"). In this regard, it is noteworthy that according to a European survey by the European Community a significant share (51%) of workers were willing to accept a temporary wage cut if their firm were in difficulties –provided that, once the firm recovers, the workers receive a corresponding share of the profits (Commission of the European Communities, 1985, pp. 1-6).

2. Numerical flexibility

Numerical flexibility refers to two aspects: adjustment of the workforce and adjustment of working hours. The first aspect is known as "external numerical flexibility" and means the ability of firms to increase or decrease the numbers of workers in

⁷ Evidence of trends in deindexation policies for Australia, Belgium, Denmark, Italy and Spain is given by Sarfati and Kobrin (1988).

⁸ This approach reflects the ideas put forward by Weitzmann (1984) whereby wage increases are linked not only to individual productivity but also to the overall performance of the enterprise and its workforce.

response to variations in demand and/or technological changes. The second aspect is referred to as "internal numerical flexibility" and relates to the freedom that firms have for modifying the number of working hours without changing the number of employees.

a) *External numerical flexibility*

The arguments for increased external numerical flexibility (or employment flexibility) are closely related to that for wage flexibility. It is maintained that the regulations for protecting employment are too restrictive and thus impede the adaptation of manpower resources to market conditions. This view is also greatly influenced by the observation of the performance of employment and unemployment between the United States and European countries. It is argued that the relatively low unemployment levels in the United States are, to an important extent, a consequence of American employers' freedom to lay off or discharge workers in response to economic changes.

It is held that enhanced employment flexibility will lead to increased employment and a lowering of unemployment. The rationale behind the call for greater employment flexibility stresses that laws which protect employment by making dismissals difficult and expensive prevent firms from recruiting extra workers as needed, because firms know that they will not be able to dismiss them easily if circumstances change (International Organisation of Employers, 1985; OECD, 1986a; ILO, 1986b). Furthermore, firms face difficulties in establishing more flexible and diversified forms of contractual relationships (so-called "atypical forms of employment").⁹ These circumstances encourage the substitution of capital for labour. It is therefore considered that measures which diminish rigidities regarding dismissal (i.e., measures to make dismissals cheaper and easier) will lower labour costs, with two effects: first, they will encourage substitution of labour for capital, thereby fostering employment growth, and second, easier and less costly arrangements for dismissals should incentivate employers to hire extra workers in periods of growth (Rosenberg, 1989a, p. 11). Moreover, if firms are allowed to rely more on atypical forms of employment, they would be able to offer more jobs.

⁹ There is a call for more intensive use of fixed-term contracts, part-time work and temporary work.

The way to enhance employment flexibility is mainly through the relaxation of dismissal laws or industrial relations agreements which regulate them, and, to a lesser extent, through the extension of fixed-term contracts, temporary work and part-time work. In fact, a good deal of the discussion is centered on regulations governing dismissals—advance notice, amounts of compensation, pre-eminence of the seniority rule, prior agreements of various bodies, etc.

Criticisms concerning this type of flexibility have questioned its allegedly positive effect on unemployment. Although studies are not conclusive, there is evidence which suggests that the effects of "labour flexibility measures in terms of jobs are...meagre and the most thorough analysis of numerical flexibility even reveals an increase rather than a decrease in unemployment" (Meulders and Wilkin, 1987, p. 15).¹⁰

Moreover, the widely disseminated view about Europe's stricter regulations concerning dismissals has also been questioned. First, the correlation between high unemployment rates and rigid labour markets does not apply to all cases. The Nordic countries and Austria have kept low levels of unemployment in spite of having "rigid" labour markets. Second, it has been argued that the degree of flexibility available to employers in Europe has been understated, while that available in the United States has been exaggerated.¹¹ Although American employers are free to cause employment levels to vary with market requirements, they are required to respect rules and procedures¹² which make dismissals very expensive, and thus inhibit new hires. In the case of European regulations governing job security, although there is significant variation among countries these rules are considerably less rigid than is claimed, their main effects being to delay employment adjustment and make it more costly.

Furthermore, it has been argued that the relaxation of rules governing dismissals encourages a shift of employment patterns from full-time, long-term workers towards more part-time, temporary and

¹⁰ Other studies which refute the positive effects of external numerical flexibility on employment are those by Boyer (1987) and Michon (1987).

¹¹ See Piore (1986), p. 155; Flanagan (1987), p. 164 (reference taken from Rosenberg (1989b), p. 396); Emmerson (1988), p. 777; and Rosenberg (1989a), p. 10, note 10.

¹² On such matters as employees' seniority, allocation of work in the enterprise, and the distribution of tasks.

fixed-term workers, not covered by employment protection legislation.¹³ This may lead to the creation of a category of workers whose conditions of employment are generally inferior to those enjoyed by full-time workers.¹⁴ In turn, it is argued that this would lead to the institutionalization of a dual labour market comprising on one side poorly paid and unstable jobs and on the other side stable and well-paid occupations (Clarke, 1985; Piore, 1986; Standing, 1986b; Meulders and Wilkin, 1987, and ILO, 1989).

b) *Internal numerical flexibility*

Increased flexibility of working time arrangements (i.e., reduction and restructuring of working time) is considered as a possible alternative to wage or employment adjustments in the face of changing economic conditions. The variety of aspects covered by this form of flexibility is wide: fixing of normal or maximum weekly (monthly, yearly) hours of work, various forms of staggered work, organization of overtime and compensatory leave, work outside authorized hours (weekend work), and entry into or retirement from the labour force (Meulders and Wilkin, 1987, p. 9; ILO, 1989, p. 18; OECD, 1989, p. 15; Rosenberg, 1989a, p. 9).

The discussion on internal numerical flexibility (or flexibility of working time) is less contested than that on wage and employment flexibility. In principle, this form of flexibility is seen as an area of potential mutual benefit for workers and employers and one which may help to reconcile part of their conflicting interests (Meulders and Wilkin, 1987, p. 9; ILO, 1989, p. 18).

Reduction of working hours has been the form of flexibility which has had the greatest acceptance. For trade unions, it "fits the idea of solidarity between workers in the fight against unemployment and with a certain fairness in the sharing of employment" (Sarfati and Kobrin, 1988, p. 26). Besides,

internal numerical flexibility fits in with the changing attitudes towards work and leisure, where workers seek more freedom to organize their private lives.¹⁵

Employers are particularly interested in the extension of operating hours beyond the normal working day. Because of the high cost of new equipment, employers seek to operate it as long as possible,¹⁶ and thus want to introduce up to three or even four working shifts (OECD, 1989, p. 15). In addition, it is argued that increased internal numerical flexibility could help to achieve more efficient use of working time by allowing closer adaptation of working time to fluctuations in demand.¹⁷

With regard to the employment effects of this form of flexibility, it is maintained that these "depend on the political and social objectives within which it is set" (Meulders and Wilkin, 1987, p. 9) and thus on the nature of the working time flexibility being discussed. For example, the shortening of the working week may create jobs or at least maintain jobs that would otherwise disappear, by sharing the available jobs among a greater number of workers. Reduction of the retirement age, in contrast, substitutes younger workers for older ones and may lower unemployment by shrinking the labour force rather than by creating jobs (Rosenberg, 1989a, p. 12).

In spite of the positive mood concerning flexible hours of work, some criticisms have been made. It is argued that there is a danger of marginalizing various categories of workers and that conflicts may arise between new styles of work and the traditional rhythm of family, social and school life, or between working time and leisure time (Gaudier, Greve, Grootings and Hethy, 1986, and OECD, 1986a). Trade unions have objected that social security and retirement schemes still operate on the basis of full-time employment for fixed hours and are incompatible with flexible hours of work (European Trade Union Institute, 1985).

¹³ According to some studies, the development of these employment patterns gives grounds for maintaining that these forms of LMF should be seen as a cause of unemployment rather than a solution to it. This assertion is based on the observation that chronically high and rising unemployment has coincided with these growing forms of LMF (casual and temporary forms of work, shift from collective bargaining to individual settlements, etc) (Standing, 1986a, and Rodgers and Rodgers, 1989).

¹⁴ Workers whose hours of work or incomes do not reach certain thresholds may be excluded from many of the basic provisions of protective legislation or benefits (ILO, 1989, p. 19).

¹⁵ This support is partly reflected in the results of a survey among employees carried out by the European Community. Most of the workers covered by the survey would accept hours of work fixed monthly (39%) or even annually (16%), and one in three would be willing to work evenings and Saturdays in exchange for reduced annual hours of work (Commission of the European Communities, 1985, pp. 1-6).

¹⁶ In this way fixed capital costs can be distributed over a greater number of hours and units of output.

¹⁷ Business intensity may vary during the hours of the day or on certain days of the week or the month, as in the case of retail stores, or over longer seasonal periods, as is frequent in manufacturing (ILO, 1989, p. 18).

3. Functional flexibility

Functional flexibility concerns the ability of a firm to use its workforce more effectively by varying the work performed in response to changing workloads and the possibilities offered by new technologies. This form of flexibility relates to the mobility of workers within the firm; it involves the capacity of firms to reorganize jobs, which requires access to a workforce capable of carrying out different tasks of the production process; it calls for operatives able to adapt to a variety of tasks of varying levels of complexity and involves such aspects as multiskilling, job rotation, work units, changes in the functional division of labour, retraining and upgrading (Meulders and Wilkin, 1987, p. 8). To sum up, functional flexibility "appeals to the know-how and skills of workers and... to their ability to master various segments of the same productive process" (Boyer, 1987, p. 109).

From the workers' viewpoint, functional flexibility is preferable to wage and/or employment flexibility, since it is not based on wage reductions or restrictions on workers' rights. This type of flexibility enables them to make better use of their know-how and skills, get more involved with the production process, and eventually, play a more active role in the management of firms. It is seen as one of the ways of responding to workers' aspirations and at the same time as one of the tools enabling the labour market to respond to the reorganization of productive systems (OECD, 1990, p. 24).

The stimulus for seeking increased functional flexibility has been mainly the introduction of new technology. Since new equipment tends to reduce job boundaries, firms are forced to seek multi-skilled workers who can adapt to different functions within the labour process. In some cases, however, the stimulus emanates from the need to cut costs: significant cost savings may result from reorganizing the existing production process and making the corresponding changes in the way labour is used (ILO, 1989, p. 19).

Moreover, functional flexibility is put forward as a way to handle an increasingly uncertain business environment (Rosenberg, 1989a, p. 12). As in certain sectors demand has become more variable, due to the emergence of more diversified and specialized patterns of consumption, and firms are forced to respond to market signals in shorter periods of time, resources must be able to be shifted to new uses. This is made possible by the existence of both modern and more

flexible technology and a polyvalent multi-skilled workforce. These elements enhance employers' capacity "to handle bottlenecks or slackness in production by moving labour rather than hiring and firing" (Rimmer and Zappala, 1988, p. 568).

A central element concerning functional flexibility, then, is the presence of workers with several skills which allow them to switch from one activity or job to another. This is the reason why training programmes are increasingly incorporated into the formal relationships of employers and trade unions. While advances have been made in the way training is perceived by both employers and workers, problems remain. For example, not all workers benefit equally from new training programmes. Some employers may be reluctant to "invest resources on training older workers, on the grounds that there is a shorter expected pay-back period or that it is more expensive and consequently may prefer recruiting young workers" (ILO, 1989, p. 21).

Another problem that has been highlighted refers to the lack of policies concerning anti-poaching regulations (i.e., preventing other enterprises from attracting newly-trained workers without bearing the costs of training)—a circumstance that may reduce employers' interest in providing training (ILO, 1989, p. 21).

Functional flexibility depends heavily on the reduction of job demarcation barriers. However, explicit or implicit rules about manning requirements and the types of work that different occupational classifications can undertake are common and thus hinder the development of this type of flexibility. This is especially so in the United States, where it constitutes the main concern among American employers. In the United States, management is relatively free to vary the level of employment but not the allocation of work within the enterprise, and American employers maintain that in respect of this form of LMF, European labour markets are more flexible than their own and that this circumstance goes a long way towards explaining why labour productivity in the United States is stagnating (Piore, 1986, p. 149).

Yet trade unions are often suspicious of management's attempts to reduce demarcation barriers. The reorganization of production and the introduction of new technologies may serve to intensify the pace of work and increase managerial control over the production process. Unions also fear that the flexible deployment of labour will increase internal labour market segmentation between a skilled "core" workforce and an unskilled "peripheral" workforce.

IV

The Latin American labour market and LMF

As pointed out at the beginning of this article, during the 1980s substantial support arose for the view that the introduction of greater flexibility into the labour market through deregulation would facilitate the adaptation of that market to the new requirements imposed by structural adjustment. In the industrialized countries this view has led to a process of deregulation concerned with the elimination of institutional obstacles which prevent the labour market from adapting to new conditions of production and international competitiveness. In less developed regions, however, the labour market is not so extensively regulated, and where such regulations do exist, institutions are often unable to enforce them. Where this is the case, it is likely that the flexibility required for the purposes of structural adjustment will not necessarily entail a process of deregulation. It is argued here that to an important extent Latin America is no exception to this phenomenon. In fact, it is possible to sustain that the labour market in the region has displayed substantial flexibility but this has not been accompanied, nor much less promoted, by major institutional reforms. It has been a process of flexibility without deregulation. In these circumstances, the recipe for securing greater flexibility through deregulation is not at all clear. In the following paragraphs, reference is made both to the process of *de facto* or "underground" flexibilization and the institutional lag.¹⁸

1. Underground flexibilization

A global analysis of developments in the Latin American labour market in the 1980s indicates that the major trends point in the direction of greater flexibility. This is consistent with the conclusions drawn

by PREALC (1990) to the effect that between 1980 and 1989 the Latin American labour market was characterized by lower job security, the replacement of full-time employment by part-time employment, and growing recourse to subcontracting.

One indicator of this process is the high annual growth rate of the informal sector (6.7%, or more than double the 3.0% growth rate of the formal sector), which caused the proportion of the population engaged in informal activities to rise from 16% of the non-agricultural EAP in 1980 to 22% in 1989.

A second indicator of the increase in flexibility is the extraordinary expansion of employment in small enterprises (those with fewer than ten employees), which are concentrated in services and industry. Within the formal sector, the rate of growth of employment in small enterprises was 7.5%, as compared with only 0.5% in medium and large enterprises. Fully 40% of all jobs created in urban areas between 1980 and 1989 resulted from the dynamism of small enterprises, whose share of the economically active population (EAP) rose from 15% in 1980 to 21% in 1989.¹⁹

A third indicator is the trend – also noted by PREALC – for large enterprises to subcontract the production of certain basic components of their own productive processes, as well as certain essential services (such as transport, cleaning, maintenance and security), to small enterprises or even to some of the more modern units in the informal sector (PREALC, 1990).

A fourth indicator of the greater flexibility of the labour market is the drop in the level or growth rate of public sector employment. This phenomenon is relevant, since this is a sector which is characterized by considerable rigidity. For the 1980-1989 period as

¹⁸ The remainder of this section is partly based on an earlier work (mimeo), co-authored with Eugenio Tironi, which was entitled *Flexibilisation and regulation of the labour market* and was written for the Employment and Development Department, International Labour Office (EMPLO/ILO), Geneva.

¹⁹ The rate of growth of small enterprises must be viewed with circumspection, however, inasmuch as the total calculated by PREALC (1990) for the region as a whole is strongly influenced by estimates of great expansion in Brazil.

a whole, the reduction of public sector employment is not really substantial, since it only went down from 15% to 14% of the EAP (PREALC, 1990). If one considers the annual growth rate of public sector employment in recent decades, however, it is evident that there has been a drastic deceleration. Thus, its annual rate of growth, which averaged 4.5% in the period 1950-1980, fell to 3.7% between 1980 and 1989. This deceleration is even more striking when it is considered that between 1980 and 1983 public employment was still growing at the high rate of 4.7% per year, but slowed to an annual rate of only 2% in the period 1986-1989.

The trend towards lower absorption of labour by the State has taken place at different rates in different countries. Nevertheless, virtually all countries in the region have adopted programmes to reduce public employment. It is too early to tell what the outcome of these programmes will be, but it is likely that they will reduce some of the rigidities in the labour market.

A fifth indicator which highlights the extent of the LMF which has taken place in the region relates to labour-cost flexibility. Both legal minimum wages and real average wages have deteriorated in the 1980s, showing substantial downward flexibility. In the early 1990s average minimum wages in Latin America fell by around 35%.²⁰ In the case of real wages, when the average actual real wages in different regional sectors of activity (agriculture, construction, industry) are considered as a whole, it is noticeable that in 1992 all of them were lower than at the beginning of the 1980s (PREALC, 1993).

There are other important indicators of the process of flexibilization which is taking place in Latin America. For example, there is evidence in nearly all countries of a shift towards piece-rates and away from time-based wages, as well as an increase in home work as a substitute for the concentration of workers in factories or enterprises. This coincides with the growing integration of women into the labour market, which was the most significant development in the supply of labour in the 1980s (PREALC, 1993).

The inescapable conclusion is that many of the changes which characterize flexibilization of the labour market have indeed taken place in Latin America and the Caribbean in the 1980s. As this phenomenon has not been accompanied, nor much less promoted, by major institutional reforms, in most cases (with some notable exceptions) it is an "underground" process, stimulated by the internal dynamics of the labour market in response to certain macro-economic factors (liberalization of foreign trade, the reduction of State subsidies, privatization), but without the State's active leadership. In other words, this trend towards flexibility is a *de facto* phenomenon which has often taken place in spite of, rather than through, existing institutions. This helps to explain its frequently unorganized nature, its partial and uneven scope, and the high costs associated with it, especially as regards unemployment.

2. The institutional lag

There have been virtually no changes in the past decade in the standards and institutions which govern the labour market in Latin American countries.²¹ Thus, even though the institutional arrangements in force have neither stimulated nor channelled the process of flexibilization, they do not appear to have raised any obstacles to it. This can be explained either by the fact that these arrangements were already rather lax, so that there was consequently no practical need for deregulation, or because general standards for the protection of workers which entail certain rigidities were usually overwhelmed by the labour market's own dynamics. This second situation seems to fit the context of Latin America, and is responsible for this underground flexibilization.

The labour market in Latin America is regulated by the State, and there have been virtually no modifications in this situation. The protection of workers is based on labour legislation of universal application, rather than on enterprise or branch-level collective agreements or individual employment contracts (Bronstein, 1990). For example, as regards dismissal (a crucial area of flexibility), the legislation establishes many conditions or requirements: in some

²⁰ Exceptions to this trend were Colombia, Costa Rica and Paraguay, where real urban minimum wages were higher in 1992 than in 1980 (PREALC, 1993).

²¹ There are exceptions. Chile, Colombia, Panama and Venezuela, for example, have amended their labour codes, and other countries (such as Argentina) are currently discussing reforms.

cases, a worker may not be dismissed without a prior inquiry into the facts on which the dismissal is based; in others, dismissals must be authorized by the administrative authority or the dismissal must be notified to a tripartite committee which rules whether the dismissal is fair or unfair. Some legislations establish that for workers whose length of service exceeds ten years, the dismissal must be approved by a labour court. Whenever dismissals are attributed to financial reasons, many countries require that the dismissal be approved by the administrative authority, or by conciliation and arbitration committees or tripartite commissions.

In every country throughout the region the employer bears the burden of proof for showing that there are valid reasons for dismissal. In some countries, if the employer cannot furnish this proof, the dismissal is automatically annulled; in others, the employer is required to pay an indemnity. There is also a third group of countries in which the employer may unilaterally terminate an employment contract without having to show just cause, but he is none the less required to pay an indemnity which may vary according to the cause for dismissal.

The most exceptional situations are those of Chile and Brazil. In Chile, following certain labour reforms enacted in the early 1980s, there are no restrictions on dismissal other than the cost which it entails for the employer, which was increased by labour reforms enacted in late 1990 and early 1991. In Brazil, workers are protected by a "Length of Service Guarantee Fund" (FGTS), which is financed by the employer. This fund, set up in 1966, protects workers in the event of dismissal, but gives the employer flexibility as regards the workforce. Recently, however, legislation has been passed which, though it does not prohibit dismissal, renders it substantially more expensive for the employer.

Recent changes introduced in some countries, as well as planned reforms under consideration in others, seek indirectly to facilitate dismissal. They do so, for example, by introducing various possibilities for temporary contracts, thus giving greater flexibility for signing and terminating employment contracts. Similarly, enterprises are increasingly resorting to temporary employment agencies or temporary service enterprises, for which legal provisions have only recently been introduced in some countries or are envisaged in the reforms under consideration in others. Both mechanisms facilitate temporary or

fixed-term contracts which fall outside the scope of job security standards. Recent legislative reforms also seek to facilitate collective dismissals based on economic or technological reasons or *force majeure*. With the exception of Chile, however, there have been no direct reforms or changes in legislation concerning job security.

Thus, from a formal standpoint the Latin American labour market seems to be highly regulated. In addition to establishing stringent requirements for dismissal, the legislation limits temporary employment, restricts performance-based pay systems, and discourages labour subcontracting. With the exception of a few countries, the region has not undertaken a systematic reform of labour market institutions in the direction of deregulation. Nevertheless, the pre-existing institutional framework has been unable to prevent the process of flexibilization which, as noted above, has unfolded as an underground phenomenon.

3. Re-regulation of the labour market

Inevitably, the underground flexibilization mentioned above, which has not been guided by the State or channelled institutionally, and which has often skirted legislation and responded to direct stimuli from economic restructuring, has assumed certain features that may give rise to concern. The most serious of these, without a doubt, is its partial nature, for while certain segments of the labour market have been subjected to a violent increase in flexibility, others have managed to "protect" themselves fairly effectively from this tendency. This is the case, for example, of large enterprises which, in addition to the protective regulations of universally applicable legislation (although, as noted, these have proved weak), also enjoy the safety inherent in collective agreements. In contrast, greater flexibility has invaded all other segments, where the ineffectiveness of labour institutions has left allegedly "protected" workers exposed to the most unrestrained forms of flexibility.

The shortcomings of Latin American labour market institutions in respect of the dynamics which have arisen as a result of structural adjustment and new requirements for competitiveness and the organization of production, have certain serious implications. For one thing, these shortcomings have stimulated a growing dualization of the labour market throughout the region, and they must be

overcome in order to stem this trend, both in order to address the problems posed by segments of the labour market where corporative rigidities persist and present obstacles to increased productivity, as well as to regulate the flexibility which has developed in other segments and left workers unprotected.

Overcoming the flaws in labour market institutions in Latin America does not necessarily mean endorsing deregulation theories. Such an approach is meaningful only where existing regulations are truly an obstacle to flexibility, and it is by no means clear

that this is the case in Latin America. Thus, the challenge faced by the region is quite different: the *re-regulation of the labour market*, in other words, an overhaul of labour institutions which, in addition to extending flexibility to all segments of the labour market, will also guarantee to all segments a basic level of protection. Essentially, this entails ensuring conditions to boost productivity while at the same time maintaining certain minimum levels of protection which will establish acceptable social limits for economic reform.

V

Concluding remarks

The different forms of flexibility examined above reflect the different approaches or views towards the issue of labour market flexibility. In fact, the debate has revolved around two different views. One view, referred to as defensive or passive, places emphasis mainly on lowering wage and non-wage costs (labour cost flexibility) and making it easier to adjust the workforce to fluctuations in market conditions and technical change (external numerical flexibility). As a reaction to this approach to flexibility, the idea of offensive or active flexibility has progressively gained ground. This offensive or active approach, while not dismissing the need to introduce higher degrees of flexibility into the labour market, questions many of the "rigidity"-based assumptions and stresses the need to provide the workforce with training and new skills in order to facilitate their adaptability to changes in the production process.

The defensive approach is based on the view that labour markets are excessively regulated, and therefore distorted, so that there is a need to deregulate them. The offensive or active approach recognises the need to introduce more flexibility into labour relations, but without reducing employment security and with emphasis on forms of flexibility which the social partners identify as less conflictive or non-conflictive (internal numerical flexibility and functional flexibility).

It is interesting to note, however, that as the debate has progressed the distinction between defensive and offensive flexibility has been substantially overcome as some consensus has been reached on certain

issues. Thus, the approaches to flexibility have tended to move from very reactive and short-term views towards longer-term (and less conflictive) solutions. There is a perception that the structural problems which, among other things, caused high levels of unemployment cannot be overcome by relying on measures that alleviate adjustment in a merely temporary way (e.g., wage flexibility, external numerical flexibility). Two quotations from the OECD—an enthusiastic supporter of defensive forms of flexibility during the mid-1980s—illustrate this point:

"The greater the flexibility of the labour market, the lower the economic costs of adjustment: there will be less unemployment and less loss of output. Standard micro-economic theory postulates that, in a perfectly free labour market, wages and unemployment adjust to rectify imbalances between supply and demand. In the real world, however, there are obstacles to adjustment. These make relevant policies that not only assist those most affected but promote the flexibility of salary structures and the adjustment of manpower" (OECD, 1984, p. 29).

"The new policy framework developed by the OECD requires a shift from a concentration on short-term problems to one on the structural requirement that labour markets should be able to react efficiently to economic and social change...Efficient labour markets are to be fostered through improving the quality of the labour force [and] reducing inequalities in access to jobs and training... Promoting the efficient functioning of the market does not mean simply letting loose market forces by indiscriminate

deregulation or a narrow focus on wage flexibility" (OECD, 1992, p. 12).

Finally, it seems appropriate to point out that the issue of LMF is also relevant in developing countries. In an international context, the scope and nature of the introduction of labour market flexibility will differ from country to country according to the structure of the economy, the prevailing institutional arrangements for industrial relations and the degree of dialogue between social partners. Since the debate surrounding LMF has taken place almost exclusively in and about industrialized countries, it is probable that some (if not many) of its analyses and prescriptions may not adequately take into account or reflect

developing countries' structural differences: especially such aspects as weak trade unions, low rates of unionization, the existence of a large proportion of the labour force involved in informal activities and thus located outside the institutional umbrella, high rates of underemployment, and labour markets poorly regulated relative to those of industrialized countries. The examination made of the Latin American situation partly suggests this. In this context, then, the idea of stressing deregulation of labour markets as a way of securing greater labour flexibility, along the lines of the approach taken in industrialized countries, is open to doubt.

(Original: English)

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