CEPAL REVIEW 91 • APRIL 2007

KEYWORDS

Employment
Trade policy
Foreign direct investment
Labour policy
Employment creation
Comparative analysis
Evaluation
Argentina
Brazil
Mexico

Employment Challenges and Policy Responses
in Argentina, Brazil and Mexico

Christoph Ernst, Janine Berg and Peter Auer

In this paper we argue that Argentina, Brazil and Mexico must focus economic and social policies on creating employment if they want to provide decent work (i.e. formal jobs with social security coverage). During the 1990s, financial and trade liberalization and the associated laissez-faire policies did not deliver in terms of growth or employment in the countries under consideration. We assess the macroeconomic, trade, investment and labour-market policies of the countries during 1990-2004 and then propose a series of recommendations that give employment growth the priority it deserves.

Christoph Ernst

➾ **ernst@ilo.org**

Janine Berg

➾ **berg@ilo.org**

Peter Auer

➾ **auer@ilo.org**

Employment Analysis and Research
Unit International Labour Office
Geneva, Switzerland

I

Introduction

Argentina, Brazil and Mexico face many employment challenges. New job growth since 1990 has been insufficient to cope with the increase in labour supply. Despite the recent economic and job upswing, a comparison between 1990 and 2004 reveals lower employment rates in Argentina and Brazil; a higher proportion of workers employed in the informal sector in Brazil and Mexico; only marginal increases in average real manufacturing wages in Brazil and Mexico, with a decline in Argentina; while wage and income inequality remained high in all three countries and worsened noticeably in Argentina. Also, social security covers less than half of salaried workers in Argentina, and two-thirds in Brazil and Mexico. The lack of job growth (particularly of formal jobs with social protection) and, in certain cases, labour-market deterioration have been the greatest disappointments of the new development strategy adopted by the countries in the late 1980s and early 1990s. However, given that the new strategy had no explicit employment goal —rather it merely assumed that the liberalization of capital, goods and labour markets would bring about job creation—the poor employment performance is not surprising.

Thus the challenge of creating employment remains for all three countries. In this paper, we attempt to answer the following question: if the creation of quality employment were the central goal of government policy in Argentina, Brazil and Mexico, what economic and social policies would be needed? Macroeconomic policies, trade and investment policies, and labour-market regulations and policies are fundamental for the creation of good quality jobs. This article discusses why these policies did not bring about quality employment creation during 1990-2004 and how they can be redesigned to promote employment.

II

Macroeconomic policies

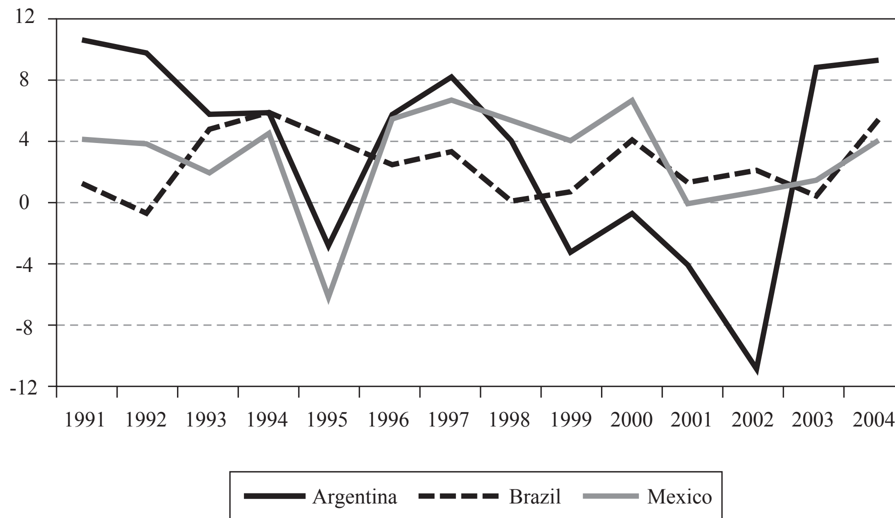
Economic growth usually leads to employment creation, but growth alone is not always sufficient, as job creation also depends on the labour intensity of economic growth. Although economic growth can spur investment —thereby improving productivity and, ultimately, the level of income in an economy— the best means of achieving higher economic growth is a matter of debate among economists. Beginning two decades ago, Argentina, Brazil and Mexico radically changed their macroeconomic policies in an effort to control inflation and reap the benefits of increased integration with the world economy. Since then, economic growth has been volatile and relatively low, affecting the ability of these economies to create employment, particularly in the formal sector.

During 1990-2004, growth averaged 3.2% in Argentina, 2.5% in Brazil and 3% in Mexico. By historical standards, economic growth during this period compares unfavourably with the 1960s and 1970s (particularly in Brazil and Mexico), when growth was near double digits. In Argentina, between 1990 and 2004, the standard deviation of economic growth was 6.5%, more than double the average growth rate. In Brazil and Mexico, economic growth was also volatile, though much less so than Argentina, with standard deviations comparable to the growth rates (See figure 1).

□ This article is a synopsis of the findings from the book *Meeting the Employment Challenge: Argentina, Brazil and Mexico in the Global Economy* (Berg, Ernst and Auer, 2006). The authors would like to thank Adriana Marshall for her contribution to the section on labour-market regulations and policies. They are also grateful to an anonymous referee for helpful comments, as well as to participants at seminars in Argentina, Brazil, Mexico and Geneva in 2004 and 2005, for their valuable insights. The views expressed in this paper are those of the authors and do not necessarily reflect the views of the International Labour Organization. The authors are also responsible for any errors or omissions.

FIGURE 1

Argentina, Brazil and Mexico: low and volatile GDP, 1990-2004



Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The relatively poor performance of these economies was associated with a sharp shift in macroeconomic policy. The volatile economic experiences of the three countries are marked by two different six-year spans: economic opening in 1985-1991 and the economic crashes of 1995-2001. During the pre-crash period, all three countries maintained a fixed exchange rate that resulted in a loss of export competitiveness and a negative trade balance. The countries had to rely on capital inflows to finance the imbalance, but these inflows and the resulting expansion in domestic credit were primarily directed towards consumption of imported goods. Moreover, exchange-rate appreciation aggravated the difficulties faced by the previously protected domestic industries in adjusting to the new competitive environment. The labour market bore the brunt of adjustment, as the declining competitiveness of domestic firms led to lay-offs and wage cuts.

In the post-crash period, the countries regained their competitiveness as exchange rates are now flexible, but the high debt-to-GDP levels and fears of renewed inflation have meant that monetary and fiscal policy remain restrictive. Price stability continues to be the central concern of macroeconomic policy, embodied in the current policy of inflation targeting. The other principal objective is debt sustainability. The restrictive bias in macroeconomic policy, particularly in Brazil and Mexico, has hurt employment creation. High interest rates have lessened domestic investment, while shrunken public resources have meant less spending on public and social infrastructure. The countries continue to maintain their capital accounts open, limiting macroeconomic policy to either controlling the exchange rate or the interest rate. In addition, although the exchange rate is no longer fixed, there are limits to its flexibility since the countries must guard against excessive currency devaluation, which can fuel inflation as well as increase the cost of servicing the debt, as much of the debt is in dollars, but national income is in local currency. As a result, many of the same macroeconomic constraints still impede the policy choices of Argentina, Brazil, and Mexico.

The governments of Brazil and Mexico have adopted inflation targeting as their policy tool for controlling inflation, and Argentina is seriously considering following suit. Inflation targeting entails having the central bank pre-announce a rate of inflation to be met for the year and focusing central bank policy on achieving this goal. Employment is not a policy objective. Inflation-reduction measures have been successful in the countries under consideration. This success has come at a price, however, since the policies implemented to restrain inflation often involve raising interest rates, which deters investment and, as a result, labour demand. Furthermore, it is not clear why inflation targeting has become the central macroeconomic policy

following the demise of exchange-rate anchoring, since there is no empirical evidence to show that an economy with an annual rate of inflation of around 10% performs worse than an economy with annual inflation of around 3% (Islam, 2003).

By using interest rates to control inflation, interest rates are higher than they need be, which has the adverse effect of increasing the cost of debt, the debt burden and, ultimately, the perception of risk. It also raises domestic interest rates, making it more expensive for domestic banks to borrow from abroad, thus increasing the cost of credit available domestically. The high interest rates in Argentina, Mexico, and especially Brazil, have aggravated the already difficult process that firms, particularly small ones, face in obtaining financing. In a 2000 business-environment survey, 73% of Argentine firms, 84% of Brazilian firms and 71% of Mexican firms reported high interest rates as a major obstacle for the operation and growth of their business (World Bank, 2000).

Another feature of macroeconomic policy in Brazil and Mexico is the restrictiveness of fiscal policy. Controlling public spending is integral to keeping inflation in check and is also necessary for funding debt payments. As was the case with restrictive monetary policy, however, restrictive fiscal policy reduces aggregate demand, which in turn hampers job creation. Because of the large debt repayment burden, these countries have to run primary fiscal surpluses to service the debt. However, this means that the government is taking in more money domestically than it is spending, which is contractionary. Furthermore, fiscal policy has been pro-cyclical, which aggravates downturns since spending is reduced when the economy goes into recession.

Mexico and, more recently, Brazil have made efforts to bring their budgets into balance by running primary surpluses to finance debt repayment. Deficit control is also fundamental to the governments' objective of keeping inflation in check. Indeed, Mexico, and Brazil and Argentina would, for the most part, meet the fiscal criteria stipulated in the Treaty of Maastricht: a ceiling of 60% for the general government debt-to-GDP ratio, and a ceiling of 3% for the government financial deficit-to-GDP ratio.[1] Some Brazilian economists have proposed lowering the fiscal surplus target so that the government can dedicate funds to investment projects.[2] The Brazilian government has also requested of the International Monetary Fund (IMF) that spending on infrastructure be counted as investment rather than government outlays. Infrastructure projects that use labour-intensive production methods would have the added benefit of reducing unemployment in the country. Moreover, by fixing a primary-surplus target without considering economic cycles, countries run the risk of aggravating downturns, since there is no built-in relief mechanism.

III

Trade and investment policies

1. Export orientation and its effects on quality employment

In the late 1980s and early 1990s, Argentina, Brazil and Mexico adopted new export-oriented development strategies that involved trade liberalization, regional trade agreements and the curtailment of government industrial policy. Trade liberalization is supposed to create new export opportunities and thus influence the export pattern of a country. Regional integration can complement this process by promoting trade among neighbouring countries. However, free trade will be more beneficial for a country's development if it exports goods and services for which world demand is increasing, and if production of these goods has a multiplier effect on output and employment. We therefore analyse changes in export specialization as a consequence of trade liberalization and regional

[1] With the devaluation in late 2001, Argentina's debt-to-GDP ratio jumped from 52% of GDP to 132%; it continues, however, to meet the public deficit criteria. With a debt-to-GDP ratio of 50%, Brazil meets the debt-to-GDP criteria, though it has exceeded the public deficit criteria several times in the 1990s, most recently in 1998 when it ran a public deficit of 7.1% of GDP.

[2] See the website of Desemprego Zero (www.desempregozero.org.br) for a variety of articles on this topic.

integration, and then compare the specialization to changes in world demand for the specific product. Table 1 shows that, between the periods 1985-1995 and 1995-2000, the number of rising-star products in which the three countries are specialized (products whose import share increased in the world market) declined considerably from 277 to 89 for all three countries taken together, while the number of retreat products (products whose import share in the world market was falling) increased considerably from 109 to 246.

TABLE 1

Argentina, Brazil and Mexico: changes in number of products within the competitiveness matrix, 1985-2000[a]

Argentina		Brazil		Mexico	
1985-1995	World	1985-1995	World	1985-1995	World
65	99	64	71	77	106
46	32	39	62	24	25
1995-2000	World	1995-2000	World	1995-2000	World
101	29	96	35	70	25
70	35	76	29	100	26
1995-2000 MERCOSUR[b]		1995-2000 MERCOSUR		1995-2000 NAFTA[c]	
64	47	73	41	68	27
59	56	48	63	90	43

Source: Authors' own calculations, based on the ECLAC TradeCAN database, 2002.

[a] In each group of four figures, the top left corresponds to falling stars; top right to rising stars; bottom left to retreats (not specialized, declining product) and; bottom right to missed opportunities (not specialized, rising product).

[b] Southern Common Market.

[c] North American Free Trade Agreement.

Generally speaking, Argentina and Brazil remain specialized in low value and low to medium labour-intensive primary and semi-processed products, creating little employment. Brazil does, however, have a comparative advantage in some manufactured goods (such as motor vehicles, textiles), especially in trade with its MERCOSUR neighbours. However, with the exception of some successful industries, the MERCOSUR countries are increasingly distant from the most dynamic flows of international trade, such as high-technology products. Mexico has continued to deepen its specialization in manufactured goods, mainly thanks to its maquila industry, as 60% of its exports in the late 1990s were considered to be of a medium to high-technological level, compared to only 20% in the 1980s (Dussel Peters, 2003). Nevertheless, these industries depend heavily on imports of intermediate goods, which represent more than 80% of total export sales, and which account for most of the value added. The declining specialization in dynamic products vis-à-vis the world market and the remaining specialization in primary or semi-processed primary products is of great concern, particularly in Argentina, but also in Brazil. Even though these exports have a positive impact on macroeconomic variables such as the trade balance, currency reserves, and, where relevant, public revenue from export taxes, this type of specialization alone is not very promising, as the goods are subject to high price vulnerability and create few good quality jobs.

Another consideration when analysing the economic and employment effects of trade liberalization is imports. Between 1990 and 2003, imports increased annually at an average rate of 17% in Argentina, 10% in Brazil and 24% in Mexico. What was the effect of this import surge on employment and wages? With the exception of the food industry in Mexico, most of the goods exposed to import competition were higher-value-added goods such as medical appliances, electronic valves or special-purpose machinery (See table 2). In contrast to major export sectors, which had a low to medium labour intensity, industries exposed to imports had mostly medium to high labour intensity and were therefore slightly more important for employment. However, their share in total manufacturing employment was not significant (under 1%), except in the case of special-purpose machinery in Argentina and food products in Mexico. Nevertheless, the labour-market impact of economic opening was mixed and strongly depended on each specific industry. In Mexico, the industries that were most exposed to import competition, as listed in table 2, experienced solid output growth (over 3%) and positive employment growth; only the processed-food sector recorded negative growth, while the electronic valves sector increased by 15%. Wage growth was negative but above average, except in the case of electronic valves (+7.0). In Argentina and Brazil, even though these industries displayed largely positive output and wage growth, employment growth was for the most part less favourable compared with the rest of the manufacturing sector. It was either negative, especially

TABLE 2

Argentina, Brazil and Mexico: industries most exposed to import competition and labour-market trends, 1995-2000[a]

	Ranking[b]	Output growth	Labour intensity	Emp. share	Emp. growth	Wage Growth
Argentina	Electronic valves, tubes, etc.	3.1	Medium	0.6	4.1	7.3
	TV, radio receivers and assoc. goods	0.4	High	0.4	-2.9	2.2
	Medical appliances	8.9	Medium	0.8	5.1	6.9
	TOTAL Manufacturing	1.7		100	3.9	4.1
Brazil	Processing of nuclear fuel	-4.4	Medium	0.9	-9.0	2.0
	Electronic valves, tubes, etc.	-1.5	High	0.5	-2.5	-8.2
	Medical appliances	5.7	Medium	0.8	-2.5	-0.6
	TOTAL Manufacturing	4.0		100	-0.9	-3.1
Mexico	Electronic valves, tubes, etc.	14.7	Low	0.1	4.1	7.0
	Processed meat, fish, fruit, veg.	-2.4	Medium	3.0	1.8	-4.1
	Special-purpose machinery	3.4	High	0.9	6.2	-1.5
	TOTAL Manufacturing	3.7		100	3.5	-4.4

Source: Authors' calculations based on data from the United Nations Commodity Trade Database (COMTRADE) (United Nations Industrial Development Organization (UNIDO), 2006).

[a] The highest ranked product groups per country are shown in this table. Output growth rates are annual average values at constant market prices, wages are real: Argentina: 1995-1999, Brazil: 1996-1999, Mexico: 1996-1999.

[b] The indicator X-M/(Y-X+M) demonstrates which industry has been most exposed to import competition: it shows net imports (X-M) divided by domestic absorption (Y-X+M), or how much has been consumed domestically.

in Brazil (between -2.5% and -9.0%), or lower than the average for manufacturing.[3]

The relatively good employment performance was partly due to the fact that by the second half of the 1990s (the period under consideration), many companies had already adjusted to the new context. Also, most of the sectors exposed to increased imports, besides food industries in Mexico and special-purpose machinery in Argentina, were those producing higher-value-added goods and employing relatively few workers, such as medical appliances or electronic valves. Moreover, some imports were of consumer goods that were not produced domestically, thus having no effect on domestic production. Perhaps more importantly, imports of intermediate goods helped to improve the competitiveness of national production.

The indirect impact of imports on employment, however, was rather negative. Greater competition in the domestic market and imports of technology led to industrial restructuring and to a rise in labour productivity in the traditional industrial sectors, particularly in Argentina and Brazil. The substitution of labour with capital resulted in a general decrease in demand for labour in manufacturing but also to a wage shift in favour of skilled workers, as was the case in the automobile sector of Argentina and Brazil. Another sector that suffered significantly from imports was the agricultural sector in Mexico where, between 1993 and 2002, around one million agricultural jobs were lost due to cheap corn imports (National Institute of Statistics, Geography and Information (INEGI), 2002).

Even though trade liberalization and regional integration caused a strong increase in trade and led to better integration in the world economy, it did not have the expected positive impact on production, employment and wages during the period of analysis (see table 3). Contrary to conventional economic thinking, the dominant export sectors were more capital intensive than labour intensive. Moreover, there was a steep rise in imports in the region, but not a similar degree of export dynamism, particularly in

[3] Table 2 only shows the three sectors most exposed to imports, but the analysis refers to the eight sectors most exposed to imports.

TABLE 3

Argentina, Brazil and Mexico: summary of the impact of trade liberalization,[a] 1990-2003

Trade	Argentina	Brazil	Mexico
Tariff reduction	+++	+++	++
Export increase	++	++	+++
Import increase	+++	+++	+++
Intraregional trade increase	++	++	+++
Specialization in dynamic exports	-	-	-
Labour intensity of major exports	++	++	+
Employment impact of exports	-/+	-/0	+
Wage impact of exports	-/+	+	0/+
Direct employment impact of increased imports	-/+	-/+	-/+
Indirect employment impact of increased imports	-	-	-/0

Source: Authors' compilation.

[a] Minus sign (-) means declining effects; -/+ means mixed; + means low/positive; ++ means positive; +++ means very positive. Also, -/0 means slightly negative effects, while 0/+ indicates slightly positive.

Argentina and Brazil. Exchange-rate appreciation was a major macroeconomic variable hampering an export drive. Only Mexico experienced an export surge in manufacturing production and employment during the second half of the 1990s, mainly due to the booming maquiladora sector. However, the maquiladora industry did not develop significant linkages with the rest of the economy and declined significantly from 2000, drastically reducing formal job creation in Mexico. The opening of the domestic market to highly subsidized agricultural products from the United States had a disastrous impact on employment in agriculture. This shows that the sequencing and targeting of economic opening are crucial for avoiding high social-adjustment costs.

2. The evolution and nature of FDI inflows and their importance for the labour market

Attracting FDI has been a key aspect of the countries' outward-oriented development strategy, as FDI is seen as compensating scarce domestic financial resources that are needed to help modernize and increase production, facilitate integration into the world market and generate employment. The new development strategy of the 1990s and the increased globalization of production worldwide led to significantly higher FDI inflows between 1990 and 2003 than in the 1980s. According to recent data from the United Nations Conference on Trade and Development (UNCTAD), FDI inflows were four times higher in Mexico, which began trade and financial liberalization earlier, six times higher in Brazil and over 10 times higher in Argentina, which had the most comprehensive privatization programme during the 1990s.

The impact of large FDI inflows on employment, however, was to a large extent disappointing. This unfavourable outcome is mainly explained by the type of investment. Table 4 summarizes the type of foreign investment the countries have received and its importance for employment.

Most foreign investment did not create new productive activities to spur the recruitment of additional workers. Quite the contrary in fact, as foreign direct investment was often associated with the restructuring of companies, implying rationalization measures that led to labour shedding. As a result, few productive assets with additional employment potential were created. This is apparent from the increased importance of mergers and acquisitions in total FDI flows to the three countries, with an extremely high share of over 80% in Argentina and a more moderate share of over 40% in Mexico. Table 5 also shows the greater importance that this form of FDI has had in Latin America —particularly in Argentina and Brazil— as compared with China and India, even though their share also expanded considerably in the period 1997-2002.

TABLE 4

Argentina, Brazil and Mexico: types of foreign investment and their dimension and importance for employment creation, 1990-2004

Investment	Importance of investment for employment	Importance of foreign investment inflows		
		Argentina	Brazil	Mexico
Portfolio	Insignificant	Medium	Medium	Medium
FDI	Medium	High	High	High
Privatization	Mixed	High	Medium	Insignificant
Horizontal investment	High	High	High	Medium
Vertical investment	Medium	Insignificant	Insignificant	High
Mergers & acquisitions	Mixed	High	High	Medium
Greenfield investment	High	Medium	Medium	High
Resource-seeking	Insignificant	High	Insignificant	Insignificant
Market-seeking	Medium	High	High	High
Efficiency-seeking	Medium-high	Insignificant	Insignificant	High

Source: Authors' compilation.

TABLE 5

Average share of mergers and acquisitions (M & As) in FDI inflows, 1991-1996 and 1997-2002, selected countries
(percentages)

M & As/FDI inflows	1991-96	1997-2002
Argentina	38.9	82.3
Brazil	44.1	58.5
Mexico	15.6	42.6
China	2.6	4.4
India	15.3	39.1
Developing countries	17.4	34.5

Source: United Nations Conference on Trade and Development (UNCTAD), 2000.

As a consequence of domestic-market opening and privatization, most foreign investment was channelled into services. Service FDI mainly came in the form of mergers and acquisitions resulting from the privatization of public utility companies or bank restructuring, which often did not create new productive assets, but rather tended to use existing ones. In addition, decades of protection led to a slack labour force, which was reduced during the privatization and modernization process of the 1990s, so that the overall impact on employment was minimal or even negative.

Economic liberalization led to increased competitiveness in the manufacturing sector, the second most important destination of FDI inflows. As in the service sector, restructuring strategies to increase productivity often involved rationalization measures and labour shedding. In addition, FDI mainly went into low to medium labour-intensive sectors. Manufacturing transnational corporations (TNCs) that were already present made little, if any, contribution to employment creation. Even though "old" capital-intensive industries, such as automobiles and chemicals, were major recipients of FDI, these sectors rationalized production and either created few jobs or experienced a decline in employment in the 1990s. Nevertheless, they experienced a rise in productivity and competitiveness as well as a further export orientation of their products, which are promising signs for the future. This trend shows that maintaining targeted sectoral support by the public sector to this industry, even during a period inspired by liberal policies, was crucial and helpful in the restructuring process. Also, the arrival of new TNCs (especially in the automobile sector) resulted in the creation of fewer jobs. Moreover, wage increases in FDI-dominated manufacturing sectors were average, especially for skilled workers, reflecting the increases in labour productivity.

In Mexico, the employment situation is much more favourable than in Argentina and Brazil, as strong manufacturing FDI has generated many new jobs. This positive trend, however, can be mainly attributed to the maquiladoras, which benefited from strong greenfield investments in labour-intensive industries. The maquiladora sector also experienced

above-average wage rises, even though their level still tends to be below the average in manufacturing. However, their comparative advantage is rather fragile, as evidenced by net FDI outflows since 2000 and a subsequent decline of formal employment. However, one encouraging prospect has been the creation of third-generation maquiladoras, based on technology-intensive production activities carried out by highly skilled workers. By competing on the strength of quality rather than prices, firms are in a better position to fight off low-wage competitors.

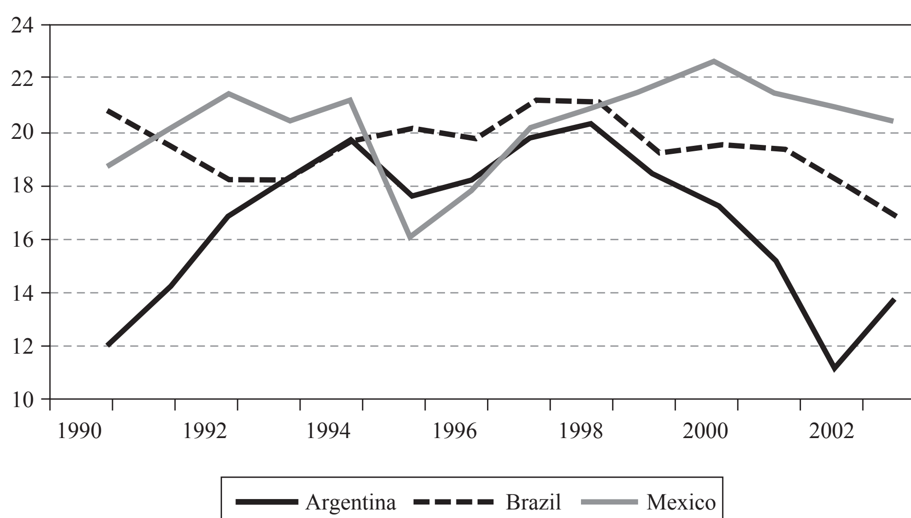
FDI is also meant to create forward and backward linkages with domestic firms. In import substitution industrialization (ISI) sectors, some linkages exist, but these were mainly formed before the 1990s. Moreover, strong capital and import inflows caused an increased substitution of national suppliers in favour of international suppliers, even in these sectors. Mexico received substantial investment in assembly plants located on the border with the United States, although this investment established few links with the rest of the economy.

Given the strong increase in FDI during the 1990s, one important question concerns the effect it had on domestic investment. If FDI had no effect, any increase would be reflected in a rise in total investment. On the other hand, if FDI had promoted domestic investment, this would have had a multiplier effect on total investment. This occurred in East and South East Asia during the 1990s, despite being the most restrictive region towards FDI among developing regions. Alternatively, FDI can crowd out domestic investment, meaning that increased foreign inflows hamper domestic investment, in which case domestic investment is simply replaced by foreign investment, or worse, the increase in total investment is smaller than the increase in FDI. Weeks (2000) and Agosin and Mayer (2000) show, that in Latin America, which undertook the most far-reaching liberalization of FDI rules during the 1990s, FDI unfortunately crowded out domestic investment. Credit-rationing associated with monetary restraints aggravated the crowding-out effect.

The crowding out is apparent if we compare overall domestic investment to FDI. Despite the large surge of foreign financing in the 1990s in Argentina, Brazil and Mexico, overall domestic investment did not increase. In Argentina, domestic investment averaged 17% of GDP during 1990-2001, in Brazil and Mexico it was slightly higher at 20% of GDP (see figure 2). In contrast, in East Asia during the 1970s and 1980s, investment-

FIGURE 2

Argentina, Brazil and Mexico: investment as a share of GDP, 1990-2003[a]



Source: World Bank, World Development Indicators.

[a] Gross Fixed Capital Formation (GFCF) is used as a proxy for domestic investment.

to-GDP ratios exceeded 30% of GDP, resulting in sustained high growth rates. Another drawback to the surge in capital inflows was that domestic investment was volatile and strongly correlated with FDI. This was especially true in Argentina, where fluctuations in foreign participation in investment and total investment-to-GDP had an astoundingly high correlation of 90% during 1990-2001. In Brazil and Mexico the relationship was strong, but not as dramatic, with correlations of nearly 60% in both countries. The strong dependence on foreign investment and the high level of fluctuation led to an increased external vulnerability of these economies. Another previously mentioned negative macroeconomic effect was that the inflows contributed to the appreciation of the exchange rate (despite attempts at currency sterilization) and a fall in competitiveness. Furthermore, foreign investment had the perverse effect of prolonging the policy of high real interest rates to sustain it. This limited access to credit for local firms, which constitute major local employers.

Rising inflows of FDI increased the countries' dependency on external financing for their development, thus increasing their vulnerability. Another characteristic of FDI was the limited influence the countries had regarding the investment decisions of foreign companies. For example, FDI inflows decreased in 2000 in the region because of the recession in countries of the Organisation for Economic Co-operation and Development (OECD) and not because of a deteriorating investment environment. While FDI is certainly crucial for the development of the region, integration into the world market and employment, domestic investment of local firms is also essential.

IV
Labour-market regulations and policies

1. Regulatory reform

Labour law reform has been advocated vigorously by the Washington consensus, given the belief that, for economic reforms to be successful, the labour market must be flexible so that firms can adapt to the changing competitive environment. In particular, easing dismissal protection laws and reducing labour costs have been among the reforms deemed necessary for the success of the new economic model. Officially, the rationale behind these reforms was that, by facilitating flexible contracts and dismissals and bringing down non-wage labour costs, reforms would reduce non-compliance and precarious employment relations, as well as increasing the competitiveness of firms, which would in turn stimulate employment creation. The nature and scope of the labour reforms in Argentina, Brazil and Mexico was determined by the importance governments attached to cutting labour costs as a means of improving their international competitiveness, the influence of trade unions and other political actors, the pressure of employers, the pressure of international financial institutions in favour of the proposed changes, and lastly, the nature and degree of protection legally guaranteed to workers.

In Argentina reforms pursuing "external numerical flexibility" (or easing hiring and firing) and labour-cost reductions progressed steadily during the 1990s, though by the end of the decade new labour reforms were implemented to re-establish some of the rights that had been previously withdrawn. Reforms were numerous and far-reaching and concerned temporary contracts and their associated social security costs (1991, 1995, 2000), dismissals (1991, 1998), and non-wage labour costs in general (1994). Despite the drastic regulatory changes of the 1990s, the employment regulations prevailing in the early part of the current decade were not dramatically different from those that had existed prior to the economic reforms of 1991. The most important of the surviving regulatory changes were the reduced dismissal compensation for workers with less seniority (though this was doubled in the 2002 decree), and the ability to hire a worker on a trial contract, but without the previous exemptions on social security payments. Also, specific, less protective regulations for small firms remained. Furthermore, the capacity to change regulations through collective bargaining remains in place and has the potential for a more drastic impact. Nevertheless, the government's decision in the 1990s to make the labour market more flexible legally, as well as through its discourse and its decision to weaken labour inspection, resulted in a noticeable increase in the number of clandestine workers.

In Brazil, reforms to labour regulations were geared, as in Argentina, to making the employment contract more flexible, though the changes were more restricted and most reforms were introduced in the second half of the 1990s. The principle reforms include the passage of the Law of Cooperatives, which permitted the creation of cooperatives of workers to deliver services to firms without the constitution of a work contract, with its recognized social and labour rights. Also in 1994, salaries were de-indexed from inflation, with the introduction of free negotiation of wages following almost 30 years of official wage policies. In 1998, working-time "banks" were introduced to make working hours more flexible and do away with paid overtime. Part-time work contracts were legalized in the same year, allowing working hours up to 25 hours per week with lessened labour rights. In 1998, another law instituted fixed-term contracts with reduced social rights.

Mexico has not reformed its labour law, though there have been several projects under discussion concerning different aspects of flexibility, such as the regulation of employment termination, severance pay, the creation of temporary and other special contracts, as well as regulations on subcontracting and on working time (de la Garza, 2002). In spite of the absence of legal reforms, many *de facto* changes have been achieved, particularly as a result of collective bargaining. Based on an analysis of collective agreements in the mid-1990s, de la Garza (2002) concluded that most of them guaranteed substantial functional flexibility and moderate numerical flexibility. In their study of manufacturing, Herrera and Melgoza (2003) found that de-regulation was increasing, given that many central issues had ceased to be formally regulated. For example, the proportion of firms having written, formal instruments (collective agreements, specific arrangements, internal regulations of firms) addressing employment contracts, use of labour and organization of production, had halved between 1995 and 1999. Nonetheless, this process was less pronounced in large enterprises, but rather was concentrated in micro, small and medium-sized firms, as well as in the maquiladora sector.

Despite the changes in labour law towards less regulation, particularly of employment contracts and dismissal protection, and a reduction in non-wage labour costs, there was no visible impact on job creation or on increased formalization. Rather, the most disturbing trend has been the increased share of non-protected waged workers in the 1990s (see table 6). In Argentina, Brazil and Mexico, the share of non-protected employment increased by between 20% and 30%, irrespective of any changes (or lack of) in legal regulations and non-wage labour costs, and regardless of changes in the level of economic activity. This trend has been encouraged by government discourse about the need for flexibility combined with weakened labour inspection, particularly in Argentina and Mexico.

TABLE 6

Argentina, Brazil and Mexico: proportion of non-protected workers in waged employment, 1991-2002[a]

(percentages)

Year	Argentina[b]		Brazil[c]	Mexico[d]	
	(1)	(2)	—	(1)	(2)
1991	23.2[e]	…	27.9	33.8	20.3
1995	23.6	30.7[f]	33.2	39.3	24.9
1999	30.9	33.2	37.2	40.3	23.6
2002	29.1	33.2	37.9	40.8	23.9

Source: Marshall (2004).

[a] Data are not comparable across countries, as concepts and methodologies differ.

[b] Argentina: (1) wage earners (excluding household services and, in 2002, beneficiaries of employment programmes) without all social benefits (Buenos Aires-Cordoba-Rosario, Permanent Household Survey (EPH), National Institute of Statistics and Censuses (INDEC)); (2) wage earners (excluding household services and, in 2002, beneficiaries of employment programmes) with no social security contributions (urban areas, Permanent Household Survey (EPH), National Institute of Statistics and Censuses (INDEC)).

[c] Brazil: wage earners without employment contracts (*carteira de trabalho*), based on data from the Institute of Applied Economic Research (IPEA, 2003, statistical annex).

[d] Mexico: (1) wage earners without social benefits, National Institute of Statistics, Geography and Information (INEGI), 2002; (2) data on 48 cities in the INEGI *Banco de Información Económica*.

[e] 1992.

[f] 1996.

2. Labour-market policies

An important and positive trend in labour-market governance in Argentina, Brazil and Mexico has been the increased prominence given to labour-market policies, both passive and active. Although programmes are still incipient, piecemeal and in need of additional and sustained funding, such policies have the potential to improve the operation of the labour market. By

providing security to workers in times of crises, these policies give employers the flexibility they need to operate in a global economy. Labour-market policies contribute concretely to alleviating the problems of the unemployed, whereas it is questionable whether "indirect incentives" (such as removing labour protection or reducing non-wage labour costs) result in more jobs.

Labour-market policies comprise passive policies, which provide replacement income during periods of joblessness or job search, and active policies, which focus on labour-market integration either through demand or supply measures. The adverse labour-market outcomes of the economic reforms, namely increased unemployment, informality and poverty, called for State intervention. Before the mid-1990s, labour-market policies in Argentina, Brazil and Mexico were sparse and sometimes existed only on paper. In the mid- and late 1990s, governments expanded and diversified programmes to respond to the continuous increase of unemployment and poverty within the region. The policies included a wide range of government interventions, including unemployment insurance programmes, employment-creation programmes, self-employment and micro-enterprise creation programmes, training programmes, and public employment services.

In the early 1990s, labour-market policies in Argentina were fragmented and on a small scale, with little political and financial commitment on the part of the government. Labour-market policies were repeatedly used spuriously to benefit the political clientele, and often announced to avoid the emergence of conflict, or at electoral times, only to not be implemented or rapidly discontinued. Moreover, the fiscal restrictions in the convertibility programme did not support the funding of employment policies (Cortés and Marshall, 1999). This was particularly true of the unemployment insurance program, which was created in 1991, but had very limited coverage, so that when the crisis hit in 2002, only 8% of the unemployed benefited from the programme (Marshall, 2004). It was only at the end of the 1990s that labour-market policies were widened in the country, with the government committing political and financial support, as it saw them as an important instrument for providing income to the jobless and controlling social conflict. This was seen most explicitly with the 2002 creation of the Programme for Unemployed Heads of Household (Programa de Jefes y Jefas de Hogar Desocupados), which provides a monthly benefit (below the minimum wage) to unemployed persons with children, who in exchange must participate in training or community activities at least four hours daily. With over one million beneficiaries in 2004, government spending on labour-market policies has surpassed 1% of GDP, making it one of the highest in the region. Nevertheless, the programme has been criticized for being more of a social assistance programme than one that facilitates entry into the labour market, as some beneficiaries did not participate in the labour market prior to receiving benefits. As a result, the government has expanded its portfolio of labour-market policies to better address the varying profiles of the beneficiaries.

In Brazil, although funding relative to GDP has also been of limited scale and coverage, there has been a longer-term, steadier effort at labour-market intervention, through the implementation of unemployment insurance, intermediation and training schemes, and assistance to small-scale employers and self-employed workers.[4] Brazil's unemployment insurance fund, created in 1986 and later expanded, has the greatest scope and coverage of the six unemployment insurance programmes that exist in the region. It covers nearly 50% of the unemployed and is also particularly innovative in that the fund is also used to finance investment projects and union-administered training programmes (Inter-Union Department of Statistics and Socioeconomic Research (DIEESE), 2003).[5]

Labour-market policies have also been sparse in Mexico, but nevertheless have gained importance, both institutionally and financially. The programme for work-training grants, BECATE (previously the work training system (SICAT)), for example, was started after the 1982 crisis, providing training and a cash benefit to unemployed workers. It has expanded in scope and coverage and, by 2000, was benefiting half a million workers. Another important scheme is the temporary employment programme, run by the Secretariat of Social Development, which consists of labour-intensive public works projects in rural areas. From 660,000

[4] Besides labour-market policies, the Brazilian government has expanded its social assistance through school allowance (Bolsa Escola) and family allowance (Bolsa Familia) programmes. It has also extended and improved pension funds for the rural population, which has led to a reduction in poverty and an improvement in income distribution.

[5] Formally employed Brazilian workers also have access to a severance fund (Fundo de Garantia por Tempo de Serviço) financed through monthly contributions by the employer, which the worker has access to upon dismissal.

beneficiaries in 1995, the programme had increased to over one million by 2000 (Samaniego, 2002). In Brazil, the government has also developed various micro-credit programmes to promote self-employment and micro-enterprise creation initiatives.

Nevertheless, all three countries are still struggling to implement the training and work components of the active policies, as well as integrating the different programs into a cohesive system of labour-market intermediation. This is particularly true of the Programme for Unemployed Heads of Household in Argentina, where the work and training requirements have often been bypassed, or have been of little productive value. Part of the problem, in all three countries, stems from the conflicting goals of the programmes, specifically, whether they are anti-poverty programmes or programmes to improve the functioning of the labour market. Anti-poverty programmes, which typically provide a benefit that is below the minimum wage, are successful in helping the poorest segments of the population but often face problems with programme delivery and implementation of the "active" components, i.e. helping people to carry out a productive activity while providing them with an income.

V

Policies for employment and decent work

We propose a set of economic and social policies to tackle the employment challenges of Argentina, Brazil and Mexico. The policies demand a more proactive stance from the governments, which should intervene more forcefully in economic affairs than in the 1990s, as well as a proactive and constructive role for trade unions, employers' organizations and civil society. The broad lines for a more balanced policy agenda to create decent work are the following:

1. Pursue employment targeting

If macroeconomic policy were driven by employment targets, then making employment the centre of economic policies would be an explicit policy goal. Employment targeting would be subject to an inflation constraint to ensure responsible policymaking, but by making employment creation the goal, the livelihoods of workers and society would be improved. Targets could be set depending on the specific needs of the country. Thus, it could be an unemployment rate target, an employment rate target—perhaps more appropriate because it encourages labour-force participation—or a target that considers formal employment rates or female employment rates.[6]

Achieving an employment target would require that central banks expand their policy tools beyond the short-term interest rate. Depending on the mechanism that the central bank believes is the most effective way to generate employment, the portfolio of tools used would vary. For example, if ensuring a stable and competitive exchange rate was believed to be the best way to increase employment, then the central banks would need to be willing to control the money supply through the use of credit-allocation mechanisms such as quantitative credit controls, interest-rate ceilings and reserve requirements on bank deposits. The central bank could also take a more direct approach with credit allocation by setting quotas that banks and other financial institutions would have to achieve in lending for employment generation. Alternatively, the central bank could impose lower reserve requirements on loans for activities that would generate employment. Even more directly, the central bank could lend to a development bank that specializes in loans for employment-generating activities (Epstein, 2005). These policy tools could then be complemented with other government macroeconomic policies, in particular, ensuring that fiscal policy is counter-cyclical.

[6] For example, the Federal Reserve Bank of the United States, which has a mandate of ensuring price stability and full employment, sets interim targets of 4% unemployment and 3% inflation. In the past, many central banks had growth and employment creation as explicit goals (See Epstein, 2007). Although not a macroeconomic target, the European Union, in its European Employment Strategy, has set the following targets for 2010: a 70% overall employment rate and a 60% female employment rate.

Developing a fiscal policy that is counter-cyclical requires policy initiatives such as restructuring debt so that it does not aggravate pro-cyclicality, as well as developing stabilization funds to smooth public spending across the economic cycle. Other possible options include indexing debt repayment to the growth of GDP or restructuring debt so that it is valued in national currency, but set at a fixed rate indexed to inflation. Stabilization funds have been established in the region, such as the structural fiscal rule applied in Chile, as well as the oil revenue fund in Mexico. The funds could be used to finance labour-market policies that would protect vulnerable groups during crises as well as improve economic performance, since the benefits they provide help to prop up consumption. Developing stabilization funds to smooth public spending across the economic cycle can also be instrumental in lessening volatility and improving macroeconomic performance.

2. Promote an export specialization in higher-value-added goods

While Argentina, Brazil and Mexico profit from increased world demand for the primary and low-processed goods that they produce, in the long term such a trade pattern has to be supplemented by the development of higher-value-added goods with a greater employment content. Though there have been some successes in producing higher-value-added goods, for example, in the automobile and aircraft industries, these countries have the potential to enhance their specialization, particularly of those products in which backward and forward linkages with domestic producers can be developed to create a multiplier effect on production and employment. An active industrial policy that facilitates the integration of domestic firms into the world market can help to improve the countries' specialization. The government, in consultation with social partners, can play a beneficial role by supporting the creation of local research and development centres, education and training programs, as well as improving physical infrastructure (such as transport and communication) through public investment. In addition, firm clustering and third-generation maquiladoras should be further supported. Clusters such as the software industry in Blumenau, aeronautics in São Paolo and the agricultural mango-grape cluster in Petrolina (all in Brazil) and electronics in Jalisco (in Mexico) have succeeded in value-chain upgrading as well as in building backward and forward linkages in their regional area. These clusters are a successful, albeit limited, industrial development experience from which much can be learned. With regard to the maquiladora sector in Mexico, the development of promising third-generation maquilas could be facilitated by public support; in particular, efforts could be made to link these maquilas with other sectors of the economy, through the promotion of joint ventures or strategic alliances with domestic suppliers.

3. Encourage productive investment

Foreign investment is an important source of financing for complementing scarce resources as well as for facilitating technology transfer and integration into the world market. However, not all foreign investment is helpful for economic and social progress; governments should therefore have a more proactive stance to influence inflows of "good" foreign investment. Governments can create rules or provide incentives to discourage speculative, rent-seeking investment and encourage foreign investors to work with domestic firms, both large and small, to promote value-chain upgrading and to invest in human-capital development. Additionally, governments should try to stimulate domestic investment through measures that increase the liquidity of the domestic financial market as well as through specific support for micro and small and medium-sized enterprises, as these firms are important employers in all three countries. Greater domestic investment will strengthen internal demand with important concomitant employment effects. Moreover, striking a more even balance between foreign and domestic investment —as envisaged by Argentina and Brazil— would reduce external vulnerability and thus improve the business climate and the macroeconomic environment.

4. Promote efficiency in labour-market institutions and expand the use of labour-market policies

Since 1990, all three countries have seen an increase in the proportion of non-protected workers in waged employment, a problem that is particularly widespread among micro and small firms. The countries should improve labour inspection as this is a highly effective tool for regularizing work conditions. In Argentina, Brazil and Mexico, there are too few labour inspectors and, as a result, enforcement is weak. Another issue concerns the development of regulations and policies that give firms the flexibility they need to compete

in the global economy, without jeopardizing workers' security. For example, it seems better for labour-market functioning to finance income replacement in the event of job loss via an unemployment insurance fund financed by employers, workers and the State, rather than relying only on individual, firm-based severance pay systems, which place a large financial burden on firms exactly at the moment when they are suffering from recession and lack of liquidity.

Labour-market policies, both passive and active, are important for helping individual workers cope with economic shocks as they improve labour-market integration, as well as providing income support to displaced workers in need. Although Argentina, Brazil and Mexico have begun to recognize the benefits of labour-market policies, the level of spending and coverage of these policies remains limited, with Brazil and Mexico dedicating less than 1% of GDP to labour-market policies, and Argentina spending just 1%. The countries would therefore benefit by discussing with the social partners how to expand their labour-market policies to make them a permanent tool that has the flexibility to respond to the countries' needs. In particular, the countries would benefit from adopting (Mexico) or expanding (particularly Argentina, but also Brazil) unemployment insurance and by developing a greater and more permanent portfolio of active labour-market policies to facilitate the labour-market integration of both informal- and formal-sector workers.

Labour-market policies should not be considered a short-term solution in response to the latest crisis, but should be a permanent feature of economic policy, as business-cycle fluctuations and partial-adjustment shocks are recurrent. In a framework of flexibility and security for the labour market, the right sequencing of policies might help to improve labour-market functioning. Especially in the low-trust environment created by a decade of failed reforms, where each attempt to touch upon vested worker's rights is seen as an attack on their livelihood, it might be advisable to first introduce the security component (such as an unemployment benefit system coordinated with active labour-market policies) before reforming those elements of employment protection that possibly impede adjustment to structural change.

VI
Conclusion

Though there are many different policy variables that affect employment creation, we believe that it is the combination of policies at the macro, meso and micro level that can facilitate the creation of decent work.[7] However, the successful implementation of these policies requires a more proactive role of the main stakeholders in society: government at all levels, employers' and workers' organizations and civil society. As both employers and workers must confront the challenges of globalization, it is important that their views are represented. Previously, governments formed corporatist alliances with social partners, but with the dismantling of import-substitution industrialization, workers' and employers' organizations have become more autonomous. This independence requires coordination among government and social partners through continuous dialogue (beyond bargaining rounds), as well as greater responsibility from all parties to shape economic and social issues. Policy formulation would also benefit from including new social actors representing informal workers and the unemployed, particularly concerning the development of labour-market policies as well as policies aimed at formalizing informal workers. However, for social dialogue to be sustained and effective, it must be institutionalized through, for example, social and economic councils and obligatory consultation with social partners.

These recommendations do not imply a return to State planning of economic activity, but rather the creation and strengthening of institutions to frame market forces and repair market failures,

[7] In this regard, the newly reassessed Global Employment Agenda (GEA) of the International Labour Organization (ILO) is a helpful strategic tool for enhancing employment growth. It proposes a comprehensive employment strategy that includes, in addition to the points above, enterprise creation and skills policies (ILO 2006).

while attempting to prevent policy failures. Making employment central to economic and social policies implies a direct route to more jobs, instead of detours via an exclusive focus on macroeconomic stabilization and economic opening with its uncertain effects on employment.

(Original: English)

Bibliography

Agosin, M. and R. Mayer (2000): *Foreign Investment in Developing Countries: Does It Crowd in Domestic Investment?*, Discussion Paper, No. 146, UNCTAD/OSG/DP/146, Geneva, United Nations Conference on Trade and Development (UNCTAD).

Berg, J., Ch. Ernst and P. Auer (2006): *Meeting the Employment Challenge: Argentina, Brazil, And Mexico in the Global Economy*, Boulder, Lynne Rienner Publishers.

Cortés, R. and A. Marshall (1999): Estrategia económica, instituciones y negociación política en la reforma social de los '90, *Desarrollo económico*, vol. 39, No. 154, Buenos Aires, Institute of Economic and Social Development, July-September.

De la Garza, E. (2002): La flexibilidad del trabajo en México (una nueva síntesis), in B. García Guzmán (ed.), *Población y sociedad al inicio del siglo XXI*, Mexico City, El Colegio de México.

DIEESE (Inter-Union Department of Statistics and Socioeconomic Research) (2003): *Seguro desemprego e abono salarial annual: algumas considerações sobre os programas de garantia de renda no Brasil*, São Paulo.

Dussel Peters, E. (2003): Ser maquila o no ser maquila, ¿es ésa la pregunta?, *Comercio exterior*, vol. 53, No. 4, Mexico City, Banco Nacional de Comercio Exterior (BANCOMEXT), April.

Epstein, G. (2005): Alternatives to Inflation Targeting Monetary Policy for Stable and Egalitarian Growth: A Brief Research Summary, document presented at the WIDER Jubilee Conference (Helsinki, 17-18 June 2005).

________ (2007): *Central Banks, Inflation Targeting and Employment Creation*, Economic and Labour Market Analysis Papers, Geneva, International Labour Organization (ILO), 2007/2.

Herrera, F. and J. Melgoza (2003): Evolución reciente de la afiliación sindical y la regulación laboral, in E. de la Garza Toledo and C. Salas (eds.), *La situación del trabajo en México*, Mexico City, Editorial Plaza y Valdés.

ILO (International Labour Organization) (2006): *Employment Strategies for Decent Work: Concepts, Approaches and Tools for Implementing the Global Emplyment Agenda*, Governing Body Document, GB.295/ESP/1, Geneva.

INEGI (National Institute of Statistics, Geography and Information) (2002): *Encuesta Nacional del Empleo*, Aguascalientes.

IPEA (Institute of Applied Economic Research) (2003): Anexo estatístico, *Mercado de trabalho - Conjuntura e análise*, No. 22, Rio de Janeiro.

Islam, I. (2003): *Avoiding the Stabilization Trap: Towards a Macroeconomic Policy Framework for Growth, Employment and Poverty Reduction*, Employment Paper, No. 53, Geneva, International Labour Organization.

Marshall, A. (2004): *Labour Market Policies and Regulations in Argentina, Brazil and Mexico: Programmes and Impact*, Employment Strategy Papers, No. 2004/13, Geneva, International Labour Organization (ILO).

Samaniego, N. (2002): Las políticas del mercado de trabajo en México y su evaluación, *Macroeconomía del desarrollo* series, No. 18, LC/L.1834-P, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC). United Nations publication, Sales No. S.02.II.G.140.

UNCTAD (United Nations Conference on Trade and Development) (2000): *World Investment Report: Cross-border Mergers and Acquisitions and Development*, UNCTAD/WIR/2000, Geneva, United Nations. United Nations publication, Sales No. E.00. II.D.20.

UNIDO (United Nations Industrial Development Organization) (2006): *Industrial Statistics Database at the 4-digit Level of ISIC (Revision 3)*, INDSTAT4 Rev.3, Vienna, United Nations.

Weeks, J. (2000): *Exports, Foreign Investment and Growth in Latin America*, Working Paper Series, No. 117, London, Department of Economics, School of Oriental and African Studies, July.

World Bank (2000): World Business Environment Survey. Available in http://info.worldbank.org/governance/wbes/front.htm.