



# **Regulation, Worker Protection and Active Labour-Market Policies in Latin America**

Jürgen Weller  
Editor



UNITED NATIONS



MINISTRY OF FOREIGN  
AFFAIRS OF DENMARK



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## Foreword

Job creation continues to be a priority in economic policy because the wellbeing of families depends on the quantity and quality of jobs available. **In 2004-2008, Latin America recorded its highest economic growth in 40 years, which has had a positive impact on job creation, in contrast to the minimal improvements in both job numbers and quality posted during periods of slow economic growth. Economic growth is not, however, the only factor that shapes these two aspects of employment.**

The three pillars of the institutional framework for labour, namely, the regulations governing individual and collective employment relations, unemployment protection and active labour-market policies, also play a key role inasmuch as they affect the dynamics and characteristics of labour supply, the quantity and quality of the jobs created, the efficiency of job-placement and contracting processes, and the conditions and prospects of the unemployed.

The debate about labour institutions, in both academic and political circles, revolves not around their importance, which is not in doubt, but about how to optimize their design, and two main positions in this regard have emerged. **On the one hand, there are** those who maintain that the institutional framework should be based solely on market mechanisms as the use of other instruments distorts the workings of the labour market and diminishes its efficiency and hence its performance in terms of equity. **On the other hand, there are** those who claim that for the labour market to operate fairly and in a sustainable manner, mechanisms need to be set up to protect workers against the structural inequalities that exist between the stakeholders.

The discussion has become more heated as the forces of globalization exert increasing pressure on countries' systemic competitiveness, forcing them to make adjustments to their labour institutions. Several questions have been raised, including: whether the regulations on individual and collective employment relations enable companies to respond and adapt adequately to changes in the market; whether they promote long-term growth and competitiveness strategies and whether they favour a fair distribution of the results of economic growth and generate individual career development opportunities in the labour market. **Policymakers also need to ask** whether the mechanisms to protect workers against job losses are fair and effectively promote reinsertion into the labour market. **Active** labour-market policies need to be examined to determine if they help people who have particular problems finding a job become more employable. **Finally, thought needs to be given to whether the three** pillars of the institutional framework for labour today foster a steady increase in productivity and contribute to the smooth functioning of the labour market.

In the last few decades, efforts have been made to improve labour institutions in Latin America. The various reforms carried out reflect the different views held on the topic. **In some cases, measures have** aimed to increase the efficiency of labour institutions and stressed the importance of establishing more flexible labour markets. Other measures have been geared towards consolidating workers' rights and protecting the more vulnerable sectors. **Various instruments have** also been combined to improve the efficiency and the equity of labour institutions at the same time.

Despite the progress made in some areas, the strengthening of labour institutions has not been properly integrated into a long-term development strategy or as part of a sustainable development project driven by the increasing incorporation of innovation and more highly skilled human resources.

The debate on how to improve labour institutions is hampered by two flawed and interrelated visions: **one is a short-term approach** that focuses on immediate gains, such as those obtained from reducing labour costs, without considering the advantages of having a skilled workforce and labour relations that make it possible to steadily improve productivity as part of a competitive strategy for ensuring the country's sustainable development over the long term; and the other is a zero-sum approach, in which labour relations are primarily conflictive and the potential benefits of cooperation between labour and employers are ignored.

It is in this context that the concept of flexicurity is analysed. The flexicurity model, which was first adopted in several European countries, spearheaded by Denmark, combines flexible labour markets with high levels of unemployment protection and active labour-market policies that ensure efficient reinsertion into the labour market and favourable conditions for workers. **Moreover, flexicurity** is implemented in tandem with an economic growth strategy that relies on the workforce becoming increasingly skilled. The model consequently has a large lifelong training component.

Obviously, it will not be possible to adopt flexicurity in exactly the same way in Latin America as it was implemented in the European Union, where it has become the main axis of labour policy; however, the lessons learned by the European countries could prove useful to the region. These include the need to adapt labour institutions to a more dynamic and volatile socio-economic context, the importance of negotiating reforms so that the institutions are sustainable over time, and the advantages of having an overall vision of how the different components of the institutional framework for labour fit in with the country's long-term development strategy.

The socio-labour situation varies considerably across the region, and each country's reality, as well as the idiosyncrasies of its processes for social and political dialogue, need to be carefully analysed when identifying priorities and policy instruments or specifying objectives for strategies to improve labour institutions.

This book is intended to contribute to this process. **It summarizes** the main outcomes of the project entitled "Labour Markets, Workers' Protection and Lifelong Learning of the Labour Force in a Global Economy: Latin American and Caribbean Experiences and Perspectives" undertaken by ECLAC with cooperation from the Government of Denmark.

In the first chapter, Jürgen Weller summarizes the recent changes in the three pillars of the labour institutions of Latin America and analyses the challenges that improving those institutions entails. In the following chapter, Henning Jørgensen explains the features of the Danish flexicurity model and analyses its relevance for Latin America. **Subsequently, Adrián Goldin, José Paulo Chahad, Mario Velásquez, Clemente Ruiz Durán and Jorge Toyama** discuss the changes and challenges associated with flexicurity in the labour markets of Argentina, Brazil, Chile, Mexico and Peru, respectively. **In** the last chapter, Víctor Tokman examines the informality that, to a greater or lesser extent, characterizes the region's labour markets and represents one of the main structural obstacles to the implementation

of the flexicurity model in Latin America. This analysis culminates with an assessment of the options for formalizing the labour markets as a precondition for constructing more integrated and cohesive economies and societies in the region. **Our hope is that these contributions will** further the complex, but necessary, debate on this important issue.

**Alicia Bárcena**

Executive Secretary

Economic Commission for Latin America  
and the Caribbean (ECLAC)

## Chapter I

# The improvement of labour-market institutions in Latin America: progress and challenges<sup>1</sup>

*Jürgen Weller*

### A. The global economy and labour-market challenges

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

To take maximum advantage of the potential benefits, countries must try to improve their systemic competitiveness, but at the same time they need to establish efficient adjustment mechanisms and social

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<sup>1</sup> This chapter is a revised version of the text published as ECLAC (2008b), which was prepared by the author under the direction of José Luis Machinea, then Executive Secretary of ECLAC. The author wishes to thank the following for their comments: Miguel del Cid, José Paulo Chahad, Adrián Goldin, Clemente Ruiz Durán, Andrés Marinakis, Juan Carlos Obando, Víctor Tokman, Jorge Toyama and Mario Velásquez. Nevertheless, he takes full responsibility for the contents of the chapter.

security systems to protect those affected by these adjustments, in order to limit the costs inherent in a volatile environment and to distribute them as fairly as possible.

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

The changes noted above have had an enormous impact on labour markets. Factors such as technological change, which makes productive processes more flexible, the growing mobility of capital and technology, and the adoption of business strategies in response to the shifting context tend to diversify and polarize occupational patterns. Moreover, the integration of the economies of Asia and of countries of the former Soviet Union into the world market has in effect doubled the global labour force (Freeman 2005a). The labour force in Latin America and the Caribbean, in particular, faces competition both from skilled workers in highly industrialized countries and from less-skilled workers whose competitiveness is based on low wages. In this setting, workers are demanding more protection and greater opportunities for promotion and advancement. Because a great proportion of the Latin American and the Caribbean workforce is excluded from institutionalized labour relations, there is an additional demand to make labour-market institutions increasingly inclusive of this segment of the population.

The ultimate purpose of labour-market institutions is to generate high-quality employment. If the institutions are to help to do that, the socio-economic changes under way require adjustments to the three pillars of the system of labour-market institutions: labour-market regulation, unemployment protection systems, and active labour-market policies. In recent decades, many countries in Latin America and the Caribbean have undertaken reforms in these three areas. However, many of these reforms have lacked mutual coherence and consistency over time, due primarily to the lack of an underlying consensus on how the overall apparatus of labour institutions should be revamped.

Some European countries have responded to the challenge of adapting their labour-market institutions (challenges which, while similar, have to be faced in a very different socio-economic context in Latin America) by combining flexible labour regulation with solid mechanisms for protecting the unemployed, including both direct financial subsidies and active labour-market policies. This response is

based on the concept of “flexicurity”. For many reasons, experiences in other parts of the world offer little in the way of models for the changes that are needed in the Latin American and Caribbean region. Nevertheless, there are some lessons to be drawn from these experiences. They include the need to adapt labour institutions to a new, more dynamic and changeable economic and social context; the importance of negotiated adaptation to make sure that the new institutions are sustainable over time; the need for a comprehensive approach that treats the different components of these institutions as complementary; and the need to consider labour-market institutions within a long-term development strategy.

This chapter offers an introduction to the main issues in the debate. After reviewing the recent performance of the region’s labour markets, it takes a historical look at its labour institutions. The following sections analyse recent changes in the three pillars of the institutional apparatus of labour: the regulation of individual and collective labour relations, protection against and during unemployment, and active labour market policies. The main characteristics of the flexicurity approach are then examined, an approach which seeks to develop a response to the new challenges for labour. The last two sections of the chapter discuss the relevance of this approach to Latin America and the Caribbean and propose some strategic considerations for improving labour institutions in the countries of the region.

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

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

This tendency is even more pronounced in urban areas. Strong migratory flows caused the urban working-age population to grow by

4.2% a year in the first half of the 1970s; 30 years later, the rate stood at 2.4% and, according to projections, will fall to 2.1% in 2005-2010.

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

- In recent decades there has been a steep increase in the female participation rate, although it is still well below that for men.

- The fact that young men remain longer in the education system has tended to slow the increase in the male participation rate. While in many countries young women have achieved higher education levels than men, this has not slowed the female participation rate, which is lower than that for men: what has declined is the percentage of women engaged in domestic work.

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

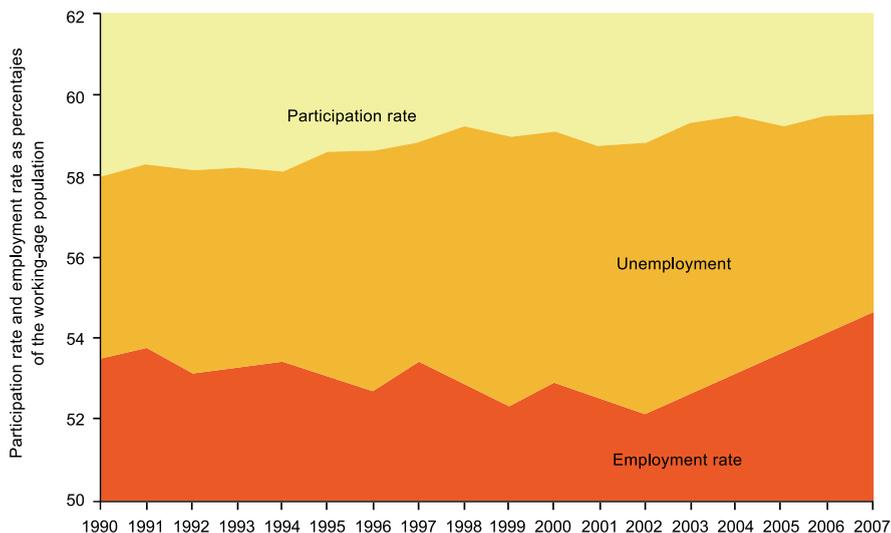
Because it was the first of these tendencies that dominated in most countries, the overall participation rate has risen, despite short-term fluctuations in the supply of labour in reaction to the macroeconomic situation.<sup>2</sup>

Notwithstanding the reduced labour supply pressures resulting from demographic trends, unemployment increased during the 1990s and the beginnings of this decade. As figure I.1 shows, job generation was insufficient to offset the increase in the labour force: as a consequence unemployment, which appears in the figure as the difference between the participation rate and the employment rate, rose throughout this period. This trend was especially marked after 1995, when successive economic crises had an extraordinary impact on unemployment, which remained at historically high levels because of the lack of sustained economic growth. The region's unemployment began to decline only in 2004, thanks primarily to an upsurge in job creation—the employment rate rose from 52.6% in 2003 to 54.7% in 2007—and by 2007 the region's jobless rate dropped to 8.0%, from a peak of 11.0% in 2002-2003 (ECLAC 2007a).

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<sup>2</sup> The labour supply response to the business cycle varies among countries: see Machinea, Kacef and Weller (2007).

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



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

The high and persistent level of open unemployment recorded after 1995 was in fact without precedent in the region, for while previous economic crises sparked a jump in unemployment, this always dropped back fairly quickly, even at times of weak economic growth, as in the 1980s. In those circumstances, open unemployment was followed by a period when jobs were more widely available in the low-productivity sector, but this process was not so apparent after 1995.<sup>3</sup>

More recently, employment trends in low-, medium- and high-productivity sectors have varied. Between 1990 and 2002, the share of employment in the medium- and high-productivity sectors increased slightly (from 58.9% to 59.6%). This increase was not generalized, however, and in 12 of 17 countries the share of these sectors declined, while that of the low-productivity sector rose (ECLAC, 2007d, pp. 133-134).<sup>4</sup> Between 2002 and 2005, the composition of employment

<sup>3</sup> The low-productivity sector is measured on the basis of household surveys, and covers employers and wage-workers in microenterprises, domestic service and self-employed workers with no professional or technical qualifications.

<sup>4</sup> Brazil was one of the countries in which the low-productivity sector's share declined, which explains much of the decline in the weighted regional average.

improved: the proportion of the medium- and high-productivity sectors increased in 8 of 15 countries, rising from 59.6% to 62.6% as a weighted regional average.

Another important factor has been heavy outward migration from the region. In addition to the long-standing emigration of Mexican, Central American and Caribbean workers to the United States, there has been a sharp increase in emigration outside the region because of severe economic crises. Partly because of differences in welfare levels between neighbouring countries, these crises have also sparked intra-regional migrations. According to ECLAC estimates, 11 countries in the region have net annual migration rates of two persons per thousand or more.<sup>5</sup>

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

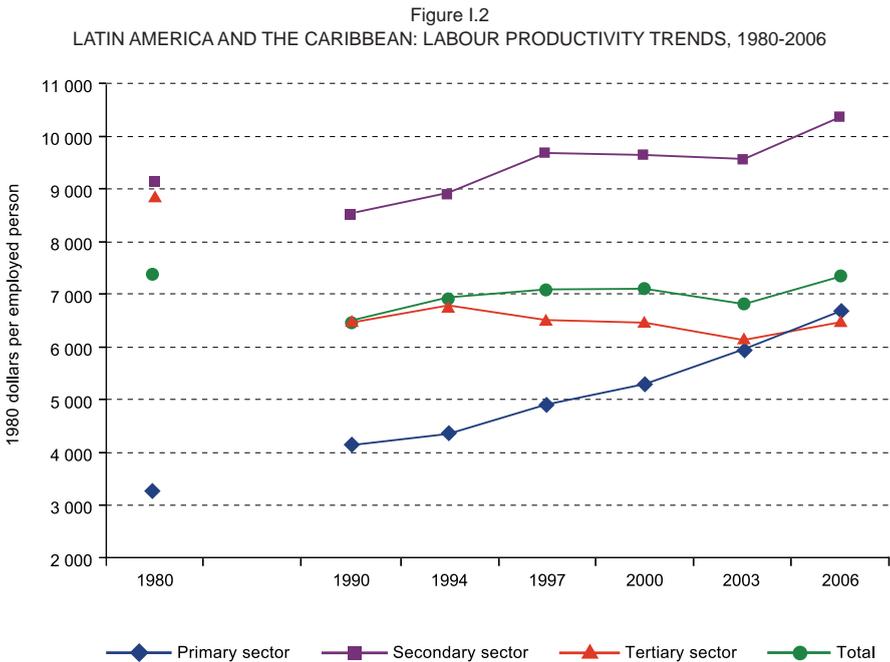
Within the region, the trend in average real wages in the formal sector has varied, depending on the method of calculation used. The index based on median annual rates of increase shows that wages rose by 30% over the period 1990-2007 (1.5% a year), more than reversing the 11% decline observed in the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

Figure I.2 shows that, after a drastic drop in average labour productivity in the 1980s, output per worker started to pick up gradually until 1997, although it did not regain its 1980 level. This pattern can be

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<sup>5</sup> Those countries are, in descending order: Guyana, Suriname, Saint Lucia, Jamaica, Guatemala, Ecuador, Nicaragua, Mexico, Trinidad and Tobago, Haiti, and Peru (ECLAC 2004a).

attributed to a significant increase in productivity in the primary and secondary sectors, in the context of freer trade. Average productivity in the tertiary sector (which is more difficult to measure) appears to have increased only in certain years, and to have retreated towards the end of the “tequila crisis”, with the expansion of the informal urban economy that characterizes many branches of the tertiary sector.



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

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

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

scant improvement of labour conditions in the region. This weakness is also reflected in the sharp drop in total factor productivity that many countries have suffered in recent decades, although some performed better in the 1990s (ECLAC, 2004c, chapter V).

Lower labour productivity translates into a high incidence of poverty among employed workers. Naturally, poverty is less prevalent among the working population than in the population as a whole, yet it is noteworthy that 27% of urban workers and 48% of rural workers earn too little to raise their per capita household incomes above the poverty line.<sup>6</sup>

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

As noted earlier, the economic momentum recorded in the region since 2004, with annual growth rates of 5.5% between 2004 and 2007, helped to boost labour performance. The following are some of the most noteworthy developments observed during this period:<sup>7</sup>

- The employment rate rose steadily, and in 2007 it was 1.5 percentage points above the average for the 1990s;
- The unemployment rate fell by three percentage points between 2003 and 2007 to stand at 8.0%, the level recorded in the early 1990s;
- Job creation was strongest in wage-paying employment, reflecting robust labour demand and a growth-employment elasticity of around 0.7 between 2004 and 2007;
- Formal employment expanded as measured both by the structure of the labour market and by enrolment in social security systems and contributions to those systems;

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<sup>6</sup> Simple average of 18 countries for urban workers and 15 countries for rural workers, based on data taken from ECLAC (2007d).

<sup>7</sup> See ECLAC (2007a, 2007c, 2007d) and Machinea, Kacef and Weller (2007).

- More unstable contractual relationships also increased;
- The impact of higher labour demand was felt primarily in job creation, while wages in the formal sector increased only slightly in most countries;
- Labour productivity improved after a period of stagnation that lasted for about 10 years from the mid-1990s;
- Poverty levels declined, thanks to renewed social policies, higher employment levels, demographic changes that reduced dependency ratios and, to a lesser degree, higher wages.

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

- foster the creation of high-quality jobs or are an obstacle to better performance;
- contribute to the systemic competitiveness of Latin American and Caribbean countries;
- promote the efficient functioning of labour markets;
- protect and strengthen the weakest players in a market with structural inequalities among participants; and
- foster the inclusion of those working in the informal and low-productivity sectors.

### **C. Labour-market institutions**

Labour-market institutions are mechanisms with differing degrees of formality that establish the rules of behaviour for participants in the labour market. Examples of such institutions include legislation governing individual and collective labour relations, active labour-market policies, unemployment protection systems, and also types of conduct that invite informal sanction. The ultimate goal of labour-market institutions is to generate high-quality employment. They should also contribute to sustainable, long-term socio-economic development and help to integrate segments of the workforce not covered by protection mechanisms. To achieve these goals, institutions must meet two objectives: they must ensure an efficiently functioning labour market,

i.e., the optimal allocation of resources, and they must guarantee protection and capacity-building for the weakest players in a market characterized by structural inequalities among participants. In this way, properly designed labour institutions stimulate economic growth, competitiveness, employment, and social cohesion.

Betcherman, Luinstra and Ogawa (2001) note that three types of mechanisms are involved in regulating the labour market: market-based,<sup>8</sup> statutory and collective voice. Table I.1 offers an overview of the possible advantages and risk of these three mechanisms.

Table I.1  
POTENTIAL STRENGTHS AND RISKS OF MARKET-BASED, STATUTORY,  
AND COLLECTIVE VOICE REGULATION

Type of regulation	Potential strengths	Potential risks
Market-based	Flexibility Efficient allocation Low transaction costs	Market failures "Short-termism" Discrimination
Statutory	Predictability Can address equity concerns Provides monitoring mechanisms	Rigidity Monitoring costs Moral hazard
Collective voice	Can promote long-term investments Provides self-monitoring	Time-consuming Insider-outsider differences

Source: G. Betcherman, A. Luinstra and Makoto Ogawa, "Labor market regulation: international experience in promoting employment and social protection", *Social Protection Discussion Paper Series*, N° 128, Washington, D.C., World Bank, 2001, page 9.

When these objectives come into conflict, it is up to labour policy to find the appropriate balance between the available mechanisms and instruments. Designing labour institutions is not a zero-sum game, however, and the challenge is to identify possible ways to fulfil simultaneously a variety of objectives. One possible option is provided by instruments for increasing labour productivity, which improve economic competitiveness while also increasing the potential to improve employment conditions. There is no single best way to strike those balances and the response will always depend on the temporal and spatial context. On one hand, shifting conditions in other markets may spark modifications in labour-market institutions. On the other hand, labour institutions are the result of historic processes specific to each country. This means that, while a given institutional arrangement

<sup>8</sup> It may be argued that, insofar as it is a "social institution", by definition, the labour market is never governed by neutral market mechanisms, but is always influenced by power relations and ethical aspects, among other factors (Standing, 1999). The differentiation between types of labour-market regulation is conceptually relevant, however.

may be broadly accepted in one country because of its social history, and may contribute to achieving objectives there, in another society that same arrangement may be controversial and its implementation may upset the functioning of other institutions.

In the context of Latin America's "inward-oriented" development, the labour institutions created were similar to those in more industrialized countries.<sup>9</sup> The intent was to establish a comprehensive framework that would take account of the sharp increase in wage employment in the industrial and tertiary sectors and respond to the demands of emerging social sectors. As happened in more developed nations, Latin American and Caribbean countries created institutions to regulate labour relationships, both directly through the State and through collective bargaining. Yet there are a number of features that distinguish Latin American experience from that in industrialized countries:

- The coverage of labour institutions was confined to a much smaller sector of the labour force;

- Within the sector with formal coverage, there was less observance of existing rules;

- In many countries, relations between the principal socioeconomic agents (public sector, employers, unions) were determined by a populist State that proposed a social covenant under its leadership. In this context, the unions came to depend heavily on certain political forces or the State, favouring political over labour negotiations, and statutory regulation over arrangements negotiated between employers and unions;

- In some cases, social and political instability sparked a cycle in which, at some point, integrative institutions were replaced by authoritarian regulations that dismantled or undermined union organization, after which those institutions were re-established;

- In countries with a weak productive base and exclusionary social and political systems, the predominant form of collective labour relations was authoritarian and repressive, while individual labour relations were frequently geared to protection of workers, even though the coverage of labour institutions was narrower than in more developed countries.

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<sup>9</sup> The two principal regulatory mechanisms in the industrialized countries were labour and social legislation, and collective bargaining. In the context of a broad national covenant, whether tacit or explicit, between firms, workers and the State, these regulations improved working conditions (with higher real wages, shorter working hours, insurance against unemployment, sickness and disability, and regulation of workplace safety and hygiene, among other improvements), and they contributed to increasing labour productivity (through training and organization of work).

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

In economies that were much more closed than those of highly industrialized countries, some elements of Latin American economic regulation had an adverse impact on economic efficiency.<sup>10</sup> Yet during the 1970s and much of the 1980s, most analysts were convinced that Latin American labour markets were functioning reasonably well (Squire, 1981; Gregory, 1986).

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

- market opening increased the competitive pressure on national economies and on firms, obliging them to make better use of the factors of production and to strive for steadily rising productivity; and

- recent technological progress has allowed production processes to adapt more rapidly, and has forced firms to make greater adjustments to shifting patterns of demand. Elements such as quality, innovation, diversity and creativity have gained importance in comparison with the standardized, large-scale production lines that characterized the Taylorist system.<sup>11</sup>

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<sup>10</sup> For example, wage increases and high earnings expectations tended to be passed on in the form of higher prices.

<sup>11</sup> Because technological change is less generalized in Latin America and the Caribbean than in the more industrialized countries, these factors are less widespread in the region. In any case, they are becoming more important as Latin America and the Caribbean countries attempt to bolster their productive structure through technological change, innovations, and upgrading of the labour force.

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

In this setting of more volatile markets, workers tend to demand more stability and protection. The traditional response of labour legislation to these demands has been to discourage layoffs through a system of compensation for dismissal “without just cause”, in an effort to avoid high turnover rates. In the current context, where economic volatility in itself tends to reduce employment stability, the focus should be on another kind of stability, relating in particular to incomes (ILO 2004a). It must also be recalled that (to differing degrees among countries) a high proportion of the workforce is not covered by labour institutions, a fact which, in structural terms, tends to weaken social cohesion. Consequently, further attention needs to be paid to two instruments: systems for protecting the unemployed and active labour-market policies that will help the unemployed rejoin the labour market promptly and improve the employability of those excluded from labour institutions.

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

## D. Labour-market regulation

The profound crisis that marked the 1980s, and caused it to be known as “the lost decade”, had severe repercussions (de facto more than de jure) on labour-market regulation. As the informal economy spread, the scope for enforcing formal regulations shrank even further and, in many cases, rising inflation inevitably caused real wages to fall since labour unions were severely weakened and minimum wage policies were subordinated to anti-inflation strategies.

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

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

Consequently, during the 1980s only a few countries —Chile in particular, and Panama to a lesser extent— took any significant steps to make labour relations more flexible. In other countries, for example Argentina, Brazil and Uruguay, priority was given to re-establishing collective labour rights, which had been suppressed by military dictatorships, and to expanding individual labour rights. Brazil took the lead in this regard, through a constitutional reform (Chahad, 2009).

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

flexibility-oriented reforms included the de-indexing of wages, more flexible working hours, and a reduction in non-wage labour costs.

Detailed ILO studies (Vega Ruiz, 2005) have found that the deepest reforms following 1990 took place in Argentina and Peru. Brazil, Colombia, Ecuador and Panama also introduced changes to key labour institutions, while efforts to achieve greater flexibility were of lesser scope in the Bolivarian Republic of Venezuela, Chile, the Dominican Republic, Guatemala and Nicaragua. Other countries, including Mexico, made no significant changes to their labour legislation (Ruiz Durán, 2009).

Notably, these legal changes did not represent a general move towards greater flexibility, either at the regional level or within the model adopted by individual countries. A number of countries extended vacation periods and adopted laws to improve protection for specific groups. For example, measures were taken to protect working mothers and to eradicate the worst forms of child labour. In addition, legal changes made during the first half of the 1990s helped to strengthen labour unions in Brazil, Chile, Colombia and Costa Rica, while these were weakened in Argentina and Peru. In Chile, some of the deregulation measures from the 1980s were reversed.

In the present decade, Chile and Peru, among other countries, have introduced new, “atypical” labour contracts. Chile, for example, developed contracts covering part-time work, the promotion of youth employment, and teleworking (Ministry of Labour and Social Welfare, 2003), while Peru designed new, atypical contracts to encourage youth employment, especially in conjunction with various training instruments (Toyama, 2009).<sup>12</sup> In a switch from the prevailing trend of the 1990s, other countries restricted the use of atypical contracts. Following the Spanish model, in the late 1990s, Argentina replaced the strategy of making contractual relationships more flexible via atypical contracts, nullifying some of those arrangements through amendments to standard contracts (Tokman 2007a).

Since 2000, generally speaking, there have been no further wide-ranging reforms for greater flexibility, and such measures as have been adopted have focused on small businesses and micro-enterprise, or on specific sectors, such as agricultural exports in Peru. On the other hand, some of the more recent reforms have stressed the overhaul of collective labour relations in order to bring them into line with ILO standards and to strengthen collective bargaining (Vega Ruiz, 2005). The spectrum of issues covered by collective bargaining has also

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<sup>12</sup> Nicaragua and Paraguay also saw the emergence of new types of contracts to help young people secure their first formal job (Vega Ruiz, 2005, p. 30). Peru also tried to encourage the hiring of persons aged 45 years and older.

broadened somewhat in a number of countries (Vega Ruiz, 2005, p. 13), by embracing new groups such as seasonal workers (Ministry of Labour and Social Welfare, 2003, p. 97). Broadly, these reforms have improved the conditions for union organization and in some cases have stopped or slowed the decline in unionization.

Furthermore, a number of countries have reformed labour relations to provide better protection for individual workers. For example, Chile has reduced the number of hours in the working week and increased compensation for dismissal without just cause (Ministry of Labour and Social Welfare 2003). Argentina has also increased compensation, especially for workers with little seniority (Goldin 2009). Some countries have placed restrictions on overtime, or raised overtime pay rates (Vega Ruiz 2005, p. 45). In some cases, such as Chile, Colombia and Peru, the abuses detected in personnel subcontracting has led to limits on the use of this contractual instrument (Toyama, 2009 and Puyo Posada 2007). In Argentina and the Bolivarian Republic of Venezuela, temporary measures have been taken to prevent the layoff of workers during an economic crisis.

Given the disparity between existing legislation and levels of compliance, several countries<sup>13</sup> have significantly bolstered the resources available for labour inspections. One obstacle to the proper functioning of labour institutions is the ineffectiveness of the labour tribunals, as reflected in the length of proceedings. A number of countries have introduced reforms to improve this aspect of labour institutions (Vega Ruiz, 2005, p. 25; Bensusán, 2006).<sup>14</sup>

Although it has not been the dominant trend, labour reforms in some countries have resulted from a process of social dialogue.<sup>15</sup> The most wide-ranging reforms have generally been implemented under exceptional circumstances that precluded adequate participation by the parties. This has rendered such reforms unsustainable, and they have subsequently been amended, sometimes in the opposite direction. International commitments today play an increasingly important role in the debate. Those commitments include the ILO conventions as well as proposals relating to labour legislation and its enforcement that have emerged in the course of trade negotiations, especially with the

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<sup>13</sup> Argentina, Brazil, Chile and Peru, among others; see the consulting reports.

<sup>14</sup> It has been argued that in some countries labour tribunal jurisprudence has had an important impact on the functioning of labour institutions, particularly as a result of inconsistencies between constitutional rights and legal provisions (Ermida, 2007; Toyama, 2009).

<sup>15</sup> For example, in El Salvador and the Dominican Republic tripartite pacts were negotiated (Vega Ruiz, 2005, p. 21). Other countries also undertook exercises in social dialogue, of varying thematic coverage and final scope.

United States. While the emphasis in the first free trade treaties between the United States and countries in Latin America and the Caribbean was on the enforcement of national legislation, in recent years some countries, including Colombia and Peru, have made commitments to amend their laws in order to promote the adoption of the respective treaties.

Generally speaking, the main changes have been to individual labour rights, while collective bargaining rights have been weakened for various reasons, including the following (Weller, 2000; Cardoso and Gindin, 2008):

- The productive structure has been reorganized, increasing the weight of small and medium-sized enterprises (SMEs) and making union organization more difficult (particularly in many tertiary fields), as well as increasing the role of occupations that do not fit the traditional pattern of union affiliation (professional, technical, administrative and other careers);
- Economic reforms, especially trade liberalization and privatization, weakened union bargaining power by increasing competitive pressure on highly unionized sectors;
- Technological change has reduced the tendency of large groups of workers to gravitate towards homogeneous occupations;
- The union movement has faced repression, especially under military dictatorships and during the economic crisis of the 1980s;
- Legislative changes have restricted the scope of union action;
- Some unions have lost legitimacy because of close ties to political parties, or because of non-transparent practices;
- The tendency of unions to look to the State, rather than employers, to address their demands is out of touch with the new development modality; and
- Employment in the public sector, where unionization rates were often high, has declined or been contained.

As noted above, some countries have taken steps since the 1990s to strengthen collective bargaining, but their intent was not necessarily to negotiate flexibility as a strategic component of institutional reform. In conclusion, labour regulation has undergone various changes in recent decades. First, during the 1980s and part of the 1990s, the employment structure became more informal and the coverage of formal labour institutions narrowed. This reflected not only the growth of the informal sector (comprising primarily micro-enterprises and unskilled own-account workers) but also “moonlighting”, and a growing

tendency towards “delabourization”, i.e., concealing the relationship of dependency between worker and employer by giving it the gloss of a business relationship (Morgado, 1999; Goldin 2008a). Second, during the 1990s, and even earlier in some cases, labour reforms were clearly (but not exclusively) aimed at achieving greater flexibility. While deep reforms were implemented in some countries (Argentina, Peru and Chile in the late 1970s and throughout the 1980s), in other countries the changes were much more gradual and often lacked a clear strategic direction. Third, during the present decade, efforts to make labour relations more flexible have been more modest in scope, and in some countries the main thrust has been to provide greater protection for workers in both their individual and their collective labour relations.<sup>16</sup> Countries that had introduced greater flexibility, such as Argentina, Chile<sup>17</sup> and Peru, in some cases within an “exceptional” institutional context, have recently amended those reforms and have refocused attention on certain aspects of protection.

## **E. Unemployment protection**

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

The traditional instrument for reducing the risk of unemployment has been to make employers pay compensation to workers dismissed “without just cause”, in order to discourage firings and layoffs.<sup>18</sup> Because the amount of this severance payment rises with the length of time on the job, this protection tends to be greater for older workers, although there are generally ceilings on the total amount a worker can receive.

There are large differences between countries in the amount of compensation and its ceiling, in the definition of fair and unfair dismissal, and in the prospect that a dismissed worker will find another job. While there is general agreement that bad behaviour on the part of the worker, such as absenteeism, justifies dismissal without compensation, there is less consensus regarding layoffs made to suit the firm’s needs. While some countries tolerate this rationale for dismissal (with appropriate

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<sup>16</sup> This coincided with the international debate from which there emerged a greater degree of caution with respect to radical deregulation measures (Freeman 2005b).

<sup>17</sup> Chile began this gradual process in the 1990s.

<sup>18</sup> The employer is usually also required to give advance notice of layoff, or to pay the corresponding wages in lieu of notice.

compensation), in Peru it is valid only for mass layoffs, and in some countries it is not accepted at all.<sup>19</sup>

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

Beyond severance payments as a mechanism for protecting workers from unfair dismissal, some countries have introduced other instruments (generally as a supplement to layoff compensation) to provide income support for the unemployed while they are looking for a new job. One approach is to have employers make regular deposits, defined by law, into individual worker accounts.<sup>20</sup> In the event of dismissal or (sometimes) resignation, the worker will then have built up a capital sum plus interest. In terms of compensation, these accounts have the advantage of offering greater security, since the deposits are made regularly and payout in case of unemployment does not depend on the employer's financial situation. In some cases, this instrument can lift the restriction on voluntary mobility by giving the worker access to savings regardless of the reason for the termination of the contractual relationship. A certain portion of these funds has on occasion been used for purposes other than protecting the unemployed worker, however, which undermines their original function.

Some countries have unemployment insurance systems funded by contributions from employers and (in most cases) from workers.<sup>21</sup> Sometimes the State may also contribute. Insurance of this kind provides a subsidy to the laid-off worker up to a specified maximum period of time (and sometimes after a waiting period), the amount of which depends on the contributions paid in. Generally, workers become eligible for insurance benefits only after making a certain minimum amount of contributions, and only if they are available to accept a new job.

In a few countries, for example Brazil and Ecuador, unemployment insurance coexists with individual accounts. Chile's unemployment insurance represents the most recent experience: it combines individual accounts (funded by employer and worker contributions and accessible if the worker is laid off or resigns) with an unemployment fund (*fondo solidario*) to which firms and the State contribute. The fund guarantees

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<sup>19</sup> There are other provisions that make layoffs difficult, such as the Bustos law in Chile, which prohibits dismissals until social security contributions are paid (Velásquez, 2009).

<sup>20</sup> For example, in Bolivarian Republic of Venezuela, Brazil, Colombia, Ecuador, Panama and Peru (Velásquez, 2005).

<sup>21</sup> For example, Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Ecuador and Uruguay (Velásquez, 2005).

payment of a minimum amount to laid-off workers who have exhausted all the money available in their individual accounts before the end of the statutory period (up to five months, depending on time in the job). If a worker is laid off, the severance payment will be reduced by the amount of previous employer contributions to his individual account. It should be noted that some aspects of this insurance are being reviewed, as the conditions for accessing the funds have been found to be too restrictive.

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

- In Argentina, an unemployed worker is covered by health insurance for as long as he or she receives unemployment insurance benefits or, in the case of a laid-off worker who has no unemployment insurance, for up to three months, through the social welfare system.

- In Chile, beneficiaries of the solidary component of unemployment insurance receive health insurance cover.

- In Peru, voluntary insurance is being introduced to ensure continuity in contributions to the national pension system during periods of unemployment.

Generally speaking, the unemployed have access to the universal health system or, depending on the features of a country's system, to its non-contributory component. This coverage is usually of lower quality, and does not include everyone outside the contributory health system.<sup>22</sup>

The various instruments of unemployment protection have some shortcomings in common, and others more specific ones. The main problem is that their coverage is restricted because they are closely linked to formal employment systems. In fact, some instruments are valid only for private wage earners with formal, indefinite contracts. Unemployment insurance coverage tends to be low in countries where the informal economy is large and the turnover rate is high, with a growing proportion of fixed-term contracts.<sup>23</sup> In reality, only a small proportion of workers laid off "without just cause" will receive severance payment, even though they are entitled to it.

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<sup>22</sup> See Mesa-Lego (2005) for an analysis of health systems in Latin America and the Caribbean, recent reforms, and their impact.

<sup>23</sup> In Chile, all workers with fixed-term contracts are in principle covered by unemployment insurance but, in this case, high turnover means that only a limited proportion of unemployed persons enrolled in the insurance system actually benefit from it, especially in the case of the system's solidary component. In Argentina, there is also a special regime for seasonal workers.

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

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

## **F. Active labour-market policies**

Active labour-market policies consist of interventions in the labour market designed to combat unemployment and raise workers' incomes. The main instruments are programmes for direct or indirect job creation, occupational training, employment services (mainly intermediation) and encouragement of self-employment and micro-enterprises. Beginning in the 1990s, these policies underwent significant changes in reaction to the critical labour situation in many countries. They tend to be less controversial than labour reforms, as they do not affect the interests of the main stakeholders in the labour market and can have a positive effect on the functioning of that market, for example by encouraging productivity and reducing transaction costs. Another factor to bear in mind is that these policies, whose efficiency is thrown into question by the uneven results of evaluations (Weller, 2004), must be financed from government revenues. The following is a brief analysis of the most significant changes to these policies in the region in recent times.<sup>24</sup>

### **1. Direct and indirect generation of wage employment**

Direct job creation programmes are normally launched in response to an emergency situation when there are no broadly available unemployment protection systems. This generally occurs at times of sharp contraction in labour demand, sparked by an economic crisis, natural disaster or seasonal factors. These programmes offer temporary

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<sup>24</sup> See Samaniego (2004) and Velásquez (2005), and the respective chapters in this volume and the non-abridged versions of Chahad (2009); Goldin (2008b); Ruiz-Durán (2009); Toyama (2009) and Velásquez (2009).

jobs at a rate of pay close to the minimum wage, where low pay serves as a self-selection mechanism and where the stress is on generating employment so that members of poor families can generate incomes, a possibility often confined to the head of the household. While the design and implementation of such programmes have traditionally been the responsibility of government agencies, non-governmental institutions have also been permitted to offer and execute this type of scheme in some countries since the 1990s. The activities involved are generally labour-intensive, such as cleaning, construction and maintenance of physical infrastructure. A frequent secondary objective of these programmes is to improve living conditions in areas with high poverty indices.

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

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

Yet there are doubts about the efficiency of these instruments, relating for example to possible “dead weight” effects (hiring people who would have been hired anyway) and the displacement of existing workers by persons under subsidized contact. One important element here is the close linkage between the programme and the economic cycle: in the upswing, the “dead weight” effect could prevail, while in the downswing the programme’s efficiency could be eroded by the substitution effect, or simply nullified because firms, seeing no need for further hiring with its attendant costs, will not take up the incentives.

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

## 2. Training

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

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

- Diversification of training providers, with greater reliance on private institutions. In the public sector, the functions of delivery and regulation were institutionally separated and programmes were decentralized, leading to greater participation by local entities (provinces and municipalities).
- Interest in the certification of skills, sparked by a greater variety in the range of training offered and the recognition of informal learning (Schkolnik, Araos and Machado, 2005).
- Attempts to make training more demand-oriented through greater involvement of private enterprise and, in some cases, trade unions, in identifying unmet needs.
- Diversification of target groups. On the one hand, there was a move from one-time training to continuous training for personnel who were of strategic importance for the firm's competitiveness. On the other hand, training programmes were developed to encourage

reintegration of the unemployed and special schemes were designed for groups with specific employability problems (youth and women with low education levels) or those working in low-productivity, low-income activities (specific occupations, own-account workers, micro-entrepreneurs).

- New instruments for the public funding of training, in particular tax incentives.

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

- Training systems are not conceived as part of a long-term development strategy focused on continuous improvements in systemic competitiveness. If they were, they would serve a key function in raising labour productivity.

- The coverage of training systems is generally limited, both in terms of training for first-time jobseekers and in terms of ongoing training or retraining for economically active persons.

- Evaluations of the impact of training on labour-market integration reveal mixed results.

- Many firms face problems in finding suitable personnel, particularly more skilled persons.

- It is common to see persons who are underemployed in terms of their education and skills. This exerts downward pressure on the labour supply.

- In several countries, training expenditure has declined or programme coverage has retreated, reflecting management difficulties and problems in matching supply and demand.<sup>25</sup>

- A contributing factor here may be that, while the importance of demand-driven training is recognized, it is not always easy to determine the exact nature of future demand and to adjust training curricula accordingly. There is seldom any capacity for prospective analysis in this respect.

- The use of incentives is often unequal: they tend to be used more by large firms than by small ones, and their benefits flow to higher-ranking or administrative personnel rather than to production workers.

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<sup>25</sup> See, for example, Chahad (2009), Toyama (2009) and Velásquez (2009).

### **3. Employment services**

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

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

Employment services are only one of many instruments available for matching labour supply and demand. Another instrument is the individual job search through direct inquiries, newspaper advertisements and, increasingly, the Internet. Despite the progress described, which has certainly made employment services more efficient, a great proportion of job placements are still arranged through personal contact and recommendations, and this tends to undermine the efficiency of matching and to reinforce segmentation in the labour market. This is because workers with more highly developed networks of contacts (social capital) have an advantage, implying a bias in favour of persons from middle- and upper-income households. Consequently, those most likely to turn to employment services are people with special employability problems, whether because of their low qualification levels, their inexperience, or their lack of social capital: this poses a special challenge to the services and makes it more difficult to measure and evaluate results.

### **4. Support for self-employment and micro-enterprise**

Given the failures of labour demand and the consequent weak generation of wage employment, many countries have taken steps to encourage people to work independently, either as own-account workers or as micro-entrepreneurs. Those measures are designed to

help create new businesses, but they also support existing ones, with a view to enhancing their productivity and output by increasing wages and generating new positions.

To this end, programmes have been established with training and financing as their chief components, along with technical assistance and support for networking. Another policy is to facilitate or reduce the cost of registering microenterprises, to encourage them to formalize their status.

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

Wherever in the world they are created, micro-enterprise start-ups often fail. This poses a special problem for programmes designed to encourage such initiatives. When it comes to nurturing existing small businesses and micro-enterprises, more information is available for assessing their viability and new plans. On the other hand, new initiatives for independent work are unlikely to offer large-scale production alternatives at times when few wage jobs are being created, for an adverse economic setting not only affects labour demand as a whole but also diminishes business opportunities for new initiatives, because of low aggregate demand. Independent employment opportunities that emerge in times of low economic growth must be considered, above all, as survival jobs.

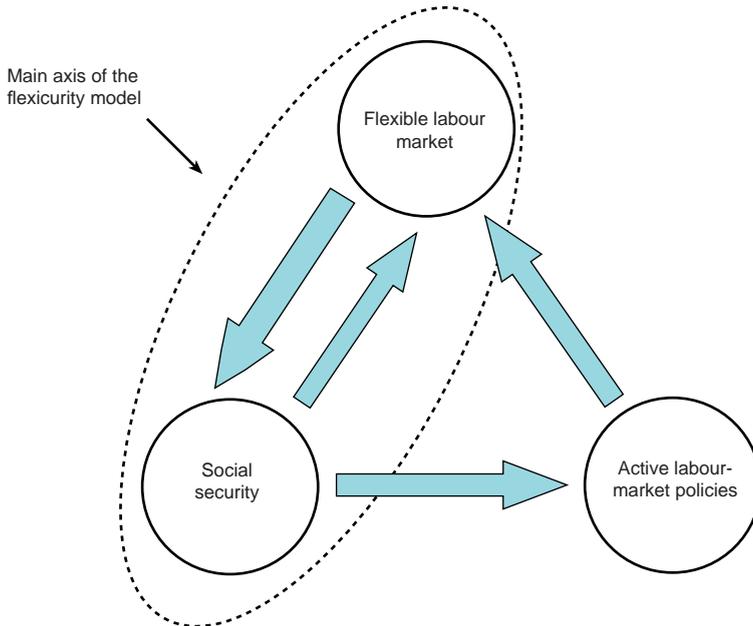
## **G. Flexicurity and lifelong learning**

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

Denmark's experience is an important point of reference for the European debate. After a lengthy historical process, the 1990s saw the establishment of a combination of policies that has been described as the "flexicurity" model. This model is characterized by a "golden triangle"

(Madsen, 2006; Jørgensen, 2009) that consists of regulations for a flexible labour market, an unemployment protection system with generous benefits, and active labour-market policies to facilitate prompt and productive reemployment of those who lose their jobs (see figure I.3).<sup>26</sup>

Figure I.3  
THE "GOLDEN TRIANGLE" OF THE FLEXICURITY MODEL



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

## 1. Flexible labour market

Flexibility in the labour market refers to the high mobility of workers, fostered by the ease with which firms can hire and fire staff, and also to the options available to these workers in a dynamic labour market. The legislation also offers ample room for collective bargaining, which is regarded as an efficient and flexible instrument of labour

<sup>26</sup> While these three components already existed, they underwent major reforms in the 1990s. The model has been further adjusted during the present decade, and there is debate today as to how far the most recent changes might affect the key elements of the model (Jørgensen, 2009).

regulation (Trade Unions Confederation/Employers' Confederation/Ministry of Employment of Denmark 2007).

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

## **2. Social security**

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

The unemployment protection system predates the introduction of flexicurity and incorporates the traditional model of the welfare state that prevailed throughout the twentieth century. In that tradition, it is regarded not only as a component of the "golden triangle" of flexicurity, but also as a key mechanism for achieving the welfare and fairness goals set by Danish society. All of this is based on the premise that society is prepared to assume the economic costs involved. This basis of protection, and Danish society's steadfast commitment to it despite the change of context, may be regarded as key elements for the social viability of flexicurity.

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

## **3. Active labour-market policies**

Passive labour-market policies, particularly unemployment insurance, are closely linked to active policies that offer various instruments of support to people unable to find a new job immediately. Among these are the intermediation system and, above all, the retraining system for workers who

have few prospects of returning to their former occupation or who lack the know-how and skills to find long-term productive employment.

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

The close connection between passive and active policies makes matching more efficient. The reason most often given for the drop in income upon entry to a new job following a layoff is that a portion of the worker's human capital is no longer useful because it was relevant specifically to the firm for which he or she previously worked. Retraining can counter this effect, if only partially, by enabling the accumulation of human capital, whether general or case-specific. This not only mitigates the income loss of the worker, but also helps to enhance the productivity of the firm hiring that person and, consequently, that of the economy as a whole.

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

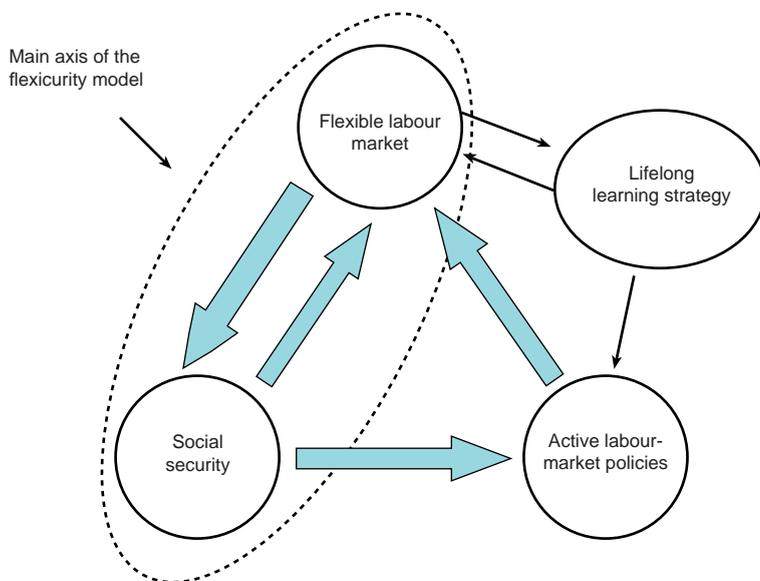
First, they are closely linked to a long-term competitiveness strategy whose main pillars are innovation and human capital accumulation.

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

In this context, the lifelong learning system constitutes a key component, beyond the education system itself and the training of children and youth (from preschool through to universities that are globally competitive). At a time when markets are undergoing continuous adjustment, it is not enough to acquire knowledge and skills that are useful only once, at the beginning of the working career. In order to achieve continuous productive integration, knowledge and skills must

be frequently upgraded and expanded. With this in mind, Denmark has opted to improve the recognition of skills acquired outside the formal education and training system; to encourage the demand for training by helping to define the skills required, above all in small and medium-sized enterprises where a mix of training in basic and specific skills is needed; to design short courses at new levels, for example at the university level; and to diversify the range of training offered through a more differentiated system of fees (Government of Denmark 2006). In this respect, the “golden triangle” is being expanded with an additional component, which is continuous upgrading of the labour force. This requires a broader vision of the training system than merely helping the unemployed to find new jobs, and makes it part of a long-term competitiveness strategy.

Figure I.4  
THE EXPANDED GOLDEN TRIANGLE



Source: Prepared by the author, on the basis of Per Kongshøj Madsen, “Flexicurity – a new perspective on labour markets and welfare states in Europe”, document presented at the seminar on flexicurity, Directorate-General for Employment of the European Commission, Brussels, 18 May 2006, and Henning Jørgensen, “Flexible labour markets, workers’ protection and ‘the security of the wings’: A Danish “flexicurity” solution to the unemployment and social problems in globalized economies?”, 2009, forthcoming.

The intent is, first, to foster productivity by having a labour force that can adapt readily to the new demands of the labour market; second, to facilitate the functional labour flexibility that firms operating in an open economy must have so that they can assign their workers to

various tasks as the productive process demands; third, to raise working incomes, which would benefit from this higher productivity; and fourth, to facilitate productive employment for persons with relatively low education levels.

The second key elements in the functioning of the labour institutions known as the “golden triangle” is social dialogue as a mechanism not only for the design and application of institutionalized flexicurity but also as an instrument for continuous adaptation and progress.

The Danish flexicurity model has its origins in a long history of social dialogue based on the recognition of differing but legitimate interests and on negotiation as the principal instrument for achieving sustainable results over the long term. Consequently, legal regulation is relatively limited and leaves considerable room for employers and unions to negotiate major aspects of how the labour market functions. This negotiation takes place at both the centralized and decentralized levels (Jørgensen, 2009).

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

Empirical findings show that the Danish model has a positive impact on various labour-market variables such as participation rates and unemployment. Denmark’s results clearly outrank the average for the OECD countries (Jørgensen, 2009). Beyond this “objective” performance, it has been noted that the Danes —like other societies with a similar institutional structure— enjoy greater employment security than exists in countries with similar protection systems but with more rigid labour regulations; or in those that have rigid labour regulations and weak protection systems; or in those that have flexible labour regulations but weak protection systems (ILO 2004b). This is due to the combination of high benefits during periods of unemployment and a rapid return to work.

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

- The model implies heavy fiscal outlays that contribute to the high tax burden. Is it feasible to reduce that burden without upsetting the system?

- Generous unemployment benefits usually pose the issue of moral hazard (disincentives to work, abuse of the protection system). How can that hazard be controlled?

- As in other economies, some specific groups such as the unskilled, young people who have not completed their studies, older people and immigrants, face greater problems in finding productive employment in the labour market. How can the system be tweaked to give these groups additional support and incentives that will enhance their employment possibilities?

- How would the model function if unionization rates declined?

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

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

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

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

In a flexicurity approach, how would the different components of labour institutions impact on their dual purpose of ensuring that the labour-market functions efficiently, on the one hand, and protecting and empowering the weakest market participants, on the other? As shown in table I.2, flexibility can make resource allocation much more efficient,

although taken to extremes it can hamper long-term growth, which requires productivity-boosting strategies to be linked to some degree of employment stability. Moreover, a large degree of flexibility in itself tends to undermine equity, by increasing job instability and hence uncertainty. The least skilled are often the most affected by greater instability, since, being easier to replace, they are usually laid off before more skilled workers. On the other hand, greater flexibility can benefit certain segments of the workforce (women and young people), whose labour-market entry is impeded by regulations that favour employment stability (the insider-outsider problem).

Table I.2  
POSSIBLE EFFICIENCY AND EQUITY IMPACTS OF THE DIFFERENT COMPONENTS OF  
LABOUR INSTITUTIONS BASED ON FLEXICURITY

Aspect of flexicurity	Efficient impacts	Equity impacts
Flexibility	++ (-)	- / (+)
Social security (unemployment)	+	++
Active labour-market policies	+	++

Source: Prepared by the author.

+ Positive impact

++ Highly positive impact

- Negative impact

In brackets: Secondary effect

Passive labour-market policies (unemployment insurance and other instruments) have a strong impact on equity by offsetting the income losses of those who usually have no other significant source of income,<sup>27</sup> but they also help to make the labour market more efficient by reducing pressure to find a new job immediately and thus facilitating a better match between supply and demand. Lastly, active labour-market policies (especially intermediation and training) can improve labour-market efficiency, although the experience as regards their effectiveness has been mixed, which poses major challenges for the design of the corresponding programmes (Auer, Efendioğlu and Leschke, 2005). This also goes for their impact on equity, which can be highly favourable.

Although labour institutions based on the flexicurity approach have the potential to improve both efficiency and equity substantially, certain characteristics of Latin American and Caribbean societies and economies are likely to frustrate any attempt to “copy” the Danish model:

- The countries of the region have an informal sector that varies in scope from one society to another but accounts for a significant proportion of the labour market. Despite recent measures, formal labour-market regulation is of very limited relevance for workers in

<sup>27</sup> In Latin America, however, only persons with continuous service of some duration in formal-sector employment have access to this type of mechanism and this does not usually apply to the poorest strata.

the informal sector, since they are not covered by protection systems or included in active labour-market policies. For these workers, the labour market is very flexible indeed, and as they have no tools to protect themselves from the harmful consequences of that flexibility, they tend not to remain unemployed for lengthy periods when they lose their job or source of income. Consequently, in this case the indicators of labour-market integration problems are underemployment, stagnating productivity, and the absence of social and labour protection, rather than unemployment. The instruments of the flexicurity model do not fit with this reality. The instruments of the flexicurity model do not fit with this reality. Yet informality is a heterogeneous and dynamic phenomenon, and there are options for formalization in each of the three components of labour institutions.

- The flexicurity model is costly in terms of public expenditure, both because of the protection component and because of labour-market policies. While the situation varies greatly, Latin American and Caribbean countries generally lack the resources to prepare programmes and policies with similar coverage and per capita outlays.<sup>28</sup>

- The design and continuous adjustment of the flexicurity model require ongoing social dialogue among the main stakeholders, who must recognize each other as legitimate interlocutors. The history of many Latin American and Caribbean countries is not only marked by conflict, but in many cases the opposing parties have viewed this conflict as not amenable to negotiated solution, which has often led to violence.<sup>29</sup> Moreover, governments have not always allowed or encouraged the various stakeholders to organize themselves and adopt independent positions. This remains true today, and it impedes the search for negotiated solutions, despite the widespread prevalence of democratic political systems.<sup>30</sup>

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<sup>28</sup> The average tax burden in Latin America is 18% of GDP, compared with 40% in the European Union (15 countries). As Berg and Salerno (2008) note, however, many countries that have broad unemployment insurance today began developing it at a time when they had per capita incomes similar to or even lower than many Latin American countries do today.

<sup>29</sup> The Global Competitiveness Report 2008-2009 (World Economic Forum, 2008), among other sources, sets out the opinions of corporate executives interviewed about labour relations in their respective countries, where 1 represents relations that are broadly confrontational and 7 denotes usually cooperative relations. Denmark headed the ranking of 134 countries with a mark of 6.2. The 17 Latin American countries covered by the survey showed an average of 4.3, but with large differences varying from 5.6 in Costa Rica to 3.1 in the Bolivarian Republic of Venezuela.

<sup>30</sup> As mentioned in section D, however, some countries have had positive experiences of social dialogue with results that have been recognized by the social stakeholders. See also Vega-Ruiz (2004).

- Models that offer a high degree of income protection and significant subsidies to support workers until they manage to rejoin the labour market often pose a moral hazard that results in the abuse of these facilities. While a proper combination of incentives, disincentives and control mechanisms can help to limit such abuse, the results will vary depending on the attitudes and values prevailing in specific societies.<sup>31</sup>

- In Latin America and the Caribbean, the short-term view tends to predominate, because the debate over reforming labour-market institutions is not part of a broader debate about long-term growth and development strategies.

- Given the heterogeneity among countries of the region, it is not surprising that the conditions for developing labour-market institutions of this kind vary greatly. Factors such as a low level of urbanization, a small percentage of wage workers, and a low degree of formalization represent structural constraints in this regard (Tokman 2007b).

As the European Commission itself has recognized, there is no single model of flexicurity nor any one road for achieving it. The countries of Latin America and the Caribbean need to find their own path to the efficient and equitable integration of the three labour institution components, adapted to their social, economic, political and cultural reality.<sup>32</sup> Those components must be regarded as mutually complementary and they must be related to non-labour policy instruments for creating a growth-friendly environment, promoting systemic competitiveness and integrating that portion of the population not covered by social and labour institutions.<sup>33</sup>

## 1. Active labour-market policies

As noted in section F, recent years have seen some promising advances in improving the effectiveness, efficiency and fairness of active labour-market policies. Yet these three criteria still show shortcomings, especially when it comes to training, which is a key component both for achieving systemic competitiveness in open markets and for giving workers opportunities for productive and stable employment and advancement.<sup>34</sup>

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<sup>31</sup> Indeed, it has been argued that for a flexicurity system to work there must be a high degree of “public-spiritedness” (Algan and Cahuc, 2006).

<sup>32</sup> The former socialist countries of Central and Eastern Europe are also seeking a combination of more flexible labour-market regulation, new protection mechanisms and more effective active labour-market policies, to suit their specific conditions (Cazes and Nesporova, 2007).

<sup>33</sup> See ECLAC (2007b), ECLAC (2008a) and Sorj and Martuccelli (2008).

<sup>34</sup> See Auer, Efendioğlu and Leschke (2005) for a review of global issues, trends and challenges relating to active labour market policies.

The strategic advantage of labour-market policies is that the coincidence of interests is greater in this area than in others. Firms and workers alike show great interest in training and in effective, efficient and fair employment services. Both parties are interested as well, although to a lesser degree, in employment creation schemes and the promotion of self-employment and micro-enterprises. This can lay the basis for bilateral alliances to promote these policies, especially in a context where most of the financing must come from government, which will be seeking a social return on the investment. The State, then, must foster debate on the role of training as part of a strategy for growth and development based on continuous improvement of systemic competitiveness. Following are some specific points that must be taken into account:

- A training system will produce better results if the education system is successful in broadening the population's general skills and knowledge. It is essential, then, to enhance the coverage, quality and equity of education in the region, and to encourage young people to stay in the education system longer.<sup>35</sup> Without these four elements, training systems are unlikely to do much to increase employment opportunities either in the short or the long term.

- Training systems need to be reviewed and adapted to the varying needs of the different segments of the productive economy and the different sectors of the labour force, i.e., new entrants to the labour market (especially youth), the unemployed and different categories of the employed.

- It would be useful to design systems of ongoing ("lifelong") training to help workers adapt to new technologies, to increase their productivity, and to enhance their employment possibilities. This will need a major effort to produce a prospective analysis of demand, involving labour-market players and academics.

- Special attention must be paid to adapting training to the needs and situation of disadvantaged groups (people with little schooling, in particular women, ethnic minorities and the disabled).

- Diversified institutional arrangements may be the answer for dealing with the great variety of demand for training and frequent changes in that demand. Yet if abuses are to be avoided, the range of training offered must be transparent and its results must be monitored, for example through recognized systems for certifying skills and knowledge.

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<sup>35</sup> See for example ECLAC/UNESCO (2004).

- Fostering small business and micro-enterprise remains a challenge that will require a combination of instruments to improve access to financing, technology, training and information as a means of simplifying the formalization process and reducing its costs. Given the limited size of the formal sector in many of the countries of the region, this is an important task for increasing social and labour inclusion.

- Employment services must pursue policies such as decentralization, the incorporation of the various players into the labour market, the creation of incentives to make intermediation more effective, technological and organizational modernization, personnel training, the integration of intermediation with the different programmes of active and passive policies, and support for the creation of individual labour strategies.

- Since direct job creation programmes are an unsatisfactory substitute for generating employment through the labour market, they should be used only in special situations (economic crisis, low seasonal demand for labour, specific local problems). Direct employment programmes and subsidies for creating new jobs must both include training components to enhance the long-term employability of beneficiaries.

- At a time when there is pressure on fiscal spending to expand and improve active labour-market policies, it is essential to improve programme evaluation practices, so that policymakers can take informed decisions on priorities in this field.

## **2. Protecting the unemployed**

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

- the focus is on income protection rather than job protection;
- a solidarity component is incorporated without raising non-wage labour costs too much;
- coverage can be steadily increased;
- moral hazard is limited;
- the system is related to active employment policies and includes a mechanism for monitoring social security coverage (particularly health and pensions).

An interesting proposal in this regard that was developed in Argentina (Goldin, 2008b) raises the possibility of transforming part of severance payment into an unemployment insurance, which would have greater coverage, would be more efficient, and would provide reasonable benefits. This would be achieved by replacing the portion of compensation that the firm would have to pay in case of a contractual rupture not attributable to either the employer or the worker by periodic contributions to an individual account. This would increase flexibility in case of layoff (although the cost of dismissal would still be higher where no “just cause” exists), without significantly raising labour costs. In addition, thought could be given to a scheme with additional contributions from workers and the State, as with Chile’s unemployment insurance, which combines individual accounts with a solidarity fund.

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

### **3. Labour-market regulation**

The regulation of individual and collective labour relations is no doubt the most complex aspect of the debate over how to redesign labour-market institutions. Many measures are seen as creating one-sided benefits or risks, and it seems to be more difficult to find solutions that are favourable to all parties, as, for example, in active labour-market policies. This situation is reflected in a lack of consensus in many areas. There is even disagreement about the diagnosis itself, since the actors on the labour market are unable to reach a common interpretation of the current situation, which is needed to serve as the point of departure for the debate on pending reforms.<sup>36</sup> Points at issue include the costs and benefits of integration into the global economy, and the characteristics of labour regulation and the functioning of the labour market. Labour flexibility is often confused with low labour costs, or it is identified with only certain aspects (such as ease of hiring and firing), but in addition

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<sup>36</sup> This disagreement is characteristic of the debate but not just in Latin America; for conflicting opinions in the global debate, see Freeman (2005b) and Berg and Kucera (2008).

to flexibility in labour costs and external numerical flexibility, internal numerical flexibility and functional flexibility must also be considered. From a broader perspective, this concept embraces not only flexibility in the labour market (flexibility of employment and wages) but also flexibility in labour input (flexibility of human capital, mechanisms for promoting productivity) (Amadeo and Camargo, 1993). This covers, specifically, the generation of opportunities for workers to advance along a career path. In short, it is a complicated matter to describe labour institutions as flexible or rigid, because there are so many variables involved,<sup>37</sup> and each side is likely to make selective use of research data, rendering dialogue difficult.

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

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

This lack of consensus on the diagnosis makes it difficult to reach agreement on how to improve labour regulation. While these discrepancies are not likely to be overcome in a short period of time, it would be as well to clarify the terms of the debate in order to address the challenges in this area. Among those challenges (with significant differences from one country to another) are the following:

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<sup>37</sup> Consequently, a country’s ranking in the classifications can change greatly, depending on the variables considered.

- Labour-market participants must recognize each other as legitimate stakeholders. Meeting this essential condition is complicated by the long history of conflict described above, which means that gradual strategies are needed to build mutual trust, in what is actually a learning process (Jørgensen, 2009). This process differs greatly among societies, because of the great variety of historic experiences.

- In many cases, unions need to strengthen their standing as valid and effective interlocutors for representing workers. To do so, they will have to set aside corporatist practices, overcome their lack of autonomy and internal democracy, and enhance their negotiating capacity by upgrading their research and analysis capabilities.

- The legal apparatus is sometimes inconsistent. For example, in some countries there are discrepancies between constitutional rights and labour legislation. This means that issues relating to the real functioning of labour institutions are removed from the political sphere, and also from collective bargaining, and are relegated to the courts, often with unpredictable consequences.

- In many countries, levels of compliance with existing standards are poor, and experience has shown that they cannot be improved merely by reducing costs and enhancing flexibility. This approach undermines the credibility of political decisions and encourages people to seek ways to evade the rules rather than make the effort to comply with them. Moreover, it is essential that regulatory compliance be objectively feasible;

- The new economic context tends to demand greater room for collective bargaining as opposed to detailed legal regulation. This is essential if labour institutions are to be efficient and fair. It is important therefore to define the levels of bargaining and the issues at stake. Yet legal regulation will remain essential for setting the “floor”, given those broad segments that lack the degree of organization and the necessary negotiating capacity.

- An integrated labour information system is an extremely important element for analysing how the labour market operates and for discussing its institutional framework. However, notwithstanding recent improvements, there is a dearth of labour-market data in many countries.

While the design of labour institutions, as has been argued throughout this paper, can only be the result of processes specific to each country, a few suggestions for specific aspects, based on experience in the region are set out below:

- Experience within and beyond the region suggests that the introduction of “atypical” contracts has done nothing to create more jobs, but that it has led to greater segmentation of the labour market. Reforms,

then, might focus on “typical” contracts, making them more flexible and combining them with better protection mechanisms (Tokman 2007a). “Atypical” contracts should be reserved for special situations, such as seasonal or part-time work, and for specific tasks or training. Moreover, care must be taken to ensure that “atypical” contracts enshrine the same rights as “standard” contracts, in the corresponding proportion.

- Because the main argument against open-ended contracts is the rigidity produced by layoff compensation systems, thought should be given to transforming a portion of the severance payment into periodic contributions to an unemployment insurance system based on individual accounts. This would not reduce financial protection against unemployment and, depending on the monthly contributions, the total non-wage labour cost might not decline, but the actual cost of laying off workers would be lower. This raises two considerations: first, the conditions governing layoffs and dismissals must not be allowed to “petrify” existing labour relations, but neither should they encourage high turnover. The positive linkage between labour stability and human capital formation and higher productivity is a key factor.<sup>38</sup> Moreover, it is frequently the case that firms do not use all the legal instruments available to them for achieving greater flexibility in their personnel management. This suggests that, from the firm’s perspective, maximum flexibility is not necessarily the best option.<sup>39</sup> Rather, it would appear that in a scenario with great and frequent changes, the ideal solution for meeting both the immediate and longer-term objectives is not obvious for many firms, which are always looking for workable solutions.<sup>40</sup> Second, there must be a clear distinction between labour costs and flexibility. If inflexibility caused by a specific regulation constitutes a bottleneck to the efficient working of the labour market, it may be advisable to amend it, even if that implies greater costs. The situation would be different if labour costs themselves constituted an obstacle;

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<sup>38</sup> Chacaltana and Garcia (2001) demonstrate this positive linkage in the case of Peru. Perry and others (2006) highlight the negative impact of labour instability on human capital formation, while Auer, Berg and Coulibali (2005) emphasize that the relationship between labour stability and productivity is positive but not linear.

<sup>39</sup> In Colombia a discrepancy has been noted between certain economists, who favour flexible labour markets, and employers, who are more cautious about this (Universidad Externado de Colombia 2003). In Mexico there is a divergence between statements by business leadership and the behaviour of firms, which do not apply all the available instruments of flexibility (de la Garza and Bouzas 1998). In any case, different entrepreneurial visions exist concerning flexible labour markets as an instrument for optimizing results. (Echeverría and others, 2004).

<sup>40</sup> For example, in the first stages of the economic downturn that marked the beginning of this decade, many US firms showed greater caution with respect to layoffs, compared to the similar situation in 1990-91, recalling the trouble they had during the subsequent recovery in recruiting back the skilled workers they let go during the crisis (*The Economist*, 2001 p. 56).

- In many countries there is debate over labour institutions as they relate to micro-enterprises and small businesses. Experience has shown that in these cases cutting labour costs is not enough to foster wholesale formalization (Chacaltana 2007). However, because these costs tend to be too high for firms of this kind, a gradual formalization strategy that would improve labour conditions in this segment could include special provisions that would lower them temporarily;

- Encouraging internal flexibility, in terms of functions, wages and working hours, is an increasingly important issue that requires a common legal framework and intense collective bargaining. While this aspect of flexibility may yield immediate productivity and wage benefits, as employment stability does, it also brings with it undeniable risks and burdens, and ongoing dialogue is therefore needed to produce the necessary adjustments;

- On the supply side, lack of flexibility may be an obstacle to labour-market entry, especially for women seeking opportunities to earn income for themselves and their family. This issue is important because, in many cases, it is precisely by sending more family members out to work that households are able to lift themselves out of poverty. At a time when cultural attitudes to the division of labour, which excludes broad segments of women from the labour market, are weakening, some restrictions persist, especially for women with preschool and school-age children. For this reason, by opening up the range of options for these women, policies whereby society assumes part of the responsibility for tasks related to reproduction can help to make the labour supply more flexible;

- A number of women would prefer joining the labour market on a part-time basis and, indeed, this is usually cited as justification for the establishment of contracts of this type. Steps must be taken, however, to ensure that these more flexible contracts do not result in labour relations based on heightened job insecurity—for example, these part-time workers must be integrated into the social security system—and that they do not operate as an instrument that increases gender segmentation; thus, this issue ties in with the broader debate on the gender-based division of labour;

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

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

There is broad consensus that, while Latin American and Caribbean countries face similar challenges, their responses cannot be the same. The strategic options available for improving labour policies, unemployment protection policies, and active labour-market policies will depend to a great extent on labour institutions that evolved over time as a result of socio-economic and political processes specific to each country; these options will also depend on the nature of the relations between the main actors in the labour market as well as on the degree of labour-market development.

In this respect, each country has to find its own way of responding successfully to the challenges posed by the global economy, in order to offer the greatest possible welfare to its people.<sup>41</sup> Labour institutions must make their contribution here: their ultimate purpose is to generate high-quality jobs by fostering labour markets that work efficiently and by protecting and supporting those who are disadvantaged by a market with structural inequalities among participants.

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

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

- Social dialogue. When reforms are imposed by certain specific stakeholders who seize upon a favourable political juncture to advance their interests, they will lack legitimacy and will usually spark pressure for counter-reforms once the political setting has shifted. This is why labour institutions in many Latin America and the Caribbean countries are in constant flux. By contrast, negotiated reforms have broader legitimacy and are likely to be more stable over time;

- International labour regulations can be a valuable reference for social dialogue, especially the fundamental rights (freedom of association

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<sup>41</sup> In order to ensure the sustainability of labour institutions, it is also important to maintain cohesion between its different components; thus, the validity of building such institutions in a given country on the basis of a series of best practices applied internationally may be questionable (Novick, 2008).

and to join a trade union and the right of collective bargaining, the elimination of forced or compulsory labour, the prohibition of child labour, the prevention of discrimination in employment and occupation). Bearing in mind their tripartite origin within the framework of deliberations in the International Labour Organization (ILO), international regulations are the outcome of social dialogue and generally there is ample opportunity to transform them through national dialogue into important and legitimate rules at the country level;

- More resources must be devoted to reorienting labour institutions. To avoid increasing labour costs, with potentially adverse fallout on labour demand, these resources will have to come from tax revenues. On various occasions,<sup>42</sup> ECLAC has proposed a fiscal and social covenant that would set out consensus-based social objectives for the long term and would contribute to their financing and their macroeconomic sustainability through responsible fiscal management;

- Gradualism. While it may seem attractive to negotiate a comprehensive package of reforms covering all areas, such an approach is unfeasible in many countries because of the mistrust that prevails among the parties. Consequently, what is needed is a confidence-building process as the basis for gradual reforms which, if successful, could pave the way for new accords;

- Incorporating labour reforms into a long-term development strategy. Such a strategy, with its corresponding objectives, would define some of the requirements for sound labour institutions and would relate them to non-labour issues (for example, education and technological innovation).

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

A significant transformation of labour institutions could spark concerns about workers' rights, especially if one component of that transformation were the elimination of regulations that are seen by workers as offering protection and by employers as causing rigidity. Merely promising that such a reform would yield benefits for workers by stimulating job creation will clearly not be enough to make such a reform feasible. It would seem essential, then, to give priority to designing or improving a system of unemployment protection. Such a system would focus not so much on preserving jobs as on protecting incomes. The features of the system would depend on the specific situation in each

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<sup>42</sup> See ECLAC (2004b).

country and on its success in promoting a social covenant for reaching consensus on the complex variables of financing, coverage, rights, obligations and supplementary services, among others.

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

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

As was argued in section C, there is no one recipe for this that is independent of space and time. What is needed is to analyse matters on a case-by-case basis and identify the obstacles that prevent labour institutions from meeting their goals in a specific situation. For that analysis, the proposal of Hausmann, Rodrik and Velasco (2005) for promoting economic growth has been adapted. This consists essentially in identifying the bottlenecks in each country that constrain more dynamic growth. This strategy stands in contrast to those that offer common recipes for all countries, and it takes account of the great diversity that exists among societies in the region, where there are different ways of combining employment protection with social protection (Tokman, 2007b, p. 51).

To identify the constraints on the generation of high quality jobs we may use the “inverted tree” shown in figure I.5.<sup>43</sup> If there is a dearth of high-quality jobs—as there is in all Latin American and Caribbean countries if we consider unemployment rates, low incomes, scant social security coverage and other factors—we should first examine

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<sup>43</sup> Weller (2007, pp. 59-64) provides some examples for identifying bottlenecks and possible solutions for overcoming them.

whether formal job creation is low, or if it is significant but low-quality jobs prevail.<sup>44</sup>

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

If economic growth is reasonably high but formal employment generation remains low, it could be that certain macroeconomic prices, such as the exchange rate, are biasing investment against the hiring of employees, or that growth is led by sectors that make little use of labour. It may also be that institutional factors cause rigidities or high labour costs to the detriment of formal employment. Moreover, there may be cases where the formal employment elasticity of economic growth is reasonably high, but the absolute number of new formal jobs created is low because of the small size of the sector.

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

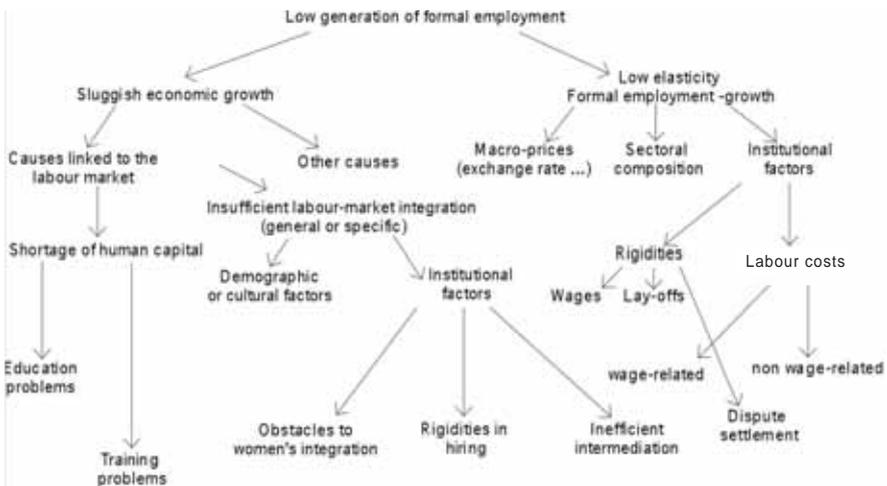
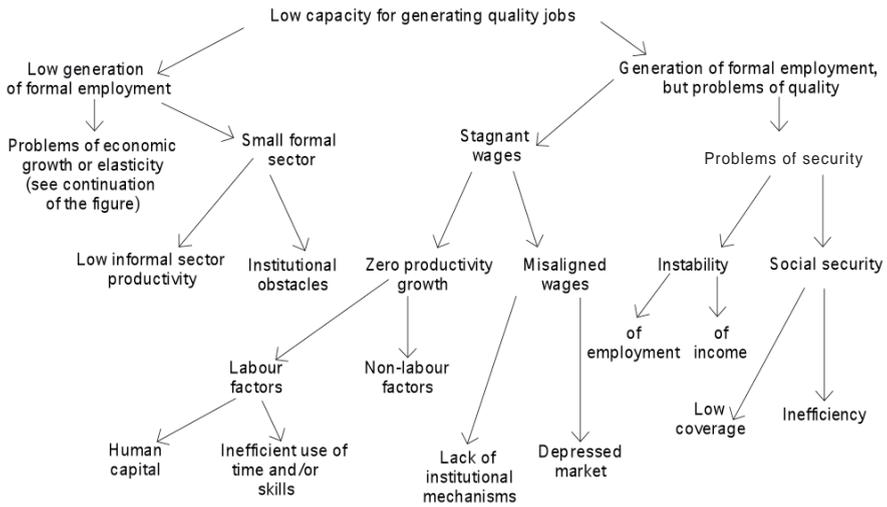
The purpose of the "inverted tree" is not to identify a single key element for resolving labour problems. Besides indicating bottlenecks, it can help differentiate between priority and secondary issues. The former represent a major constraint on quality employment generation, and eliminating them could have an important impact. Eliminating obstacles in the second category will have a lesser and sometimes doubtful impact, and will frequently carry high political costs in

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<sup>44</sup> For the sake of simplicity, we assume that good-quality jobs are concentrated in the formal sector, and so the main intermediate objective is to generate formal employment. This is not to deny that there may be good-quality jobs in the informal sector, where improving labour conditions is an important challenge, or that there may be low-quality jobs in the formal sector. The concept of the informal economy, which is broader than the sectoral perspective, partially embraces these dimensions (see Hussmanns, 2004).

relation to the expected benefit. If politically feasible, reforming these secondary features could be part of a negotiated package, where the consensus would relate to the package as a whole and not to each of its individual components.

Figure I.5  
MECHANISM FOR IDENTIFYING OBSTACLES TO THE CREATION OF QUALITY JOBS



Source: J. Weller, "La flexibilidad del mercado de trabajo en América Latina y el Caribe. Aspectos del debate, alguna evidencia y políticas", Macroeconomía del desarrollo series, No. 61 (LC/L.2848-P/E), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2007. United Nations publication, Sales, No. S.07.II.G.171.



## Chapter II

# The Danish “flexicurity” system and the relevant lessons for Latin America<sup>1</sup>

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### **A. Diverse government approaches to adaptation**

As a result of globalization, investments, capital, goods and services, and to a certain extent, labour can easily move from one country to another. This facility has increased pressure on national employment relationships, wage formation, and tax and welfare arrangements to adapt in order to promote competitiveness and efficient economic performance. New economic and social situations have bred insecurities related to modern economies and labour markets, and both governments and wage earners must respond. Employer demands for more flexible labour markets and less restrictive labour regulation are met with the hopes of more jobs, higher incomes and greater employment protection from employees. The contradictions inherent in these demands make the discussion of flexibility and security increasingly relevant. Questions on how to modernize labour markets in response to external pressures and domestic demands and how forward-facing decisions can be taken in relation to such politically sensitive issues are central to the debate.

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<sup>1</sup> For an extended version of this chapter, see Jørgensen (2009).

In most Western countries, adaptation needs have for a long time been met by lowering taxes and spending, and deregulating the economy and labour market. This formula has been implemented to different degrees depending on the country in question, but one cannot deny that these neo-liberal theories have been used in most advanced capitalist countries. The concept of “*flexicurity*” offers an alternative to this policy blueprint and is a way of combining competitiveness and social cohesion in an alternative understanding of the relationship between flexibility and security. The concept of flexicurity avoids the assumption that only flexibilization will lead to more jobs and better functioning labour markets. *An intelligent and fair balance between flexibility and security*, taking into account the different interests of social partners, will facilitate labour-market efficiency. Even the OECD has endorsed this policy (2004) and the European Union in 2007 made flexicurity an official institutional policy after many years of intense debate. International interest in flexicurity has grown enormously over the past four to five years.

The basic philosophy behind flexicurity is that flexibility and security are not mutually exclusive; on the contrary, in many situations they can be mutually supportive. New ways of orchestrating the interplay between flexibility and security have the potential to create win-win situations in cases that would otherwise be considered conflict-ridden or dangerous to competitiveness and perhaps the social order during adaptation processes. This also implies that flexibility is not to be seen as the sole concern of employers and security is not to be seen as the sole concern of employees. Modern labour markets bear witness to the interests of many employers in maintaining stable employment relationships and in keeping loyal and well-qualified employees. For their part, many employees have realized that they have an interest in flexible ways of organizing their work-life balance and adjusting their lives to more individual preferences. The public sector has an interest in balanced developments and in reaching public policy goals. Therefore, flexibility and security are multi-dimensional concepts and flexicurity has to be studied in national settings, describing and analysing the interaction between the components in each concrete system.

Denmark is considered one of the best real-world examples of flexicurity, despite the fact that Denmark is a small, open economy that is particularly vulnerable to the competitive pressures of globalization. The Danish system of flexicurity has been recognized by the European Union and other actors as a “good practice” example to learn from. In Denmark, weak job protection is combined with strong income and employment protection. Denmark has high tax rates, a comprehensive public sector, generous welfare benefits, and strong policy coordination

with corporatist traditions —clearly not in line with the internationally dominant economic orthodoxy. But the Danish capacity to reach socio-economic success as a result of the interplay between economic, political and social institutions is unquestioned now. Danish flexicurity is now highly regarded, but the flexicurity system's mechanisms and rationale are still not very well understood. The literature on flexicurity often classifies it as identical to Danish labour-market arrangements, but this is too one-dimensional. More evidence-based knowledge is needed as are comparisons and considerations of policy transfer of flexicurity elements. In this connection it is important not to fall into the trap expressed by a Chinese proverb: "The chicken in our neighbours' garden looks like a goose."

Even if there is no commonly established definition, nor the means to qualitatively or quantitatively characterize flexicurity, research and political debate concur that Denmark has a flexicurity system that works and can provide lessons for other countries. Flexibility has not been reduced in Denmark but the precariousness associated with it has diminished, and the more offensive elements of employment security and skills enlargement have contributed to Denmark's successful economic and social development. To be effective, the encouraging of flexible labour markets and ensuring of security must allow wage earners to be adaptable, to enter and re-enter into productive employment, and to further their careers. This calls for a strong public emphasis on active labour markets, lifelong learning strategies, and strong social security systems, providing people with income security and allowing them to combine work life with private care and family life. Equal opportunities for men and women should also be a trait of the flexicurity system.

This paper's working definition of flexicurity is *the institutionalized relationships between a labour-market regime and interventionist policies in relation to security for wage earners and the dynamics of the labour market*. This understanding stresses the interplay between institutions and the production of complementarities that can promote competitiveness and social cohesion at the same time. It is not a trade-off between flexibility and security as it is not a zero-sum game. Flexicurity is not a simple, one-sided political strategy, as will be documented by our analysis of the Danish system.

Denmark is performing well at the moment. We believe that other countries could learn more about Denmark's success with the flexicurity system. The question of the system's transferability to Latin American countries is to be addressed at the end of this paper. On the following pages an analysis of the Danish flexicurity system is offered.

## B. Institutional pillars of the Danish flexicurity system

Situated in the northern part of Europe with a rather cold climate, Denmark is a highly developed capitalist country with a universal welfare-state framework. For more than 35 years, the service sector—public as well as private—has been dominant in the production structure and, currently, three out of four wage earners are involved in administrative and service-based activities. For a short period of time only, from the 1950s to the start of the 1970s, the manufacturing sector employed a majority of wage earners and provided most of the country's exports. Now, the changing composition of the production structure has resulted in the mushrooming of knowledge-based activities. Small and medium-sized enterprises are characteristic of the Danish production structure. The country has a workforce of 2.8 million people out of a population of 5.6 million.

During the second part of the twentieth century, the Danish welfare-State developed into a comprehensive social security system with relatively generous economic compensation schemes and much public-sector aid. A strong tax system based on progressive scales is fundamental to the operation of the public sector. Compensation, prevention and public services are used to redistribute wealth and consequently, there are extensive public social expenses. In 2003, public sector expenditures in Denmark amounted to 28% of GDP. The universal welfare system is highly redistributive; it takes over care functions and promotes female employment. It builds on *citizenship*, giving everyone the same kind of benefits and services in accordance with politically defined welfare standards. The system is female-friendly, and has redefined the concept of family to include two breadwinners. The State also employs many women in public functions. The high taxes needed to finance this comprehensive public welfare system are generally accepted by the majority of voters as they benefit from these arrangements and because egalitarian values have been accepted by a vast majority of citizens. Almost one-third of the labour force is now employed by the State.

Full employment and economic growth have been core political goals from the very beginning of macro-economic governance, highlighted as perhaps the most important policy objectives during the 1950s and the 1960s and these are still top priorities in Denmark. The Social Democratic Party has held power during many periods; but normally there are minority government coalitions in Denmark, making compromises obligatory. Right wing governments have also supported the core policy goals. Full employment was never abandoned even during periods of acute economic crisis, particularly in the 1980s and the beginning of the 1990s. Macro-economic policies and selective

interventions, especially through active labour-market and educational policies, have been the central means of trying to reach the goal of full employment. During the 1980s and the beginning of the 1990s, there was no great success in this respect as unemployment actually rose to 12.4% in 1993. Since then, Denmark has been very successful in combating unemployment, which is now down to 1.6% (August 2008). Employment has been growing as well and there is a surplus of all basic economic indicators. The Danish employment rate is 77.4% (2006), one of the highest in Europe; and most economists and analysts would credit good governance as the cause.

Our assessment is that this is only to be understood as being promoted by the institutional structure behind the Danish flexicurity system. A special interplay between the labour market and a universal welfare-State has been institutionalized, and this can be interpreted as a "hybrid" between the flexible, free market-based welfare arrangements (with liberal hiring and firing rules) and the generous Scandinavian welfare-State regimes (with high social security and universal coverage). Denmark is an outstanding or extreme case with regard to flexicurity.

There is a dual structure of social protection in Denmark following the division between social assistance and social insurance. Only with regard to unemployment benefits does Denmark have elements of social insurance maintained in the form of a so-called Ghent-based system, operating with unemployment insurance funds closely connected to the trade unions (and following the educational criteria for differentiation in trade union structure). The system got its name from the town of Ghent in Belgium in which the system was first introduced more than 100 years ago. The Ghent system is defined as a State-subsidized, but voluntary, unemployment insurance system administered by trade unions. From 1907, the State supported these unemployment insurance funds financially and from 1969-1970 the State also took over the financial risk of rising unemployment. Economic conditions heavily influence the real burden put on taxpayers in this respect. The unemployment insurance system is basically a State-run system, while the social assistance which benefits non-members of the insurance system is administered by the municipalities. Normally, strong service and assistance-based systems are not as easy to change as insurance-based systems. But the Ghent system has strong support from the trade unions, which have an important recruitment channel opened in this way. The dual structure of the Danish system is further reflected in the activation policies of the last two decades, administratively organized in a two-tiered system: one run by the State-run employment service and one by the municipalities. Today, 31 State-recognized unemployment insurance funds exist, ten of which operate within specific occupational

fields and only accept people with the same educational background. Unionization is high in Denmark. Almost 80% of all wage earners have joined a union.

“Non-insured” unemployed people must apply for social assistance (cash benefits) at their local municipality. These cash benefits have a ceiling but are fundamentally means-tested and the amount depends on the individual’s family situation. An applicant must always be ready to take up work in the open labour market in order to have social assistance as well as unemployment benefits. The universal welfare-State does not simply give rights to all citizens —it also defines duties. As to members of the unemployment insurance funds, there is no family concept operating in Denmark. It is important to stress that in Denmark citizens have been defined as wage earners with both rights and duties. An element of the protestant work ethic is clearly seen in the State’s universal welfare-State framework.

Denmark has a low level of job protection and this is a long-standing feature of the Danish labour market. This was institutionalized by the so-called “September compromise” of 1899, the first general collective agreement in the world. This agreement was the outcome of a big general strike in 1899 that lasted for five months and had severe implications for all parts of society. In the final September compromise, involving half of the total workforce, employers had to accept the trade unions as legitimate collective actors and counterparts in agreements but the compromise also defined the right of employers to hire and fire. Since then, the two sides of industry, the social partners, have been allowed to regulate wages, working conditions, working hours, possibilities of further training and education and many more matters via collective agreements. A tradition of voluntary labour-market regulations, by resolving problems in bilateral negotiations, has been formed.

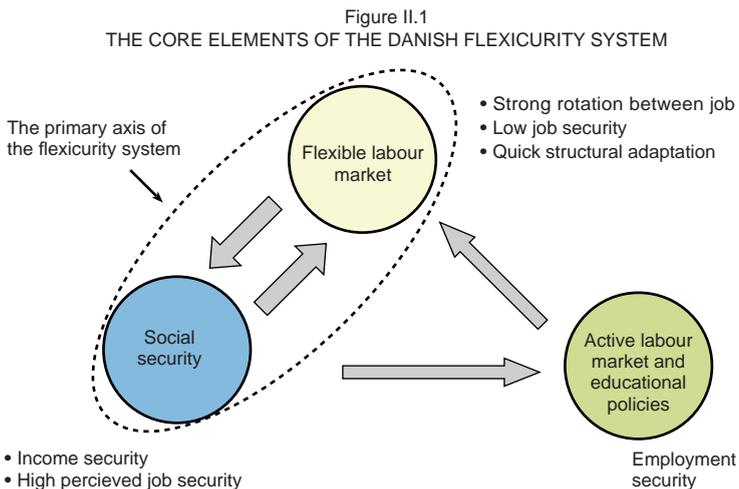
Normally, the political system does not only consult the social partners before formulating labour-market legislation; the social partners are often invited to participate directly in policy formation. One implication of this is relatively few political interventions in the industrial relations system (IR system) during the last 100 years. The low level of job protection created by the September compromise has persisted until now. The Danish IR system is most important in explaining arrangements operating now as core elements in the flexicurity system. It is the sectoral agreements that define individual job protection and the rules applicable to dismissals. Therefore, one will find different regulations within branches of the Danish labour market. In Denmark there is no politically defined minimum wage; here again one must look to the different sectoral agreements in order to find concrete regulations. The diversity of collective agreements and regulations implies that there is dispersion

between different groups. For example, in the construction industry dismissal periods can be down to only one day while other blue-collar workers enjoy protection similar to white-collar workers.

Decentralization of negotiations and agreements and the inclusion of more elements during the last 10-15 years have implied more flexibility and also more security in these private arrangements. Besides wages and working conditions, rights for workers to further training and education, co-determination, working time flexibility, pensions, protected jobs, and leave arrangements are examples of issues that are dealt with in collective agreements. At many levels the system secures flexibility in labour regulation. Stronger multi-level regulation has not eroded or weakened the flexicurity system even if the decentralized actors have gained more autonomy.

### C. The Danish flexicurity system in operation

The flexibility options of employers and the interplay between the private IR system and public policies are crucial in trying to explain the operation of the Danish flexicurity system. The primary axis of this flexicurity arrangement is a highly mobile labour force and income security that is equally supported by active labour-market and educational policies. Together, they constitute one of the three pillars of the so-called Danish “Golden Triangle.” Graphically, you can see this represented in figure II.1.



Source: Per Kongshøj Madsen, “Flexicurity - a new perspective on labour markets and welfare states in Europe”, document presented at the seminar on Flexicurity conducted by the Directorate-General for Employment, Social Affairs and Equal Opportunities of the European Commission, Brussels 18 May 2006 (See chapter II of this publication).

No single element exists or operates in isolation; it is the interrelationships between the elements that account for the robust results achieved. Three general qualifications must be made in order to understand the processes operating between these elements and the consistency in the system. Firstly, there is a need for support from macro-economic policies in numerous areas; secondly, social partners (or “the labour-market organizations” as they are called in the Scandinavian countries) are central actors in the system; and, thirdly, communication patterns between and contact capabilities of actors at different levels of society are inherently important. Often, the social partners are placed in pivotal positions in policy-making processes.

Without *employment friendly macro-economic policies*, selective policy efforts will not have much chance of success. Both push and pull factors must be at work in order to have balanced growth and rising employment. And from 1994, the Danish government has actually tried to “kick start” the economy with financial and tax reforms, helping to raise domestic demand. A policy mix of general economic policies and fine-tuned labour-market policies has been central to the Danish success story since the mid-1990s. Demand-driven growth and active labour-market policies have supported each other. When the economy recovered and the labour-market situation changed, macro-economic policies were corrected once again, to not let inflation rise. This exercise in synchronization succeeded, as can be witnessed by the fact that the Phillips curve for Denmark flattened out, simply, despite growing employment and falling unemployment. The policy mix seems to have worked well. Denmark has also turned a budget deficit into a surplus. But this has to be regarded as a side effect of successful governance experiments and experience with the flexicurity system, supported by welfare investments and sound general economic steering.

It is also important to stress *the central position of the social partners*, not only because of their own regulations through collective agreements —of huge importance in the Danish system— but also because of their central role as policy makers and implementation agents. “Competitiveness” and substantive, as well as procedural, justice are basic to the policy efforts. This is also an argument for the Scandinavian welfare-States to take overarching responsibility for labour-market policy developments as well as steering arrangements; but—as noted—the public authorities share their powers with the social partners and decentralized actors (municipalities and representatives of civil society). The social partners must be placed in key positions if there is to be cooperative adaptation as the labour-market organizations have effective veto power positions within the system.

Thirdly, *contact capabilities* —*not only contract capabilities*— are *fundamental*. At almost every level of Danish society short power structures have been developed, allowing for easy access to decision-makers and other actors. A culture of cooperation and consensus is preserved by institutional and behavioural reproduction of common hands-on policies. Information, consultation, and co-determination are highly developed, resulting in the formation of trusting relationships between actors over time. This constitutes the institutional glue in the system. In reality, no security for the development of trust and cooperation is given; it is an open empirical question. No labour-market regime is without conflict dimensions —a regime simply builds on conflict lines. But the ways that actors find institutional frameworks for combating and finding solutions to changing problems are decisive for cooperation and learning.

The reduction of open unemployment from a higher level than the European average in the beginning of the 1990s to one of the lowest ones currently is one obvious result of the Danish flexicurity system. Other results to be recorded are growth in employment, high numerical flexibility, high mobility, low job security but high income and employment security. Inflation has also been avoided. This all makes quick and cooperative structural adaptation possible. Without active labour-market policy (LMP) and educational policies it would not be possible to reallocate resources and give wage earners the qualifications and motivations needed for bearing the costs of adaptation. It is also important to foster acceptance of the practice of coping with constant uncertainty. And here the collective representation of interests in the system on both the employer and employee sides is most vital to the process of joint decision-making and to the contact capabilities used.

Two diverging coordinates seem to be at work simultaneously. As noted, Denmark is special in having liberal traditions as to the flexibility element and Scandinavian welfare-State traditions as to security, creating a hybrid employment system. High mobility has been important for many years also because of the fact that Denmark and the other Scandinavian countries are open economies in need of quick adaptation and innovative organization of work. The dominance of small and medium-sized enterprises contributes to a readiness on the side of workers for job shifts and transitions within the labour market. Craft traditions and common skills and qualification priorities have facilitated the flexible labour market. Internal labour markets are seldom seen in Denmark because of the predominance of small and medium-sized enterprises in the industrial structure. And with lower entry barriers at the enterprise level it is easier to shift from one firm to another. Danes take up many jobs during their lifetimes. As a

consequence, tenure is low in Denmark compared to the rest of Europe, almost as low as in the United Kingdom and the United States (see Auer and Casez, 2003).

The level of job turnover and mobility between jobs is high for most categories of employees within the Danish labour market. *Almost every third person within the Danish labour market shifts employment each year.* Even if regulated job security is very low, perceived job security might be higher. It is the subjective job and employment security that counts. Political regulation of job security for wage earners is concentrated on collective dismissals as a response to European Union regulation. The tradition from the September compromise with high degrees of freedom on the side of employers has been so strong that protection of people in ordinary employment is very low in Denmark compared to other European countries. Despite having one of the lowest levels of job protection among OECD countries, Danish employees have a feeling of high employment security (OECD, 2004). This counts for all subgroups of employees (Auer and Casez, 2003). As to a recent Eurobarometer report, more than 70% of Danes found it was a good thing to change jobs every few years, while a level of below 30% was found in Germany, Austria, and Poland (Eurobarometer, 2006).

It goes without saying that this hybrid character of the Danish system is a speciality seen in a European context. Denmark has one of the highest rates of turnover in Europe and the highest level of mobility—but also has one of the most advanced welfare-State arrangements with regard to income security and public services. Each year, many employees are affected by unemployment and will receive unemployment benefits or social assistance during a short period of time. But most of these people will succeed in finding a new job rather quickly. Long-term unemployment has been reduced dramatically since the beginning of the 1990s. Those who are unemployed for longer periods of time end up in the target groups for active labour-market policy arrangements, bringing them back to the open labour market with the help of various programmes (e.g., job training and education).

The more passive elements of income security are supplemented in the Danish system with strong interventionist policies and public services. Reforms during the 1960s installed a public employment service system (“AF-systemet”) operating with decentralized offices all around the country and with social partners in important steering positions since 1975. The place for LMP has been clear to all political parties and to the social partners as well. Unemployment since the late 1970s and especially during the late 1980s and the beginning of the 1990s was the background for stronger political efforts to fight social exclusion; and this implied raising ambitions and mobilizing resources.

Now Denmark is the European country that spends the most money on LMP. In total, Denmark spends 4.5% of GDP, of which about 2% is spent on active LMP measures. Compared to this level, the United States spends only 0.5% in total on LMP; the United Kingdom less than 1%; Canada a little more than 1%; Italy, 1.4%; Austria, 2%; France, 2.7%; and Germany 3.4% (European Commission, 2006a).

Without doubt these heavy expenditures on active LMP are seen as productive social investments in Denmark. Even the present right wing government that took office in 2001 supports strong investments in labour-market and educational arrangements because without these the Danish flexicurity system would simply not be operational. Employers support the investment strategy of LMP also because they benefit from the active programmes that allow them to secure a supply of qualified labour even if they do not want a social rationale for public policy decision-making. As a result, Danish employers benefit from the hire-and-fire options and from very few political restrictions regarding their licence to operate as well as from strong public policy arrangements in labour-market and welfare policies. The public employment service helps all kinds of employers, free of charge, in both recruiting and providing further training and education for employees; and the costs of active LMP are placed only with taxpayers, that is, the employees themselves. The way public welfare institutions function with comprehensive childcare and health care facilities, leisure-time facilities, educational arrangements and eldercare, heavily supports women taking up full-time jobs in the open labour market.

This calls for a closer look at the importance and elements of active LMP and lifelong learning strategies in the Danish system.

#### **D. Active labour-market policy and lifelong learning strategies**

When discussing active LMP, academics, observers, and politicians as well, always refer to Denmark and the other Scandinavian countries, as they constitute the active corner of Europe with regard to LMP. The Scandinavian countries all have a long tradition of work being a prerequisite for receiving economic compensation for the loss of income. Citizens in the Scandinavian countries have for a long time been defined as “workers”, backed by the powerful position of the labour movement, especially in Sweden. Early on, the norm was institutionalized that wage earners would be given rights only if they also accepted duties in relation to the labour market: one should actively be seeking a job. This “*working line*” and the public interventions through active LMP are among the most

important components for encouraging labour-market participation. The definition of (potentially) everyone participating in the labour market is not seen only as a public good and a measure to improve productivity, but also as a resource for tax revenues and a way of financing the welfare system. In the early part of the twentieth century, however, it was mostly men who benefitted from this consideration; during the last three decades women participate on an equal basis in active working life.

There is a moral principle behind the Scandinavian labour-market policies: *rights and obligations go together*. A generous income substitution level presupposes a strong work ethic: one has to be ready to take up a job. Citizen rights cannot be understood unless one also recognizes the obligations of the individual. Income compensation is also calculated on the basis of earlier income from paid work. It is mostly within the policy field of pensions that there is a clear dominance of universal social rights. Now, as the active elements of LMP have been strengthened during recent years in Denmark this is mostly to be seen as a revival of the working line and qualification principles. “Activation” is the European concept for new State-sponsored ways to help unemployed people including measures such as job training and the upgrading of skills, but also to motivate workers to quickly return to the open labour market. Carrots and sticks support each other. These measures have not resulted in a break with the guiding principles of governance. However, elements of a “work first” approach have been seen during recent years. The job perspective has been strengthened. The municipalities have become more important producers of services and organizers of activation measures —also in order to mobilize those people that are outside the open labour market. Since 2007, new common organizations of activation measures in which State and municipalities cooperate are being created in Denmark.

The labour market is crucial to solving adaptation problems nationally. The functioning of active LMP and educational policies in Denmark promises solutions to key issues in European labour markets: raising labour productivity in general and especially by investing in the skills and abilities of the labour force, reducing unemployment with the help of a mix of general employment-friendly measures and targeted measures to reintegrate unemployed people into the labour market, to encourage higher employment for those presently out of the labour market, to increase mobility on both a geographical and a professional basis, which will help both firms and individuals and which can keep wage increases and inflation down, and, last but not least, to compensate and redistribute income, work, and life opportunities. Readjustment and adaptation processes to combat mismatch problems have been facilitated in this way. And from the very beginning, the working line has been the focal point of labour-market and qualification policies.

All of these objectives were part of the original contributions to active LMP, with Sweden as the fore-runner. Corporatist steering further aided LMP development. From the early 1950s, more and more measures were developed in accordance with the *Rehn-Meidner model*, which posits that interventionist policies should be based on the general economic control of prices and the acceptance of trade unions' solidarity-based wage policies —with the “creative destruction of capital” as a positive side effect. This is to be seen as a Schumpeterian way of letting unproductive firms get watered down by competition. The model was accepted and has been used both as an identifier for the Swedish society (“folkehemmet” or the People’s Home) and for sectoral policy designs. Until the mid-1990s, Sweden kept its leading position in this policy area but Denmark has since taken the lead, particularly since 2000. Social policy goals and economic developments have not been seen as opposites, on the contrary: greater economic efficiency can go hand-in-hand with more welfare programmes provided for citizens. This also partly explains why neo-liberal policies have not been implemented in Denmark as they have been implemented in most other European countries during the past several decades. Institutionalization of interest representation, selective mechanisms built into the system with the division of labour between politicians and social partners as an important variable and path dependencies as to social and labour-market policies are operational.

Brought to its most fundamental elements, active LMP consists today of four functions: allocation, qualification, activation, and income security. Eventually, one could also add occupational health and safety, but this regulatory function is not very well integrated into the active parts of LMP as occupational health and safety is part of an independent system of policy regulations. The first three are the active functions. *Allocation* is fundamental and embedded in the way every modern economic system works: public help to bring demand and supply into balance. It is a kind of labour exchange, allowing employers and wage earners to find each other as quickly as possible by making the labour market transparent, giving guidance and information, and by matching firms and job seekers in a proper way. The transaction costs can be diminished, and mismatch situations, bottlenecks, and quantitative disequilibrium can be avoided. Seen qualitatively, the matching process will improve the functioning of the labour market. The allocation function also brings strong political backing to public employment services because it is a functional part of the operations of every liberal market system.

During the last two decades, more and more decision makers have realized that the *qualification* structure of the labour force is a crucial factor in improving competitiveness and for the individual wage earner it is of crucial importance in order to stay in a labour market with changing

demands and job opportunities. The European Union's Lisbon strategy from 2000 and the revised edition of 2005 strongly build on this view, promoting lifelong learning (LLL). LLL is now also one of the four core elements of the European Union flexicurity approach. Qualifications, mostly formal ones, give workers access to jobs and to careers. Both on-the-job training and formal learning are crucial and the publicly organized and financed continuing vocational training (CVT) system in Denmark is key to the functioning of an economy in which small and medium-sized firms dominate. There will be a permanent underinvestment in improving the skills of wage earners if the public sector does not intervene and organize activities, which, in the case of Denmark, it does. Denmark has set up a further education and vocational training system for both employed and unemployed people. A system was founded in 1960 for non-skilled workers and an equally broad and comprehensive educational system was founded in 1965 for skilled workers. Secondly, the unemployed also need to improve their qualifications through "activation" measures and education and further training have also been central elements in the programming and implementation of active LMP. A stronger ambition is to have LLL for all persons realized and this has been an official goal for several decades now. In fact, Denmark is one of the European countries with the most adults taking part in CVT courses every year. More than half of the labour force has been registered as being involved in some kind of education —public or private, job-oriented or not job-oriented, during or after work hours— during 2007 and 13% conclude a CVT course each year.

Until 2000, the number of people and the financial resources spent on vocational training and education were on the rise but since then these figures have stagnated. Politically, efforts to try to change this trend are now being made with the help of neo-corporatist arrangements. In 2006 and 2007 tripartite negotiations resulted in the new allocation of public money and joint efforts on the part of the social partners to bring LLL to a more prominent position within the system.

Giving unemployed people training and education is part of this ambition, and by combining qualification measures for the unemployed with measures for the employed one might produce immediate gains for the labour market and develop potentialities. However, a number of traditional economists still challenge this assessment, based on quantitative evaluations made on the measures of individual support and income situations. Others use other methodologies. Our position is that the quality of the *activation* is most important for positive motivation and for producing robust results. Here the Scandinavian countries again were early pioneers as to "activation" arrangements, helping with transitions and change of occupations. Carrots have been used more

than sticks. Rehabilitation and efforts to bring down sickness levels are becoming more and more important as the labour market is approaching full employment and a greater supply of labour is needed. Then all productive resources in society are to be mobilized with the help of employment and labour-market policies, and it is not only individuals who must be reactivated: it is a question of mobilizing the whole system of social protection.

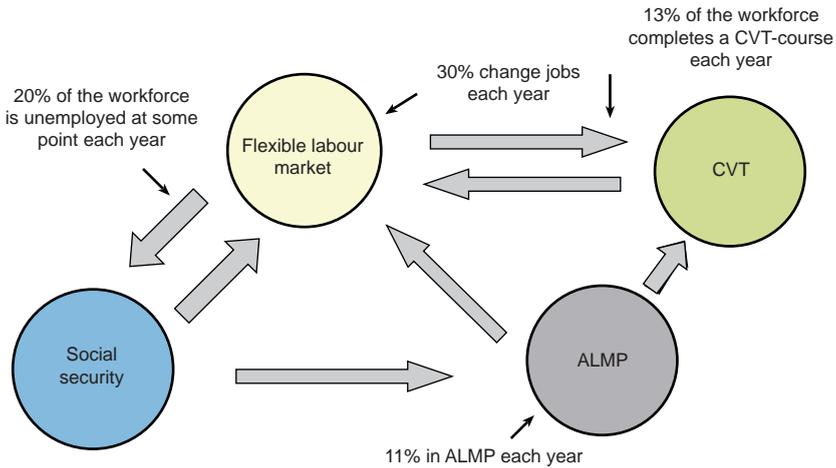
High unemployment benefits and other forms of *income security* give people a way of coping with temporary placement outside the labour market and help the unemployed to not lose faith in the future. By trying to reallocate resources in this way, the public sector helps the individual and his or her family to still function at a decent level, it keeps up total demand in society, thereby securing total employment levels, and it prevents the development of unjust and unacceptable exploitation practices in the labour market. This passive part of labour-market policy is, however, a necessary element in giving people “welfare security” and the capacity to cope with flexibility. The relative generosity of the Danish unemployment benefit system is documented by the OECD, which indicates that it has the highest net compensation rate in Europe (OECD, 2004). The Danish level is 30% higher than in France, almost 20% higher than in Germany, and more than four times higher than in Italy and Greece. In addition, unemployment benefits last up to four years in Denmark, much longer than in most other countries (Madsen, 2006a and b).

In recent years, the Danish compensation ratio has not been regulated in full accordance with increases in the general price and wage levels. Therefore, the unemployed have suffered a relative loss of about 10% during the last decade. Some marginal groups in Danish society—couples on social assistance and new immigrants—have seen their economic compensation reduced even more. Political decisions placing a ceiling on social assistance and a special low rate for “start help” for new immigrants have downsized social security for these groups since 2003. This is not in accordance with the general and traditional trend in Danish labour-market and welfare policy.

The active elements in LMP along with educational measures are, however, the most important ones for understanding how the flexicurity system works. By adding the LLL arrangements in the form of continuous vocational training and education to the Danish flexicurity system, we can reformulate the core elements and their interrelationships. This means adding to the “Golden Triangle” of high mobility, income security and LMP, a fourth element of LLL. This new coordinate brings to wage earners the opportunity to be mobile within the labour market during more years of their active working life: they will, it is to be hoped, experience “*the security of the wings*” (Gösta Rehn). This means the

combination of employability, permanent further training and education, and wage earner mobility. Flexibility on the side of the work force, high mobility and skills enhancements and education go together. A life-course perspective is also brought into the picture by this extension of the “Golden Triangle.” Graphically, the reformulated Danish flexicurity system looks like this, now forming a “Golden Quadrangle.”

Figure II.2  
 “THE GOLDEN QUADRANGLE”: EXTENDED VERSION OF THE DANISH FLEXICURITY SYSTEM



Source: Prepared by author on the basis of Per Kongshøj Madsen, “Flexicurity - a new perspective on labour markets and welfare states in Europe”, document presented at the seminar on Flexicurity conducted by the Directorate-General for Employment, Social Affairs and Equal Opportunities of the European Commission, Brussels 18 May 2006, and Henning Jørgensen, “Flexible labour market, workers’ protection and the ‘security of the wings’. A Danish ‘flexicurity’ solution to the unemployment and social problems in global economies?”, *Macroeconomía del desarrollo series*, N° 76 (LC/L.2993-P), Santiago, Chile, CEPAL, 2009.

Skills enlargement, job rotation possibilities, and reintegration measures are interrelated in the Danish system. Qualification elements and LLL strategies do not only stem from education in active LMP but also —and fundamentally— from the Danish CVT system set up for both employed and unemployed people. Active help for both groups of people is orchestrated in ways that improve productivity, employability and mobility opportunities at the same time. The history of this CVT system goes back to the 1960s as does the history of LMP in Denmark, but the flexicurity system is not identical to the new active LMP of the 1990s, as often described in international contributions to the flexicurity literature. Here “activation” has been made the core element in LMP. Even if it is a major European reform strategy one has to see the Danish policy

elements as broader and more strongly integrated into an existing axis of dynamic labour market and social security elements.

The system functions not only to cover an immediate demand for labour power, but also to stress a more long-term strategy because the general qualifications of the labour force have a dynamic effect on trade composition and productivity, and thus also on flexibility in establishing different types of trades. The formula has been: improve skills rather than increase flexibility or training and education rather than work in return for benefits. However, the newest LMP reform of 2003 did bring more “work first” elements into the policy mix. Finally, the training efforts can also be seen as an element of social integration. It is important to stress that the unemployed have rights in this context: the availability requirement is accompanied by *a right to an individual job plan and activation*. The changes in 2003 again reduced the role of qualitative activation offers, and immediate job placement was given priority. The shortest possible route to a job and in the quickest possible way has been stressed again and again by the present government as the policy choice. This clearly is a “work first” approach now being integrated into the Danish activation system and it is another kind of logic than the one prevailing during the 1990s. Now, threats—or the motivation effects of activation—are to dominate qualification effects according to the government. But not all municipalities and regional bodies agree.

As mentioned, a right wing government took office in Denmark in late 2001. In 2003 the government succeeded in getting a political majority, including the Social Democrats, to support LMP changes. The reform was called “More people to work” and substituted longer activation measures with successive contacts and talks with the unemployed as to firm timetables, introduced “other actors”—meaning privatisation—in the implementation of policy, and reduced the share of education in activation measures to 50%. The result has been more “creaming” and “parking” of unemployed, and a re-regulation of processes, resulting in a more bureaucratic system. The instruments in use were reduced to three: (a) guidance, training, and education; (b) practical introduction; and (c) wage subsidies. From 2004, unemployed people have also been classified in five groups of “matching” categories, according to skills and immediate employability. This classification system was copied from the Dutch system.

The new LMP programme, “More people to work,” was not announced as a break with the former policy, but in reality it slowly changed the policy profile, the content of the work, and the activities. The municipalities and the AF were slowly merged. From 1 January 2007 there has been *a total rearrangement of the steering structure*: integrated job centres for both insured and non-insured unemployed—formed

after policy transfer from the Netherlands— organize labour-market activities together with the “other actors” (mostly private firms); the municipalities have taken the lead within a two-tier system of benefits. The employer organizations and the trade unions were strongly against this “municipalization” of labour-market policy, but their common protests were not accepted by the government.

A recalibration of the steering structure was orchestrated. The social partners are no longer in pivotal positions in the steering bodies. The regional labour-market boards were transformed into monitoring bodies only, but the municipalities —especially the bigger ones— have clearly become important players in the game. The social partners still have a say as to the outsourcing of services, but they are no longer policy-makers. This has repercussions as to the implementation and legitimization of policies. This might reduce motivation and commitment from the side of employers and trade union representatives. Special “problem groups” have now also experienced reductions in benefit levels (people receiving social assistance, immigrants and refugees). A change of policy content and an abrupt change of steering processes will form a path breaking point as to active LMP —and to the fundamental principles of universal rights and equality and the dialogue and consultation principle of the Danish system. To observers, these changes may appear odd as they are so different from the 1994 policy arrangements that brought international awareness of the winning potential of the Danish labour-market regime.

## **E. Dysfunctional elements within the Danish flexicurity system**

Some dysfunctional elements or badly functioning policy components in the Danish system can be found also. Denmark has not been very successful in reducing the number of people between the ages of 18 and 65 that are on public assistance, and large groups are actually expelled from the labour market.

The integration problem is perhaps the most severe. The share of inactive adults between the ages of 16 and 64 is still almost 25% and the groups forming this percentage have been remarkably stable during the last twenty years, even during several years of booming economic conditions and many job openings. However, the high demand for manpower during the last two years has given more people on social assistance the chance to find employment and a reduction of 10% has been reached during this time. But this is not the normal situation for these people; for the most part, they remain outside the open labour market. It is a labour-market regime that functions well

for core groups and some people in transitional positions. Solidarity with the people outside “the Golden Triangle” might not be that big—not even with the extension of the system into “the Golden Quadrangle”. One reason for this is the fact that a highly dynamic labour market, involving many job shifts, continuously tests the productivity of each individual employee. There is an inherent selection process installed in this regard and some wage earners will be expelled from the labour market when they do not meet the productivity criteria of the employer. Because of the few restrictions placed on employers in Denmark in regard to dismissals and lay-offs this risk becomes manifest in a large number of cases. Marginalization as a labour-market problem can occur at the same time as bottleneck problems. This is now a prevailing situation in Denmark. There is a price to be paid for the Danish labour market’s high level of efficiency.

It must also be recorded that about half of all people on social assistance have a non-Danish background. Elements of social exclusion and discrimination within the Danish labour market cannot be totally ignored. From the mid-1990s, there were several shifts in welfare elements in the LMP: introduction of activation requirements and tougher conditions for staying in the unemployment insurance system; introduction of activation requirements for non-insured unemployed; and the option to reduce the benefits if the activation requirements are violated. The benefit level has not been changed, however, for core groups. The “working line” has been strengthened and the benefit period has been reduced from seven to four years, which is still comparatively a very long period of time. But during recent years, the right wing government has reduced social assistance for immigrants and placed a ceiling on permanent social assistance as well. There are also more cracks in the Danish system’s success. For example, persons who are not of Danish origin have limited participation in the labour market; only 47% of ethnic minorities are employed compared to 77% of Danes.

Lack of qualifications by newcomers—or lack of recognition of immigrants’ qualifications—is part of the problem. Job and educational preferences based on immigrant cultures constitutes another problem, but surely discrimination within the Danish labour market is also to be found. Anti-discrimination legislation is rather weak in Denmark compared with most other European countries. This is also due to the fact that the social partners themselves want to regulate employment relations and production and the norms are not that favourable for the integration of immigrants and refugees.

As for social assistance, income levels have also been reduced in recent years for some immigrant groups: a special “start help” for

new immigrants and a ceiling of social assistance for families have put strong pressure on the universalistic principles of the Danish system. Some groups within Danish society are not well covered by the public assistance system and thus by the flexicurity arrangements. In fact, a poverty trap might be visible for people on start help. Very few people actually find new jobs this way.

Another problem with the flexicurity system is, in a paradoxical way, the high mobility of the labour market. This means that workers not only find new jobs in case of restructuring or closure but that they seek other jobs and occupations on a regular basis. This gives businesses and public authorities a disincentive to invest heavily in further training and education because they can lose their investment. This is why it is important to have strong public interventions to secure education and CVT courses.

It goes without saying that the high public sector costs of running active LMP and educational policies are a problem addressed in political discussions. When using between 4% and 5% of GDP on labour-market measures it is understandable that discussions pop up as to the efficiency and effectiveness of the measures and the benefit levels. The relatively high income replacement rates might produce a risk of financial disincentives, and especially for low-income groups this will be a reality, according to economic textbooks. However, it has been difficult to document the magnitude of the problem empirically in Denmark, and the authorities have heavily relied on early activation measures to counteract these potential problems.

## **F. Policy lessons to be learned**

Unilateral government decisions will not suffice to establish and develop a flexicurity system. Collective learning processes are important in finding out which kinds of policies will help tackle uncertainties and foster flexibility and security at the same time, thereby producing institutional complementarities. An important lesson to be drawn from the Danish experience is that *a policy must be economically reasonable and politically and institutionally feasible at the same time*. Otherwise actors during the implementation process will do damage to the policy or target groups will not use the measures. The solution to this decisive policy formation question often lies in the process itself: in interaction, mutual understanding, and learning (Jørgensen, 2002). But the political authorities must actively secure conditions for these interplay and decision-making rounds. The State has to set up institutions, norms and

procedures as well as accountability rules and evaluation criteria for a well-functioning flexicurity system.

We also know that labour-market regimes are created historically in national welfare-State frameworks. All markets are socially and institutionally embedded—but some are more strongly embedded than others. In Denmark, a central role has been given to the social partners in setting policy priorities, in participating in (de)centralized programming and implementation, and in securing and evaluating results. Positive functions of the participation of social partners in public policy making and implementation and in finding cooperative solutions to adaptation problems have been strongly stressed, especially during the 1990s. Mutual trust and collective learning processes are part of the success formula. Other systems, in which social partners do not have a comparatively strong position, will have to rely more heavily on governmental and political actors when formulating and implementing flexicurity strategies, but the goal of supporting and integrating the social partners must be followed. Good decision-making processes and robust results do go together.

In trying to learn from the Danish experience there is a strategic point of view to be stressed: the different kinds of employment and labour-market problems call for a *two-tier strategy*. As to general economic policy, *employment friendly policies* as well as policies to control inflation are recommended but they have to be combined with other sectoral policies and especially *active LMP and educational policies (lifelong learning)*. These policies will help to overcome mismatch problems in the labour market, reallocate resources, and prepare the working population to meet future employment and qualification demands. “The security of the wings,” high qualifications, and employability are fundamental to adaptation processes and the positive attitude of wage earners. Open jobs and unemployed people have to be matched quickly and the qualification structure of the workforce is crucial for productivity and adaptation. Strong numerical flexibility in a system may induce employers to invest less in vocational training and further education, thereby reducing the employment security of employees. This results in the need for strong public engagement in organizing and financing educational measures. For the unemployed, the public sector’s labour-market measures offer transitional positions in the move back to the open labour market. Activation is important when tailor-made efforts are made to combine individual profiles and the needs of the local and regional labour market with the help of qualitative offers. Many long-term unemployed people simply do not react to economic incentives as they have other problems in addition to the lack of a job. They need specialized help. In Denmark, *employment security* (not job security) is being promoted, and together

with publicly guaranteed securities and services, “labour-market security” is installed. It is important to note that Denmark has chosen not to decrease levels of unemployment benefits —meaning lowering the reservation wage— not to deregulate, and not to have welfare retrenchment policies implemented.

It has been more important in the Danish system to keep employers in situations where they can respond quickly and easily to changing demands and pressures. The easy ability to hire and fire workers is part of this —liberal— element in the Danish system and socializing the cost via the tax system together with active measures in LMP and social policies are other elements. The flexibility advantages are only accepted on the basis of strong income security and strong public policies to improve qualifications, employability, and the learning potential of wage earners. Qualification effects of activation have also been more important than motivation effects, documented by developments from 1993 to 2003. Forms of security are important for flexibility. This is a central policy lesson.

To formulate the central line of argumentation in this chapter:

*- Interaction and institutional coordination across policy areas and between different levels of society is crucial to social and economic governance that aims to secure full employment and the balanced development of the labour market. Social dialogues and compromises are central to processing policy adjustments and societal adaptation is necessary to handle changing environments and pressures.*

*- Core elements of a flexicurity approach are market-oriented and employment-friendly economic and industrial policies, collective bargaining and active and offensive labour-market and educational policies that bring the skills and abilities of the workforce into focus. The wage earners are to be flexible, skilled, mobile, and motivated all the time.*

*- And from the Danish experience, we can see that public welfare policies that provide security for wage earners are crucial, as well as removing conflict-ridden negotiation issues from the enterprise level and providing general conditions for flexibility arrangements. Labour-market security fosters flexibility.*

Real learning from the Danish experience and policy transfer might be difficult in the short run. But the tendency is strong to look abroad to see how other systems have responded to similar global trends, pressures, and labour-market problems, to share ideas, to draw lessons, and to bring foreign evidence of success to comply with domestic policy-making traditions. The relevance of the Danish flexicurity system for Latin America is an important and difficult question.

## G. The relevance for Latin American countries

Latin American countries have a diversity of institutions, interests, cultures, and policy traditions. This is also documented in other contributions to this book. Differences seem more important than similarities in some respects. Welfare institutions are relatively poorly developed and embedded in the social reproduction structure of each country. Social and welfare policies are generally of a haphazard nature. In the region's labour markets, the partial modernization of the economy has resulted in a strong division between firm job holders at the core of the labour market that have strong job protection, and many underpaid workers with precarious employment relationships. Many unemployed people are also unrecorded. One of the problems with exporting Danish solutions to employment and social problems is that social protection has always been a closed nation-State affair: solidarity and social justice pertain to closed communities. Political cultures are mingling practices, values, and language and national governments and communities still have difficulties in learning in this new environment.

Because one cannot copy a system, it is much more interesting to ask what can be taken from the Danish experience and used in a *political strategy* for introducing and implementing flexicurity elements in the national system. Even if the transferability of Danish flexicurity to Latin America is limited at the system level, some *guiding principles and lessons* can be addressed, highlighting the relevance of the system's components and the relationships of these elements for those countries. Three aspects of policy change can be considered: the content side, the processes of policy-making and implementation, and the policy outcomes. This equals principles of (1) *policy design*, (2) *social dialogues*, and (3) *outcomes*.

(1) The fundamental principle as to the content of the policy in question must be *to integrate flexibility and security in policy drafts and arrangements*. To simply change one of the core elements will do damage to the whole flexicurity construction. More risk taking on the side of wage earners presupposes stronger income security and employment security. And more flexibility for the employers' benefit requires better training and education of workers, stronger binding of the actions of the firms to goals in public policies, and measures to make transitions worthwhile. A goal must be to give wage earners the experience of "the security of the wings."

Uncoordinated production structures in Latin America do not eliminate the possibility of redistributive welfare policies. They may complicate the decision-making process but the successful formula is to include reforms in the production structure, the labour market, and the welfare regime at the same time. The growing informal sector is of course a special Latin American problem as is the power structure.

Latin American labour markets cannot be called inflexible because they have absorbed many new workers and many different kinds of workers. Supply has been excessive, however, and unemployment is a well-known phenomena. In a few cases, countries have experienced falling employment rates—and thus rising unemployment—but in the rest of the region rising unemployment seems to be related to growing participation rates which the labour markets have not been able to absorb, especially not in the Middle and Southern countries. Youth unemployment and urban unemployment are among the pressing problems to be addressed by flexicurity strategies. Low productivity developments also need to be addressed. More and more workers are employed in jobs and sectors that pay very low wages. It is not to be expected that flexicurity arrangements can conquer all these problems immediately. Therefore a medium-term and a long-term perspective for changes might be appropriate.

(2) In regard to the processes themselves, a *principle of supportive and productive social dialogue, involving negotiated trade-offs* must be applied. Building social and political consensus is essential to advance reforms. In order for plus-sum-games to be imagined and arrangements accepted by all actors, some kind of “horse trading” and compromise is needed. Flexicurity does not install itself. It needs social and political forces to promote this new set of policy principles, and it needs broader acceptance within the regimes in order to be implemented. By including social partners and making associations stronger in the decision-making process in Latin America, better policy-making and implementation can be facilitated. The social partners are to be permanent participants in the policy-making process. The more polycentric structure of interest representation here could, however, be used more strongly by integrating more associative networks and organizations in security arrangements.

(3) Finally, as to the outcomes of flexicurity arrangements, *principles of sustainable employment, protected mobility and social cohesion* are relevant. Realizing sustainable employment for both core groups and groups in weak positions can only be done when these groups are included in active measures to further skills and abilities as well as the motivations of the persons involved. More than economic incentives are needed to secure these principles. A positive motivational base is to be fostered by strengthening actors’ social positions and income support. People in weaker positions should be empowered to cope with their own situations by supporting them in developing labour-market and life projects. To ensure continuous adaptability of firms, to keep up productivity levels and employability of workers, reliable and responsible lifelong learning systems must be established or improved.

Women still have a low employment rate in Latin America and are typically employed in informal sectors, with low wages and benefits.

The participation of women in the labour market is limited by their responsibilities as mothers and caregivers, and also by the low status accorded to women in some countries and to the lack of public childcare facilities. The last element can be changed rather easily with the expansion of public services as part of a flexicurity offensive. Gender mainstreaming in public policies is also highly relevant. The challenge is to intelligently design reforms that will have the support of social and political actors and civil society representatives while avoiding opposition from families. The interests of firms as well as the interests of workers are to be taken into account to foster stronger LMP and LLL priorities.

Flexicurity as an *integrated* policy and policy-making formula has to be developed in ways that will improve firms' competitiveness, facilitate transitions within the labour market, reduce segmentation, and improve workers' labour-market security at the same time. But again: flexicurity will take different forms from system to system. The initial conditions and national traditions will influence the processes and designs strongly. No single road map can be outlined for Latin America. No one-size-fits-all approach is appropriate (contrary to those recipes to be found in the "Washington Consensus"). *Flexicurity must be promoted not as a question of imitation but as one of inspiration.* National change strategies must be elaborated in each case, sequencing changes and integrating existing institutions in the arrangements. Political and cultural diversity is to be addressed as well. Employment security and broader labour-market security are to be promoted together with the creation of more and better jobs. Bringing flexicurity principles into Latin American policies will surely be in line with the ongoing turn away from the "Washington Consensus." It will require a renewal of policy programmes and institutional structures within the labour markets in order to facilitate innovation and adaptability of the national system. Public investments in better health care systems and childcare facilities are to be regarded as productive economic developments; they should not be run down by outdated economic theories or political ideologies. But flexicurity must also be regarded as a new test to national reform programmes of the labour market. A recalibration of existing elements might be the first step, both following and challenging national traditions.

Flexicurity is not a recipe to save society from the ravages of uncontrolled economic competition but rather a way to rethink and reorganize structures and ways of behaviour in order to redeploy resources and give new meaning to the reconciliation of economic and social forces. This must be done in accordance with national traditions, institutions, and levels of development. Reorientation of macro-economic policy could supplement these efforts. Rapid policy proposals might inspire—but may not have persistent effects. The

results of reforms can neither be trivial nor cosmetic if support for flexicurity solutions is to be produced and renewed.

In modern labour markets, interest structures have eroded old understandings and conflict perspectives, and new flexicurity arrangements can show that flexibility and security are not contradictory, but can be mutually supportive. This also implies that there should be no talk about striking a balance between flexibility and security as it will unduly simplify the nexus —also in a Latin American context. The Danish example should be instructive in this respect. But the systemic character of the Danish case is documented by the long and winding road to its installation. A long history, political and professional compromise, and a highly evolved learning process are part of the explanation of this system. These systemic traits are not transferable to Latin American countries. Preferences, norms, and ideas are difficult to understand outside the context in which they are constructed and Latin American meaning has to be constructed by detaching policy ideas from the Danish institutional context. But with the help of, firstly, communication and, secondly, local and national decoding and re-conceptualization, policy diffusion could be facilitated in the form of flexicurity translation. Thirdly, the institutionalization of adopted policy ideas and principles will be a separate and long-lasting affair in which re-interpretation will be a permanent national element. A fitting flexicurity policy must be fluid.

## Chapter III

# **Labour flexibility and worker security: an Argentine perspective<sup>1</sup>**

*Adrián Goldin*

### **Introduction**

This document starts from the premise that labour institutions have a threefold calling: they must balance their functions of worker protection and security with their own modalities of interaction with the economy and the production system and with their impact on the labour-market and employment situation. This is undoubtedly a precarious equilibrium in which the different stakeholders' interests must be constantly juggled, in a context of more open markets, the demands of competitiveness and growing needs for innovation in technology, organization, knowledge and skills. The revision of employment standards and rules of labour-market institutions and policies is no easy task and certainly cannot be reduced to a simple choice between indiscriminate deregulation and unthinking adherence to the existing rules.

This discussion takes as its reference the Danish model known as "flexicurity"<sup>2</sup> and enquires into its relevance to institutional reform in

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<sup>1</sup> For an extended version of this chapter, see Goldin (2008a and b).

<sup>2</sup> See the chapter by Jørgensen in this volume for a more detailed account of the Danish model.

Argentina. In grappling with the complexity of labour institutions as mentioned above, the Danish model could be taken as a possible route towards establishing the balance described there. This is because it consists of a systematic array of policies that promote flexibility in labour markets, work organization and labour relations, on the one hand, and social and labour security for workers in and outside the labour market, on the other (Bredgaard and Larsen, n/d). In other words, the model seeks to facilitate the adjustment of labour markets at the same time as increasing worker security in terms of continuity of income and social inclusion. It goes about this by deploying active labour-market policies, a system of lifelong learning, adequate compensation in the event of unemployment, services aimed at reconciling work and family life and a health coverage regime that does not depend on the worker's employment situation. Seen again in relation to the complexity described at the outset, the security that is lost through the flexibilization of labour rules is regained through policy instruments outside the worker-employer relation as such, in the form of social security and labour-market policies.

To what extent is the Danish experience relevant to Argentina? This will be elucidated later, after examining practices and institutions in Argentina that could be linked with the concept of flexicurity. For the moment, what can be said—as European analyses of flexicurity unanimously conclude—is that no single model is suitable for all countries. Each society must explore its options to find the combination between flexibility and security that suits its circumstances and the best road ahead from its particular point of departure. Those who acknowledge the value of “assisted mobility”, active market policies and a strong social security presence, as well as the irreplaceable role of stakeholders and social dialogue in designing and developing them, broadly agree that the combination of the instruments and the resulting balance is a non-transferable product of each national situation.

## **A. The employment situation and the normative framework of individual working relations**

In early 2003, after the deep crisis unleashed in 2001, different calculations placed Argentina's unemployment rate at between 20.4% and 26.6%. In the first quarter of 2008, only five years later, that rate had dropped to 8.4%. In the interim, employment expanded strongly on the back of active creation of registered jobs and the emergence of new employers, whose number increased by 51.6% in those years. Underemployment, too, decreased considerably in that period, from a rate of 17.7% in the first quarter of 2003 to 8.2% in the first quarter of 2008.

The regulatory framework governing individual worker-employer relations is analysed from the perspective of labour flexibility, to use a typology that can be compared with the flexicurity model.

In this regard, consideration will be given first to the hiring and firing regime and second to the instruments of productive decentralization, given their relevance to what is known as “external flexibility”.

The Argentine hiring and firing regime may be qualified as a system of *impure relative stability*, which manifests a clear preference for non-timebound contracts and admits modalities of hiring for a fixed term or for a particular purpose only when objectively justified. Arbitrary dismissal or dismissal without just cause merits constitutional sanction and is thus illicit but nonetheless valid. This means that the employer can end a contract of employment at any time, even without invoking or demonstrating a justifiable cause and, illicit though it may be, such a decision effectively ends the contract and obliges the employer to pay an indemnity which, generally speaking, is equivalent to one month's salary for each year of employment. The legal regime also provides a number of conditions under which the employment contract expires through causes that are not imputable to either party; here the employer is obliged to pay compensation equivalent to half that provided in the case of unjustified dismissal. All this is apart from the particularities of hiring and firing regimes that exist for special categories and situations, such as those applicable to construction workers, internships and other training contracts. The regime is thus *legally flexible*, although its degree of flexibility or rigidity may be debatable from the point of view of *cost of indemnization*.

Conversely, the constitution enshrines “the stability of public employment” to which, under the law, employees are entitled after a trial period of 12 months. This means that dismissal is invalid unless it can be attributed to a legally recognized, just disciplinary cause, which must be duly accredited at a prior proceeding in which the worker is guaranteed the right to a defence. The law also provides for restructuring measures, including the elimination of bodies, departments or functions and the resulting destruction of jobs. The procedure here leans towards staff relocation as a first option or, failing that, termination of contract upon payment of an indemnity.

The decentralization of production processes and outsourcing are treated in a variety of ways in labour law: where employment fraud is presumed to have occurred, the figure of the intermediary is dismissed and, accordingly, a direct link between the worker and main company is acknowledged; in other cases, depending on the type of activity the employer has hired the intermediary to do, either solidary

responsibility is imposed on both —so that they are jointly responsible for the worker’s entitlements— or the intermediary is solely responsible for the worker’s entitlements, freeing from responsibility the principal employer who uses the intermediary’s services. Although the law does not forbid the use of productive decentralization strategies, it does impose certain conditions that make them problematical. The legal scheme of employment protection is also weakened because the figure of the employer is made more diffuse by the implementation of those organizational strategies.

With respect to the normative mechanisms associated with the different forms of internal flexibility, the first point to consider is that the employer has the right to change certain conditions in employment contracts, provided that this power is not used unreasonably, the basic conditions of the contract are not altered, no material or moral damage is caused to the worker and the alterations are not used as disciplinary sanctions. The definition of professional categories and the application of functional versatility *are not governed by the law but by collective agreements* in the Argentine institutional system. Those matters were negotiated in rounds of talks in the 1990s and more recently, which have continued to incorporate —though to a much lesser extent— functional versatility clauses, modes of organization of work that presuppose them and changes in professional categories.

With the exception of the minimum wage and the complementary annual wage, the structure and amount of wages are mostly determined autonomously: by collective agreements for workers covered by such instruments and by individual contracts of employment for those who are not. On the matter of wages, the technique of “desalarization” (treating wage items as if they were not) merits some criticism. This is one of the strategies used to lower the cost of labour and consists of deducting part of the wage on which the calculation of social contributions is based and replacing it by other entitlements. Argentine law places no restrictions on the use of variable wage modalities, however, which is one of the most widely used tools of internal numerical flexibility.

Working hours are regulated basically by ILO Convention No. 1 on Hours of Work (eight hours per day or 48 hours per week, in the case of Argentina); hours are shorter for night-time or insanitary work. In terms of internal numerical flexibility, the modulation of working hours —or average hours— regime established in 1991 by law 24013 remains in force. Under this regime, collective labour agreements can set longer daily or weekly hours for certain periods of time, which must then be compensated, on a basis of averages, with shorter hours during a subsequent period. This sort of internal numerical flexibility enables employers to draw more heavily on their workforce while the market

for their products so requires, and then compensate when demand is lower. Collective agreements made extensive use of this instrument in the 1990s and have continued to do so, albeit to a lesser extent, in the most recent rounds of talks.

It may be concluded that the scope for internal flexibility as regards professional categories and functional versatility, wages and working hours depends to a great extent on the regime, performance and coverage of collective bargaining.

## **B. Collective labour relations**

With respect to collective working relations, this section will examine trade union organization, collective bargaining and conflict. Having stated that collective stakeholders, especially trade unions, play such a significant role in improving labour security, it would seem logical to examine trade union organization in Argentina, its historical structure and institutional make-up. The more centralized —supra-firm— forms of trade union organization in Argentina have advantages as far as representation is concerned. Conversely, disadvantages arise from heavy (legally empowered) State intervention in the life of trade unions and the fact that the unity of these organizations, though valuable in itself, is not the product of free choice on the part of workers and their leaders, but is imposed by law.

As far as collective bargaining is concerned, it is important to look at the legal regime, the parties to the negotiation and its effects (which are broad, since it confers obligations and benefits upon all workers within the scope of application of the agreement, whether they are affiliated or not, and on business owners, whether or not they form part of the negotiating group). Other important aspects are the duration of agreements (which remain applicable even after they expire, until substituted by new ones) and the diversity of spheres in which negotiations can take place (the firm, group of firms, activity or sector). Under the legal regime, staff delegates (up to four) acting in the firm must take part in any agreement signed at that lower level by a union pertaining to a higher level. Notably, while a new agreement may alter a previous one—whether to the benefit of workers or “downwards”—made at the same level, any new agreement made at a different level must establish more favourable conditions for workers, institution by institution.

The collective bargaining regime can also be distorted by the practice of *ultra actividad*, whereby, in the absence of further negotiations or agreement, a contract's provisions remain in effect indefinitely, with the result that some of those in force now are over 30 years old.

Other distorting factors are the negotiation of employer contributions to the trade unions, which can compromise the unions' determination to pursue demands, and restrictions on mutual concessions when the level of negotiation changes.

In this normative framework, there has been a notable increase in collective bargaining—in terms of volume, coverage and numbers of agreements—in the last six years, and in supra-firm bargaining, which had declined heavily in the 1990s. These negotiations refer mainly to wage issues and, to a lesser extent, to other matters such as hours, organization of work, hiring modalities, labour relations and contributions to unions. As a result of this intensive negotiating activity, wages set in collective agreements began to converge with wages actually paid, narrowing the wide gap that had developed between the two in the preceding decade in the context of waning trade union power.

Social dialogue is severely weakened by the fact that government and social interlocutors are not strictly separated or mutually independent in Argentina. This is due, in turn, partly to the legal and political instruments that allow the State to intervene in the formation, organization and internal and external relations of the stakeholders, particularly trade unions.

That wages are such a conflictive issue in Argentina has to do with a combination of output and employment growth, a shift in the power balance (this time in favour of the trade unions), high inflation and the resulting loss of the purchasing power of wages. In addition, certain cultural and historical traits permeate the approach to conflict in Argentina: one is a historical (neither democratic nor pluralist) view of conflict as something pathological, dissentious and troublesome—and hence something to be denied and repressed—and the other is a predilection for skirting around the legal system's dispute settlement framework and working out ways of compatibilizing the different interests involved in the conflict.

## **C. On the (in)effectiveness of labour rules**

### **1. Inefficacy and “in black” work**

Having described the institutional fabric of individual and collective labour relations, mention must be made of the gap between the letter of the rules and the extent to which they are applied in reality. In a broad context of a regime that is weakened normatively (in the degree to which rules can govern practice), subjectively (in the personal sphere of social

law) and applicatively (in the efficacy of rules), the law and the reality of social rights are far apart in Latin America in general. In addition, there is the specific Argentine tendency towards anomie, manifested in a detachment from the law.

This ineffectiveness has been worsened by the employment crisis that swept over Argentina in the early 2000s. One of the most conspicuous effects of this is unregistered or “in black” work, which peaked at 49.7% of all wage employment in the third quarter of 2003. It then began to trend gradually downwards and stood at 37.3% in the first quarter of 2008.

The problem was serious enough to prompt the legislature to introduce sanctions at the contractual level, mostly in favour of “in black” workers (as well as administrative and penal measures available to the labour oversight agency), aimed at making it potentially very expensive to hire workers illegally. These sanctions were established under successive pieces of legislation, which were not always consistent with each other. This approach does not appear to have been particularly efficacious, since the incidence of unregistered work continued to rise strongly even after the new rules came into force.

Market incentives such as lowering employer contributions to social security during trial periods and fixed-term contracts, the treatment of certain labour relations as if they were not, and “desalarization”, as described earlier, also failed to produce satisfactory results. Despite all these strategies, the level of unregistered employment continued to rise.

## **2. Inspection of labour**

The existing system of labour inspection recognizes the faculties of the provinces and the city of Buenos Aires, which are enshrined in their respective policing powers. It also invests the Ministry of Labour, Employment and Social Security as the “central authority” and attributes an important role to the tax collection agency. The system has unmistakable failings, however: the extremely tight budgets of most local jurisdictions, shortage of inspectors, low wages, lack of means of transport and training gaps. Although better endowed, the federal government inspection service does not have the means to adequately compensate for those failings.

The National Work Regularization programme, which was created a few years ago with the purpose of identifying unregistered workers, appears to have been more successful. By July 2007, it had inspected 463,407 establishments and 1,258,672 workers and had found up to 24% of surveyed workers to be unregistered. Of those unregistered workers found, up to 36% were regularized through the work of the programme.

## **D. Social security**

### **1. Health-care coverage**

#### **(a) The social works regime**

The regime of health-care coverage, which encompasses medical care, medicines and complementary benefits (prosthesis, orthopedics, rehabilitation, and so forth), comes under the social works system. These operate mainly under the auspices of trade unions, but there are also regimes under State or public-private administration, corporate and management schemes, regimes for the armed forces and security personnel and social schemes created by agreement with public and private companies. The primary beneficiaries are employed workers in the public and private sectors, retirees and pensioners of the national level social security and of the government of the city of Buenos Aires, and those in receipt of non-contributory pensions. Secondary beneficiaries are the primary family group (spouses and children, as well as common-law partners and dependents of the primary beneficiary). The regime is funded by contributions from both workers and employers (3% and 6%, respectively, of wages). Of these resources, 10% go into a solidarity redistribution fund to be channelled to agents (social works) that receive lower average income per beneficiary and to provide loans, grants and subsidies to agents and health programmes and plans to beneficiaries. Social works must provide health benefits in line with national health policies, either by providing services directly or through third parties, and must cover at least the benefits included in the compulsory medical programme set forth by the Ministry of Health.

Viewed from a flexicurity rationale, the first thing to note is that beneficiary status lasts for the life of the contract and only three months after it expires. It also lasts for three months during medical leave and other types of paid and unpaid leave, unless the worker undertakes to pay his or her own contributions as well as those that would have corresponded to the employer. Workers in receipt of unemployment benefit also retain their coverage. In sum, health coverage is closely associated with the worker's employment status, registration and formality. Workers in the informal sectors and those who have not been registered by their employers are not covered. Neither are unemployed persons who are not receiving unemployment benefits, those whose coverage has ended, those yet to begin their first job, or those working independently.

### **2. Unemployment coverage**

The Argentine system of unemployment insurance recognizes as beneficiaries duly registered employed workers covered by the employment contract law. Rural and construction workers (who both

have special regimes of their own), domestic employees, public employees and civil servants, workers in private education establishments, own-account workers and those employed by single tax payer employers are not covered. Neither are unregistered workers —just under 40% of the wage-earning population— or first-time (usually young) job-seekers. Unemployment insurance gives the right to 4, 8 or 12 months of benefits —depending on how long the person has been paying into the system— and its wage-replacement ratio is very low; the benefit ceiling was of 400 Argentine pesos at the end of 2008, when the minimum wage stood at 1,200 pesos and the average wage at 1,800 pesos.

The coverage of unemployment insurance is very low, owing to the exclusions mentioned and to the fact that many potential beneficiaries are unable to properly demonstrate their unemployed status. The population eligible for unemployment insurance tends to represent 6% to 9% of all unemployed, of whom between 60% and 80% actually receive the benefit. In 2002, at the time of highest unemployment and greatest coverage, a mere 6.2% of the unemployed were able to claim unemployment benefit; in 2006, only 1 of every 25 jobless workers was covered.

### **3. Work and family: labour rules and social security**

The labour and social security rules governing different aspects of work-family relations provide for various types of leave for meeting the requirements of family life (the birth of children, marriage, death of a family member, and so on). There are also provisions enabling married couples who work for the same employer to take vacation at the same time and rules on maternity-related issues: prenatal and post-natal leave (which are covered by a social security benefit), time off for breastfeeding, the non-regulated requirement to set up day-care facilities, additional unpaid maternity leave or time off for caring for a sick child. As for the right to return to employment, the law forbids dismissal by reason of pregnancy or marriage and provides for additional indemnity if this rule is infringed; women with newborn children also have the right to compensation in the case of resignation from employment.

The law also offers special protection to workers with family dependents in the case of illness and concerning sanctions for absence from work. Certain benefits related to the worker's family are "desalarized" and exempted from tax, such as the provision of school supplies and overalls, reimbursement for day-care costs, reimbursement of medical and dentistry expenses, among others.

The social security system has a regime of family allocations specifically aimed at covering dependent workers' families (except in the case of domestic employees). This regime is financed by employers, with a contribution of 7.5% of wages paid, and it provides monthly benefits

for each child under 18 years of age and for disabled children; annual benefits to help with schooling for basic and differential education and for rehabilitation; single payments for marriage, birth and adoption; and fixed-term benefits, such as prenatal benefit—up to 9 months from conception—and a maternity benefit, equivalent to the worker's earnings, during the period of leave before and after the birth.

## **E. Labour-market policies**

The profound crisis unleashed in late 2001—which took unemployment to the highest levels ever and pushed 53% of the population below the poverty line and 24.8% into indigence—led the government of the time to create a massive income supplementation programme, called Unemployed Heads of Household Plan (PJJHD from the Spanish acronym). The coverage of this programme peaked in early 2003, with 2 million recipients. Beneficiaries were jobless heads of household (male or female) who also met certain other conditions relating to family composition. The plan offered beneficiaries 150 Argentine pesos monthly, against accreditation that their children were attending school and having regular health care and check-ups and that they themselves were engaged in training to facilitate their reentry to the job market. They also had to work between four and six hours per day in community productive or services projects.

Although PJJHD was not satisfactory as an programme to promote employment, education and health and although it created a certain disincentive to work, analysts broadly agree that that its massive deployment was a decisive instrument of social containment—much more as a programme of social aid than of employment promotion—that helped to ease some of the worst lacks in the most dramatic moments of the crisis.

The economy began to recover in 2004 and the government set about gradually “exiting” from PJJHD. Those who did not meet employability conditions were moved into programmes for vulnerable groups—passive social welfare programmes—created by the Ministry of Social Development. One of these was the Families for Social Inclusion Programme which, up to September 2007, had absorbed 289,838 individuals from PJJHD. PJJHD beneficiaries who met employability conditions were transferred to active programmes launched by the Ministry of Labour, Employment and Social Security. What is known as the Integral Employment Plan “More and Better Jobs” arose out of that effort to “activate” labour-market policies. The Plan consists of several programmes and components:

- **Sectoral skills-building plans.** Sets of measures designed and coordinated by stakeholders —trade unions and businesses— in a particular sector of the economy, in coordination with institutions that offer professional training services. They receive financial and technical support from the Ministry of Labour, Employment and Social Security (which oversees the quality of training institutions, which must be registered with it) and from other government departments. Their purpose is to meet specific needs for skills in order to broaden opportunities and improve job quality. These plans were created to promote worker training in response to real, specific demands of the different branches of the economy and to improve the quality of training, infrastructure and teacher profiles. Arrangements of this sort were made in many sectors, including clothing, footwear, construction, the naval industry, metallurgy, timber and furniture, agribusiness, software, and so forth.
- **Area training programmes.** Consisting of two components: projects to boost employment by area; and area training plans and educational projects. The employment projects are arrangements between the Ministry of Labour, Employment and Social Security and the stakeholders in a particular geographical area and are aimed at promoting the quality of employment there. Local stakeholders are responsible for promoting development in their geographical area; the business community, in particular, is the best placed to boost local development opportunities. These plans should be treated as a specific dimension of local development strategies that already exist. The Ministry of Labour, Employment and Social Security identifies those development processes and offers to partner with the local stakeholders in order to increase their momentum. Management is local, although efforts are made to coordinate with provincial and national policies. The geographical training plans, meanwhile, are aimed at coordinating policies with production, labour and training at the provincial level, in order to meet the demand for skills in the region and reach out to unemployed or underemployed segments of the population. By the 2003-2005 biennium, 155 agreements were in place across all the Argentine provinces. In that period, 9,315 unemployed underwent skills training.
- **Employment quality and professional training programmes.** Created to boost equity and competitiveness by developing work competencies and enhancing the quality of employment and the employability of workers. These programmes are aimed

at stakeholders involved in identifying, regulating, evaluating and certifying work competences, and at professional training institutions, in their capacity as executors of training activities. In 2005, the system had prequalified 152 institutions; another 42 were in the process of upgrading and 230 teachers had been trained. In addition, 1,500 workers and 35 assessors had received skills certification.

- **Training and employment insurance.** Created basically to serve as a means of “activating” the back-to-work process of PJJHD beneficiaries who met certain employability conditions. The aim was to encourage beneficiaries to update their skills, provide job-seeking support and help them find quality jobs. The programme may be accessed gradually and is voluntary for PJJHD beneficiaries, except for those under 35 years of age who have not been absorbed into the Families for Social Inclusion Programme. It provides a non-remunerative monetary benefit of 225 Argentine pesos per month for the first 18 months and 200 pesos per month for the following 6 months. Beneficiaries must draw up their own job-search plan and engage in activities to enhance their employability, such as orientation, training, work experience, work-related intermediation and technical assistance for drawing up self-employment schemes. They are also expected to take any suitable job offers they receive. The duration of the monetary benefit is treated as time worked for pension purposes. Although this regime provides an unemployment benefit (which reproduces one of the passive elements of PJJHD, which it is intended to replace), that benefit is activated through coordination with measures aimed at increasing employability and adaptation to the job market, including intermediation and job-seeking assistance, orientation, professional training, work experience and self-employment initiatives.
- **Employment offices.** The purpose of these is to intermediate and place people in employment, assisting job-seekers and helping to fill vacancies in firms and organizations that need staff, by placing people with the right profiles; in other words, to align employment supply with demand.

There is a legal regime for fee-charging employment agencies, which were prohibited in Argentina until the ratification of ILO Convention 96, particularly part III, which provides for the regulation, rather than the suppression, of such agencies. Another legal regime concerns the right to professional training, which is provided under the Constitution and regulated by law 24576, whose text was incorporated

into employment contract law. These regimes are also factored into many collective work agreements.

## F. The position of the stakeholders

It may be said that the Danish model of flexicurity has yet to enter the debate in Argentina. The social stakeholders make little—if any—reference to that rather complex approach. One of the few such references was made in a work published recently by the Ministry of Labour, Employment and Social Security and its Office of the Under-Secretary for Technical Programming and Vocational Studies. It refers to the flexicurity model indicating that: "...the outline of the new labour policy in Argentina suggests initiatives more along the lines of a strong return to the social (of the Welfare State variety), than akin to schemes such as workfare in the United States or the Active Welfare State proposed by Boyer for Europe..."<sup>3</sup> During his administration, the Minister for Labour, Employment and Social Security has repeatedly distanced himself from the flexibility policies developed in the 1990s, referring to them as failures and "inefficient for creating employment". On another occasion he expressed his lack of faith in "those reform packages based on one set of justifications after another, none of which have worked". The Minister's position seems to lean much more towards active labour-market policies, as is evident from the strategies developed to activate social containment policies in response to the deep crisis of the early 2000s.

The position of the trade unions—especially the largest, the General Confederation of Labour (CGT), led today by secretary general Hugo Moyano—is openly opposed to any reform proposal premised on greater flexibility. With slight variations, this stance is also taken by the alternative union known as the Central of Argentine Workers (CTA). On the contrary, CGT backs reform proposals that strengthen legal protection and, as this chapter was being written, was in parliamentary procedures brokered by Héctor Recalde, president of the parliament's commission on work legislation and adviser to the office of the secretary general of CGT.

The unions' position was less monolithic during the labour reforms of the 1990s. At that time, CGT—then steered by the leaders of the major unions (light and power, sanitation and commerce, railway workers, mechanics, telephone company workers, and so forth)—had aligned, or at least gone along, with the economic and social policies of the Justicialista government of the time, even those that entailed privatization of social security (pensions, occupational hazards) and employment flexibility. Another trade union group, the Argentine Workers' Movement (MTA), headed by Hugo Moyano

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<sup>3</sup> See Novick and Tomada (2007).

(now Secretary General of CGT), took a very different stance at that time, strenuously questioning the economic model and employment flexibility policies of President Menem.

The business community, once adamant in its demands for and efforts to obtain greater employment flexibility, is not so militant in this regard today. With the political delegitimization of the previous decade's reforms, together with the unmistakable orientation of the current administration, businesses have been more circumspect about their preferences. They are now rather more on the defensive, confining themselves to denouncing the hypothetical normative excesses of the before mentioned proposals of Héctor Recalde, a member of parliament.

Although the position of the business community tends more towards the defensive, it also has concerns over the need for differentiated legislative treatment for small companies and for a review of the occupational hazards regime, some of whose rules the Supreme Court declared unconstitutional.

When the present administration was about to take office, it announced its intention to convene a social dialogue, both the large business organizations and the trade unions expressed a willingness to take part. One of the objectives of this dialogue was undoubtedly to table a strategy of wage moderation, in view of the worrying inflationary trend under way in Argentina. After meeting with trade union leaders, however, the government announced that it would opt for negotiations by sector. Social dialogue was dropped as an imminent political enterprise and thus far the social stakeholders have not shown any interest in starting it on their own initiative.

## **G. Conclusions**

### **1. Prior considerations**

Debates on labour institutions in Argentina in the last few years have been marked by extreme and rather biased perspectives. While some appeared to see no alternative to indiscriminate deregulation (as far as the unavoidable political restrictions would allow), others professed an unshakeable faith in the existing rules, which they assumed to be good simply because they existed (from which perspective any reform proposal was seen as regressive).

A first concluding reflection on the idea of flexicurity is that any attempt to reproduce or replicate the original Danish model would be just as simplistically schematic as the extreme positions taken in the Argentine debate. Although the Danish model implies a more complex and balanced perspective (indeed, its very conception combines flexibility and protection),

in conditions so different from those prevailing in Denmark, it would inevitably be totally unviable. As the introduction to this chapter noted, each society must establish the optimum combination of flexibility and security for its own situation and find the road ahead from its own starting point.

Any pretense at literally transferring a model so at variance with the institutional, historical and cultural factors at work in Argentina would simply entrench the biased and one-sided positions of the stakeholders more deeply. Workers would suspect, not without reason, that flexicurity was nothing more than a fresh exercise —albeit less direct and perhaps merely cosmetic— in covert dismantlement of the entitlement structure. Businesses, for their part, would probably bear out this suspicion, by treating the proposal as a strategy for inducing acceptance of larger degrees of employment flexibility, while avoiding the substantive commitments written into other components of the model.

In the Danish experience, the determinants of levels of worker protection and security grew naturally out of that society's firm commitment to the Welfare State. If labour-market and social security policies were used to justify the introduction of greater employment flexibility in Argentina, the very idea of flexicurity would be taken as stark confirmation of the biased perceptions mentioned earlier.

It must be understood, then, that the social legitimacy of flexicurity depends absolutely on the means and the sequentiality employed to build up the equilibria implicit in the idea. In any case, the flexicurity rationale can be channelled only through long-term policies which, for example, provide for increased formalization of employment relations and acceptable income continuity as essential conditions for legitimacy. What kind of security can there be when almost 40% of workers are outside the system? What expectations can workers be presumed to have of increased flexibility—which is legislatively easy to implement— when its only counterpart is a mere promise of income security, a promise uncertain to be kept and costly to fund? Ironically, flexibility, which is actually more controversial, can be implemented with a single stroke of legislation, whereas labour-market and social security measures guaranteeing worker security, which are probably less polemic in terms of the employee-employer relationship, are much more costly and sometimes inaccessible.

If Argentine workers are to feel, like their Danish counterparts,<sup>4</sup> that their security depends more on active labour-market policies and social

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<sup>4</sup> See the joint paper on the flexicurity concept prepared by the Danish Confederation of Trade Unions, the Confederation of Danish Employers and the Danish Ministry of Employment [online] <http://www.ambathen.um.dk/da/menu/OmOs/Nyheder/ConferenceMaterial/JointPaperOnTheFlexicurityConceptPreparedByTheDanishConfederationOfTradeUnionsTheConfederationOfDani.htm>.

security instruments than on a guaranteed right to job stability, then they must be made to experience it; they cannot be expected to simply believe or sense it. It follows that the security scheme must necessarily be built first.

Be that as it may, it will be no easy matter to interest the government or the social stakeholders in such a scheme, since neither appear willing to consider anything that involves rethinking employment flexibility strategies for a second time. And, for the time being, businesses do not appear to be making a priority of the issue either.

## **2. Worker security in Argentina**

What is needed first, then, is a security scheme which, as Bredgaard and Larsen (n/d) note,<sup>5</sup> carefully and harmoniously combines job security, provided by the employment stability regime; the capacity to recoup a job lost, which is clearly related to the worker's endowments vis-à-vis the labour market; income continuity, through a regime of unemployment coverage and other social security instruments; and continuity of health coverage, beyond occupational status at a particular point in time. Without lapsing into the simplistic pretense of replicating a social security system built in another context and within another historical trajectory, the following paragraphs attempt to identify measures that could be compatible with Argentina's institutional culture and financial capacity.

A security scheme in the Argentine context should have at least the following components:

### **(a) Employment security and registration**

It is imperative to significantly improve rates of employment formality. These have increased somewhat in the last few years, but have yet to rise much above 40% of the wage-earning population. Any labour security measure is merely academic from the point of view of a worker who is not formally registered. The government should continue its efforts to regularize workers, but this will require it to tackle other unresolved institutional matters. One of these is the need for a special statute for work inspectors. Inspection work should be hierarchical, stable and well paid. Inspectors must be formally trained and participate in ongoing programmes of specific training, in the framework of an oversight model that is adapted to the local context and practices and inspection policies that are sustainable and consistent.

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<sup>5</sup> See the chapter by Jørgensen.

In this connection, it is also necessary to reorganize the regime of sanctions for unregistered work, now regulated somewhat haphazardly by laws 24013, 25323 and 25345 (the anti-evasion law), which suffer from contradictions, gaps and overlaps. The contents of these pieces of legislation need to be rolled into a single instrument in the interests of consistency and effectiveness. The objective must simply be to impose a financial sanction on employers who fail to register workers and provide incentives to them to do so. Hiring workers “in black” must necessarily be made more costly than hiring them legally.

### **(b) Security of income and health coverage**

At present, Argentina’s institutional system offers little in this regard. On the one hand, as explained earlier, the authorities have taken measures to activate PJJHD, a programme of social containment that was developed in response to the critical situation that arose at the start of the decade. That process will be revisited later, in relation to the subject of professional training; for now, suffice to say that it is mainly an exit programme for beneficiaries of PJJHD, which is considered, justifiably, to have fulfilled the purpose for which it was created.

*Unemployment insurance and benefit.* Work now needs to begin on developing a regime that offers wider coverage for unemployment and income continuity, to replace the extremely limited existing unemployment insurance, which has provided only meager assistance to a mere 6% to 7% of unemployed thus far. It is necessary to substantially broaden coverage, lengthen the period of benefits and raise the replacement rate, as well as incorporating compulsory activation mechanisms such as job-seeking assistance and orientation, intermediation between supply and demand for work, and training and retraining to suit market needs. Some of the instruments created as part of the PJJHD exit strategy could well provide the experience and institutional capacity for these components of the regime. The unemployed worker should have the right to be covered by an income continuity regime, but this should also carry obligations and incentives aimed at ensuring proper use of the regime, averting moral hazard and enabling the beneficiary’s timely reintegration into the labour market. It should also be articulated with a regime of non-contributory unemployment benefits for jobless who have come from the informal sector or are not registered, subject to the same “activating” conditions.

*Additional severance benefit.* A benefit of this sort could take the form of a contractual obligation and be financed from the non-punitive component of severance indemnity. It could usefully be linked with the system of unemployment coverage, in order to assist those recently made redundant until unemployment benefit is activated. This idea will be explored in reference to the flexibility and dismissal issues discussed below.

*Duration of health coverage.* As noted earlier, the health coverage provided under the social works regime ends three months, if not sooner, after the termination of a contract of employment. Although it also remains active for workers in receipt of unemployment benefit, the poor coverage and limited duration of this benefit means that the Argentine system offers little security in the event of illness or accident. It is hard to see how proper continuity of social protection can be provided unless health coverage is separated from employment status and protection is assured throughout periods of unemployment as well as during employment. This broader protection is unlikely to be covered by contributions; the State must necessarily contribute to this sort of coverage.

### **(c) Professional training**

In this area too, the efforts institutions have made in the last few years have basically been directed at backstopping the exit strategy from the social containment programme implemented to deal with the aftermath of the monumental crisis that swept through Argentina early in the decade.

During the period of recovery, professional training programmes will have to meet a wide range of demands. They must cater to the training needs of young people—one of the worst-off groups in Argentina's labour market—trying to break into the employment market and find their first job. One step in this direction is the plan implemented by the Ministry of Labour, Employment and Social Security in early 2009 to train some 600,000 young people, with financial support from the World Bank.

Naturally, as noted earlier, training must also function as a counterpart and trigger of systems that provide unemployment benefit and ensure income continuity. From this perspective, the redesign of those regimes—essential in itself—must tie in with professional training programmes that respond efficiently to demand and to markets. To this end, the State needs to partner with social stakeholders to provide sectoral training programmes that can properly identify those needs. Because it is socially responsible for coverage, the State must take the initiative in those programmes, provide financing (directly or through tax incentives) and supply technical assistance for implementation. The sectoral approach should facilitate the transition from training to actual employment.

Employed workers, too, should be offered training and retraining programmes to equip them to deal with productive, technological and organizational changes in their existing jobs and in others, in the event of a change in occupation becoming necessary. There is a strong role for the State in encouraging the adoption of programmes of this type, particularly through tax incentives and direct financing. It is

especially important to ensure that, as well as the specific skills that firms are looking for, training schemes impart other, transferable skills that strengthen the worker's later position in the labour market. This requires active public policymaking.

Collective agreements also play a prominent role in this area. With the levels of intermediate centralization existing in Argentina (by activity or branch of the economy), it is possible to organize and finance training on a sectoral basis. Trade unions should use this sphere to promote training in transferable skills. Collective agreements provide scope for trade offs that can ensure the incorporation of both job-specific know-how and other broader or more transferable knowledge, thus helping to overcome firms' reluctance to fund training that may then be captured by other market agents.

Social dialogue and the resulting broader macro agreements form a framework that is well suited to developing training programmes on three levels—for first-time job-seekers, the unemployed and the employed—particularly the second two of these. Inversely, professional and "life-long" learning represent a good bargaining chip for negotiation and consensus-building and are therefore valuable in helping to revert the weakness in Argentina's social dialogue.

#### **(d) Work and family obligations**

Much remains to be done in this area in Argentina; for example, regarding the provision of care for children and dependent older adults.

Efforts to align labour provisions with paternity and maternity issues, in line with prevailing international thought, offer a good point of departure. For example, a project now in parliament aims to provide fathers with 15 days of paid leave upon the birth of a child, to enable them to assist mothers at this crucial time of integrating the newborn into the family. If this receives legislative approval, the wage-equivalent for that period should be covered by the social security in order to ensure its economic sustainability. Argentine law also gives new mothers the right to request unpaid leave of between three and six months after the end of post-natal leave. From a perspective of equality, such leave should be available indistinctly to either parent, or to both simultaneously. If the social security regime had the resources, the mother or father could obtain a wage-equivalent benefit during this period, in order to encourage their enjoyment of and dedication to the newborn child.

### **3. Labour flexibility**

In order to consider something along the lines of flexicurity in Argentina it would be necessary to surmount inevitable prejudices and

build up an appreciable degree of worker security before moving ahead with other components of the model. It would also be necessary to bear in mind that in the 1990s Argentina experienced a whirl of labour reforms that, in the framework of the simultaneous economic reforms, failed to produce positive effects on either socio-labour conditions or on the Argentine labour market (with high unemployment, growing informality, precarious and insecure employment conditions, lack of job protection, declining real wages and social protection and sharply rising poverty and inequality). Starting in early 2004, this situation led to a virtual reversal of the reforms of the 1990s, which were blamed for the poor social conditions. Consequently, any attempt to retable the issue of labour flexibility, in itself a politically sensitive issue, is bound to meet with the reservations, rejection and warnings born of this traumatic experience.

This is not the occasion to embark on a critique of those reforms, although the author has done so on other opportunities.<sup>6</sup> Suffice to state here that the possibilities for institutional reform have not been entirely exhausted, despite the frustrations encountered. But the inspiration and contents of any proposed reform would have to be different this time around. So too, would their timing; hence the importance of building up worker security. More broadly, it is necessary to arrange the process in a manner less prone to anachronistic declamations and more committed to effective employment protection, real applicability and compatibility with production and employment processes. This is the logical and conceptual sequence on which the proposal on flexibility offered below is based.

The original model of flexicurity refers to a balance between worker security and labour flexibility, based on the Danish situation. Again, the balance is unique and non-transferable; each society must identify what it needs to reach that point of equilibrium in the context of its own situation. Dogmatic and indiscriminate stances on flexibility have no place here; instead, what must be asked is what degree of labour flexibility may be compatible with the security scheme existing in Argentina.

#### **4. Internal flexicurity**

First of all, in the Argentine context, an emphasis should be placed on the continuity of employment relations, given the clear social advantage of this and the positive externalities it offers in terms of gains in terms of on-the-job training, accumulation of human capital and productivity. With regard to flexicurity, continuity should be preferred whenever possible (Gazier, 2006) and the severance regime and related external flexibility treated as a necessary, though secondary, alternative.

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<sup>6</sup> See Goldin (2007).

It is therefore advisable to seek the best possible balance of internal flexibility (functional and numerical) and, therefore, internal flexicurity, as its most valuable component.

Besides other smaller details, it will be recalled that such important issues as wage-setting, professional categories and multifunctionality, organization of work and the modality of working hours are governed in Argentina by collective bargaining. Since it is so important here, there follow some considerations on collective bargaining in Argentina:

- (i) It is a relatively well-equipped system for negotiation. The supra-firm trade unions, which prevail in the Argentine system, help to maintain a good balance of power, facilitate dialogue and, above all, give the workers of small firms access to trade union representation. Trade union unity is valuable when it comes to negotiation, but when this is the product of legislation—as in Argentina—it can distort representativeness.
- (ii) The law has enshrined compulsory participation of grass-roots leaders (staff delegates) in collective bargaining at company level, which enhances trade union representation. Despite the imperative of the legal provision, however, participation is still not insufficient.
- (iii) The existing legislation prevents mutual concessions when the negotiation is conducted at a level different from that of the preceding agreement. It would be beneficial if the system were to evolve towards legitimizing such concessions in all cases, obviously operating “above” the floors established by the legislator. Among other things, this would help to broaden the scope of collective bargaining, which is confined basically to wage matters today.

## **5. External flexicurity**

### **(a) Severance indemnization**

The first point to consider in relation to external flexibility in Argentina is that paragraph 2, article 14 of the Constitution provides “protection against arbitrary dismissal” and the “stability of public employment”. As constitutional provisions, these must be fully respected. In the Argentine regime, indemnization for dismissal without cause<sup>7</sup> is conceived as perhaps the least restrictive means of complying with that constitutional provision. The legal regime for dismissal from

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<sup>7</sup> Unjustified dismissal is not prohibited nor in any way non-valid, as it is in other Argentine ordinances.

private employment is *legally flexible*, insofar as its validity is not subject to prohibition, prior legal or administrative proceedings, annulment or obligation of prior payment.<sup>8</sup>

However, as has been noted, dismissal carries a cost: broadly speaking, a month's salary for every year of employment. The degree of *economic flexibility or rigidity* is therefore debatable. The upper limit the law sought to establish—that the sum of the months per year of employment could not exceed three times the average wage in the respective agreement—was disqualified by the Supreme Court. The total indemnity payment thus has no limit in Argentina, as it does in Uruguay, where it may not exceed the equivalent of six months' wages, or in Chile, it may not exceed the equivalent of 11 months' wages.

### **(b) A severance benefit?**

In Argentina there is virtually no basis for contract termination—except for the employee's sole will or responsibility—that does not involve the payment of an indemnity by the employer, equivalent to half the amount provided for unjustified dismissal (15 days' salary per year of service). Therefore, that "first half" of dismissal indemnity does not form part of the punitive component of indemnization, but has more to do with social security provisions—here, those covering job loss—attributable, in this case, to the employer.

From this perspective, it would be possible to convert this first 50% into a *severance benefit*, which the employer would pay regularly into an individual account in the worker's name. The worker would then have access to this upon termination of the contract of employment for whatever reason. It would thus serve as a secure and immediate first assistance in the event of unemployment, and could be linked in with the unemployment regime in the strict sense of the term. This application would not affect the punitive imputation of the other 50% of the indemnization, which the employer would pay the worker directly in the case of unjustified dismissal. In this case, the worker would receive payments for both items; compensation would not be diminished, but improved, since the 50% provided in the form of a security benefit would not be subject to the employer's willingness to pay and would also be received in severances not imputable to the employer. In turn, the employer's financial burden at the end of the working relationship would be lighter, since the funds for the severance benefit would have been built up gradually.

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<sup>8</sup> Such restrictions do exist in the case of public employment or in the event of dismissal of a trade union leader or staff representative; conversely, certain collective dismissals are subject to the crisis procedure regime and, therefore, must be preceded by reconciliatory proceedings.

## Chapter IV

# **Flexibility and security in the labour market: improving social protection for Brazilian workers<sup>1</sup>**

*José Paulo Zeetano Chahad*

## **Introduction**

The globalization of the world economy and the changes it has brought in its wake have imposed a new reality on social actors in nearly all modern societies. Enterprises need new tools to maximize their competitiveness, including flexibility in market regulation, particularly labour legislation. Workers, in turn, need additional training to enhance their productivity in more competitive markets and, in particular, a new system of social protection to cope with the greater vulnerability that comes with labour-market flexibility. Governments have fewer degrees of freedom for policy-making in a globalized setting but also need to enhance the social protection system, by strengthening social security and at the same time deregulating the labour market.

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<sup>1</sup> For an expanded version of this paper, see Chahad (2009). The author is grateful to Jürgen Weller of ECLAC for comments on earlier drafts. He also thanks José Pastore, José Dari Krein, Paulo Tafner, José Celso Cardoso Filho, Rodolpho Torelly and Sérgio Lisboa dos Santos for providing bibliographic material; Carolina Chahad Secco for assisting with bibliographic research and revising the final text.

The challenge of finding a satisfactory solution to these dilemmas is even greater in the current Latin American reality: most of the region's countries display alarming levels of income concentration, compounded by poverty and social exclusion affecting broad swathes of the population. Nonetheless, while those structural problems will ultimately only be overcome through a sustainable economic development process, the problems caused by globalization, such as greater workforce flexibility and the need for greater social protection for workers, may possibly be addressed through models that emphasize changes, reforms and improvements in the country's institutions.

This paper uses the Danish model described by Jørgensen in chapter 2 as a paradigm to discuss possibilities for adopting a similar model in the Brazilian labour market, while bearing in mind current stakeholder attitudes towards the institutional changes needed to successfully implement a Brazilian model of flexibility with security, or *flexicurity*.

The text is structured as follows: the first section considers the present degree of flexibility in the Brazilian labour market in the light of current individual and collective labour relations. Section 2 describes the Brazilian system of social protection for the unemployed. Section 3 describes the active labour-market policies currently in force, indicating the scale of expenditure involved; and Section 4 discusses stakeholder attitudes towards the reforms needed in the labour and union domains and in active labour-market policies. Section 5 reviews discussion of the scope and limitations of a *flexicurity* model with Brazilian characteristics to expand protection for Brazilian workers.

## **A. Regulation of labour relations: implications for flexibility in the Brazilian labour market and social protection for workers**

As explained by Jørgensen in his contribution to this volume, the Danish *flexicurity* model can be characterized as a "golden triangle", involving a flexible labour market, high levels of social protection for the unemployed, and active and efficient labour-market policies. This section presents the first component of the *flexicurity* model, represented by the implications of regulating individual and collective labour relations in terms of flexibility and social protection for workers, and particularly their consequences for the functioning of the Brazilian labour market.

Brazil's very extensive labour legislation (see Chahad, 2008, Chapter 3), which has governed individual and collective labour relations since 1930

when the country's worker and social protection system began to be consolidated, can be summarized as follows:<sup>2</sup>

(a) From the outset, based on the Italian corporate model Brazilian labour relations featured strong intervention by Government, which still plays a key role, particularly in collective bargaining.

(b) There was also a predominance of protection for individual workers' rights to the detriment of collective rights, which meant that collective bargaining in Brazil remained underdeveloped, partly because this formed part of the ideology underlying the model implemented in 1930;

(c) Labour legislation has always been relegated to secondary status owing to the weakness of "upward mobility" (Süssekind and others, 2002), so that social struggles put pressure on society and the government to set up top-down labour-market protection systems, which were longer-lasting and more cohesive, and strengthened institutions that protected workers more permanently; and

(d) As a consequence, at each point in the country's economic history, labour legislation and the functioning of the labour market have responded to the needs of economic policy, e.g. wage policy after the military uprising of 1964, economic recovery following the 1983 recession, the Cruzado Plan in 1986, the fight against hyperinflation in the early 1990s, price stabilization with the Real Plan in 1994, and labour-market deregulation to cope with globalization at the end of the twentieth and start of the twenty-first century.

Nonetheless, Brazilian labour legislation has always aimed at consolidating State involvement in guaranteeing individual workers' rights; and only recently, in the early 1990s, did it try to prioritize collective bargaining. The reality is a labour market that is apparently very well protected with everything guaranteed by law, and where bargaining can only address wages, profit and earnings sharing, and the length of the working day, under certain conditions. The main result is that:

*"The situation in Brazil is an apparent paradox: legislation is rigid but the labour market is flexible. The rigidity of legislation is reflected in the impossibility of bargaining over most individual rights that guarantee worker protection. That type of bargaining is not allowed even if the parties consider it useful to exchange a benefit guaranteed by law for another (more advantageous) benefit guaranteed by negotiation"* (Pastore, 2005, p. 25).

<sup>2</sup> Apart from the report that underlies this paper, the reader interested in the history and characteristics of Brazilian labour legislation should also consult the following bibliographic references, among others: Mascaro Nascimento (2004), Moraes Filho and Moraes (2003), and Süssekind et al (2002).

In view of this reality, how can we measure the rigidity and degree of protection provided by Brazilian labour-market regulation compared to international standards? What economic factors are involved in this market rigidity?

One way to assess this would be through the impact that excessive labour laws and regulations, interference by the justice system in employment negotiations and underdeveloped union activity have on labour costs, through their influence on labour productivity and non-wage costs.

Although labour productivity has grown considerably in Brazil, especially in the industrial sector and particularly after the trade liberalization that occurred in the early 1990s, it is still low by international standards, as shown in the studies outlined in Chahad (2008, Chapter 3).

Apart from the low quality of the labour force, the factors that undermine productivity in Brazil include excessive regulation of all kinds governing the functioning of enterprises, excessive informality in labour relations, the tardiness and mode of action of Labour Courts, the causes of excessive labour turnover in the Brazilian labour market, including the Length of Service Guarantee Fund (FGTS) (a severance payment fund), and the rigidity imposed by labour laws that are intended to provide social protection for workers.

Another key component in determining the cost of labour are non-wage costs. There is a major controversy in the Brazilian literature over what should be included in this cost category, and how to distinguish it from the wage. Anyway, excessive legislation covering individual and collective rights, consisting of 46 constitutional provisions of 922 articles in the Labour Law Consolidation (CLT), in addition to a vast complementary legislation, generates a high level of non-wage costs (Pastore, 2005; Chahad, 2008).

Wide-ranging and well-known international experience shows that the non-wage costs involved in hiring a worker in Brazil are clearly above those prevailing in other regions and countries of the world (Chahad 2008, p. 109). Consequently, the overall cost of labour in Brazil, *ceteris paribus*, tends to be high by international standards, because excessive legislation tends to produce adversely impact on productivity and considerably raise non-wage costs (known as *encargos*); and both of these put upward pressure on labour costs.<sup>3</sup>

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<sup>3</sup> Although the discussion concerns the concept of the cost of “hiring” a worker, it also represents the cost of “dismissing” a worker; both hiring and dismissing workers in the formal Brazilian labour market are relatively expensive.

The Brazilian labour-market features high labour turnover rates, high levels of informality, many possibilities for atypical labour contracts, relatively high open unemployment and significant wage flexibility. No further information is needed to understand that the country has a labour market with high levels of mobility and flexibility, whether numerical, occupational, or in terms of wages. But is this the result of the labour legislation in force in the country? The answer is no, according to the international institutions and organizations that have analysed this issue (Djankov and others, 2004).

The flexibility existing in the Brazilian labour market does not stem from labour legislation or the existence of a wide-ranging system of collective bargaining. Brazilian labour laws provides rigid conditions for hiring workers and relatively inflexible conditions for laying them off. This can generate high costs and make employment conditions within firms very inflexible.

It is also important to ascertain the degree of social protection that labour legislation provides to Brazilian workers who are employed, i.e. what level of protection is received as a result of employment in a formal-sector enterprise. Does Brazilian legislation protect the worker employed in a firm a lot or a little? The answer is: a lot.<sup>4</sup>

To summarize, Brazilian laws governing individual and collective labour relations are not responsible for the high level of flexibility prevailing in the Brazilian labour market, because they actually make hiring workers difficult. Secondly, they generate high non-wage costs at the time of hiring, and thus promote high labour costs overall, in a low-productivity setting that is also caused by excessive labour-market regulation. Lastly, the legislation gives considerable protection to workers, but only to those employed by a firm in the formal sector.

## **B. The system for protecting unemployed workers**

This section considers the second element of the flexicurity model, namely the social protection system for the unemployed.<sup>5</sup>

Brazil has two main tools for providing assistance in situations of involuntary unemployment: (i) the payment of unemployment insurance

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<sup>4</sup> For information on recent international experience in terms of social protection evaluated through indicators, see Botero and others (2003).

<sup>5</sup> The basic document underlying this chapter (see Chahad, 2008) also includes a wide-ranging review of the Brazilian Social Security System (*Previdência Social*). This system plays a major role in providing social protection for labour force, mainly by combating poverty and extreme poverty, defining the specific characteristics of Brazilian social security arrangements, bearing in mind the Golden Triangle of the Danish model.

(UI) benefits to the unemployed, which can be viewed as the only passive labour-market policy along the lines of internationally recognized models; and (ii) the Length of Service Guarantee Fund (FGTS), which makes a compulsory severance payment to a worker dismissed without just cause, following the models proposed by the International Labour Organization (ILO). Both of these are entitlements for workers placed in situations of involuntary unemployment, although only covering workers employed in the formal labour market.

## 1. The trend and size of unemployment insurance in Brazil<sup>6</sup>

Despite forming part of Brazilian law since the Federal Constitution of 1946, this benefit was finally integrated into the social protection system for Brazilian workers by Decree Law 2.284, of 10 March 1986, the main objective of which was to set up a price stabilization plan. The mechanism proposed included the requirements contained in existing international programmes, with the aim of providing temporary assistance to private-sector workers who became involuntarily unemployed.<sup>7</sup>

UI gained notoriety and effectively became incorporated into the system for protecting involuntarily unemployed workers under Law 7.998/90. This consolidated previous item and regulated all constitutional purposes, except the provision on funding the programme from the contribution made by firms on the basis of their turnover rate (Article 239 paragraph 4 of the Federal Constitution of 1988). The merits of this law included an autonomous fund to finance unemployment insurance, known as the Workers' Protection Fund (*Fundo de Amparo ao Trabalhador - FAT*), of a financial-accounting type funded out of federal tax revenues. Subsequent legislation up to the present day has generally been based on Law 7.998/90, adapting and/or amending its content to address specific situations.

Ordinary and complementary legislation on UI displays increasing liberalization in terms of access for unemployed people, firstly by relaxing the need to have contributed to the Social Security System (*Previdência Social*), and later by requiring less of an engagement in the formal labour market. Nonetheless, in a country short of resources, the "wealth" of the FAT has increasingly been coveted for other purposes,

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<sup>6</sup> Readers seeking a detailed explanation of the main aspects of the emergence, development, and implementation history of insurance employment in Brazil should consult Azeredo (1998) and Chahad (1987, 2004, 2008), among others.

<sup>7</sup> See the report prepared for the then Minister of Employment by Chahad and Macedo (1985), which was used by the Federal Government as a reference for introducing unemployment insurance in Brazil.

when in fact it could have been channelled into active programmes to improve the workings of the labour market.

Table IV.1 shows how Brazilian unemployment insurance has developed. In the period 1996-2006, it paid benefits to an average of roughly 4.7 million unemployed people, with demand peaking in the latter year at around 5.8 million. Average expenditure per year between 1996 and 2006 amounted to US\$ 2.8 billion, reaching a level of US\$ 4.77 billion in 2006, equivalent to 0.44% of GDP. Each unemployed person received a benefit equivalent to 1.5 times the national minimum wage on average for that period.

Table IV.1  
BRAZIL: HISTORY OF UNEMPLOYMENT INSURANCE; 1996 - 2006

Year	Total of Number of insured ( <i>Thousand</i> )	Habilitation rate (%)	Average value of the benefit ( <i>In minimum wage</i> )	Expenditure on UI GDP (%)
1996	4 360 917	99.2	1.6	0.42
1997	4 400 738	99.4	1.6	0.40
1998	4 357 528	99.1	1.6	0.44
1999	4 315 593	97.7	1.6	0.40
2000	4 176 004	98.0	1.5	0.37
2001	4 686 756	98.2	1.5	0.40
2002	4 803 535	98.4	1.4	0.44
2003	4 971 712	98.4	1.4	0.43
2004	4 812 008	98.4	1.4	0.40
2005	5 362 968	98.0	1.4	0.41
2006	5 749 511	98.2	1.3	0.44
Average 1996-2006	4 727 025	98.4	1.5	0.41

Source: Ministry of Work and Employment. Public Employment Policies Secretariat. Employment and Wage Department. General Coordination of Unemployment Insurance and Wage Support.

Although relatively recent, especially by industrialized-country standards, the size of the Brazilian unemployment insurance programme should not be underestimated. Table IV.2 shows that UI expenditure in relation to GDP in Brazil is greater than in developed countries with already consolidated markets and low levels of employment protection, such as the United Kingdom and the United States; similar to that in developed countries that offer greater employment protection such as Japan, or those with similar economic characteristics as Australia; and much less than in countries that have a strong welfare state, such as Denmark.

Table IV.2  
BRAZIL VS. REST OF THE WORLD: EXPENDITURE ON LABOUR-MARKET POLICIES  
IN RELATION TO GDP

Countries/regions	ALMP <sup>a</sup> [1]	PLMP <sup>b</sup> [2]	Total [3]=[1]+[2]
Australia / 2005-2006	0.45	0.61	1.06
Denmark / 2005	1.74	2.51	4.25
United States / 2005-2006	0.13	0.24	0.37
Hungary / 2005	0.29	0.39	0.68
Japan / 2005-2006	0.25	0.43	0.68
OECD / 2002	0.69	1.10	1.79
Poland / 2005	0.43	0.86	1.29
United Kingdom / 2004-2005	0.49	0.19	0.68
Czech Republic / 2005	0.25	0.24	0.49
Brazil	0.44 (2005)	0.44 (2006)	0.88
Brazil	0.44 (2005)	1.72 (2006)	2.16

Source: Organisation for Economic Co-operation and Development (OECD), *Employment Outlook, 2007*, Paris, 2007; and J.P.Z. Chahad, "Políticas ativas e passivas no mercado de trabalho: aspectos conceituais, a experiência internacional e avaliação do caso brasileiro", document prepared for the ECLAC/UNDP/ILO project, São Paulo, June 2006.

<sup>a</sup> ALMP: active labour-market policies.

<sup>b</sup> PLMP: passive labour-market policies.

<sup>c</sup> When expenditures are measured with employment compensation payments from FGTS.

## 2. A summary of the distortions and shortcomings of UI in Brazil

In terms of historical development since its implementation and up to the present day, unemployment insurance in Brazil has pursued three lines of action: (a) expansion of the service in terms of paying benefits; (b) diversification of the target public in line with the growth of surplus funds in the FAT, and mainly, the specific nature of the Brazilian labour market; and (c) coordination, albeit far less than desired, between payment of the UI benefit and active policies (labour-market intermediation, microcredit and vocational training).

Protection for unemployed people in Brazil provided through unemployment insurance has expanded rapidly, as have the problems, disadvantages and distortions involved in its operation, as numerous studies have pointed out. According to Mazza (1999), Cunningham (2000), Thomas (1999) and Chahad (1999), the main shortcomings and difficulties of Brazilian unemployment insurance include the following: (a) unemployment insurance and active labour-market policies are poorly integrated; (b) UI is increasingly accessed by young people and high-income workers; (c) demand for the benefit depends little on unemployment as such; (d) payment of the benefit has perverse effects owing to the existence of an extensive informal sector; and (e) there is an accumulation of benefit payments at the end of an employment relation.

### 3. Brief history of FGTS as a system for compensating workers who are laid off<sup>8</sup>

The FGTS was created by Law 5.107 of 13 September 1966, and in practice replaced the old regime then in force for compensating the employee for termination of contract.<sup>9</sup> Until then, Article 478 of the CLT provided that a worker dismissed from a firm without just cause would receive compensation of one month's pay for each year worked. If the worker stayed in the same firm for over 10 years, he or she would become permanent, and could only be dismissed for a serious fault or for reasons of force majeure (Article 492).

From the legal standpoint, the FGTS was definitively established as a worker's right when it was included in the list of social entitlements in Title II (Fundamental Rights and Guarantees), Chapter II (Social rights), Article 7, paragraph III of the Federal Constitution of Brazil of 1988. Nonetheless, not all Brazilian workers are covered by the FGTS legislation: beneficiaries include workers governed by the CLT, along with piecework and rural labourers, but exclude self-employed workers and casual workers, as well as public-sector workers and the military, who have their own labour legislation.

### 4. The main FGTS statistics

Table IV.3 shows the trend of withdrawals from the FGTS between 1996 and 2006, reflecting compensation payments made to workers dismissed without just cause. On average in this period, US\$10 billion was spent each year in paying FGTS to laid-off workers, i.e. the equivalent of 1.39% of average Brazilian GDP in that period.

Taking the period 1996-2006 as a reference, more resources were allocated to protect unemployed workers under the FGTS than the amounts paid out in unemployment insurance. In fact, FGTS payments represented 1.39% of GDP, while the UI/GDP ratio was much lower at 0.41%. As a whole, Brazil spent an average of roughly 1.80% of its GDP each year to pay compensations and benefits, with a view to guaranteeing protection for formal-sector workers who became involuntarily unemployed.

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<sup>8</sup> Further details on the history, functioning and other aspects of the FGTS can be found in Ferrante (1978), Chahad and Macedo (1985) and Carvalho and Pinheiro (2000). This section will only provide an outline of the FGTS as a compulsory severance payment system to protect workers who become unemployed without just cause.

<sup>9</sup> In fact, at the outset, the FGTS was not a replacement as such but an alternative. Over time, however, firms began to hire workers only under the FGTS regime, and did not permit additional employees in the employment stability regime. Under the new Federal Constitution of 1988, the stability regime ceased to exist, and the FGTS was no longer optional but a compulsory compensation in the event of dismissal without just cause.

Table IV.3  
 BRAZIL: FGTS - WORKERS' WITHDRAWALS; 1996-2006  
 (Thousands of dollars)

Year	FGTS: Worker withdrawals (Thousands of dollars)	FGTS payments as % of GDP	Unemployment rate <sup>a</sup>
1996	10 921 495	1.32	6.95
1997	12 425 777	1.45	7.82
1998	14 569 102	1.76	9.00
1999	9 783 313	1.65	9.63
2000	9 087 952	1.46	
2001	8 039 548	1.44	9.35
2002	6 084 889	1.33	9.16
2003	6 828 670	1.20	9.73
2004	7 917 900	1.14	8.90
2005	10 869 320	1.21	9.31
2006	13 763 806	1.28	8.40
Average 1996-2006	10 026 525	1.39	8.83

Source: Coordination-General of Employment Inspection / Federal Employment Inspection System (SFIT) / MTE Caixa Econômica Federal. Central Bank of Brazil.

<sup>a</sup> PNAD.

Prepared by the author on the basis of the listed sources.

## 5. Access for unemployed workers to the health sector and *Previdência Social*

Both the Single Health System (SUS) and the National Workers' Health Policy in Brazil, as well as the *Previdência* social security system, have guidelines for dealing with access to worker health services for unemployed workers.

The SUS is premised on the basis that health is a citizen's right and a State duty; and it establishes universal and comprehensive coverage, benefiting all citizens and residents in Brazilian territory. Thus any Brazilian citizen is entitled to health care through the SUS, irrespective of work or employment status, and including unemployed workers of any type.

For its purposes, the National Workers' Health Policy defines workers as all individuals engaging in activities to earn their own livelihood and/or that of their dependants, irrespective of their mode of participation in the labour market, in the formal or informal sector of the economy, together with those who are temporarily or permanently outside the labour market owing to illness, retirement or unemployment. Thus, the policy further strengthens access for unemployed workers to the Brazilian health system.

*Previdência Social* also offers opportunities for re-education or vocational retraining to its insured affiliates who are work-disabled (as a result of illness or accident), to enable them to return to the labour market. Other benefits include sickness subsidy (paid to the insured worker who is unable to work as a result of illness or accident for over 15 consecutive days), provided he or she has contributed to *Previdência Social* for at least 12 months.

An unemployed worker can receive benefits, such as sickness subsidy, from *Previdência Social*, provided he or she has contributed to the system for at least 12 months and submits certain documents such as the work identification number - NIT (PIS/PASEP), a medical certificate, laboratory exams, hospitalization certificate, outpatient treatment certificates, among others proving medical treatment; identification document (ID card and/or employment and social security card); and the natural person register (*cadastro de pessoa física*).

### **C. Active labour-market policies in Brazil: history, scale and balance**

The third element of the Golden Triangle model of *flexicurity* is the existence of a wide range of active labour-market policies to help unemployed workers return to the labour market, thus complementing the solidity of social security. This section describes current Brazilian experience with active policies and their importance for a national model of flexibility with security.

#### **1. History of active labour-market policies in Brazil**

Active labour-market policies (ALMPs) are relatively recent in Brazil, having emerged mostly in the early 1990s. Table IV.4 summarizes the main federal job creation, work and income programmes which constitute active policies currently institutionalized in the country.

There are various reasons for the late appearance of active labour-market policies in Brazil. Part of the delay can be explained by the belief that prevailed until the mid-1980s that the country had innate characteristics of permanent economic growth, such that any unemployment would only be frictional. As a result, all labour-market issues were relegated to secondary status, and many people considered the social issue and labour-market problems as a “matter for the police”. The delay can also partly be explained by the historical composition of political forces that have formed Brazil’s governments over the years, where the pursuit of harmony in labour and social relations has been overly subordinated to business interests, resulting

Table IV.4  
BRAZIL: MAIN FEDERAL EMPLOYMENT, WORK AND INCOME POLICIES (ACTIVE POLICIES), 2007

Name/starting year	Area of action	Description of activities	Executing agents	Spheres of social participation
National Employment System (SINE) (1975)	Labour-market intermediation	Training for vacancies in firms and sending workers seeking employment to firm with vacancies	State/municipalities union federations	CODEFAT: Tripartite and Parity Council
National Vocational Skill Development Programme (1995) and National Skill Development Programme (PNO) (2003)	Vocational training and skill development	Supply of vocational training courses for unemployed workers or those at risk of unemployment and for micro- and small-scale entrepreneurs	State/municipalities union federations /System -S" /NGOs	CODEFAT: Tripartite and Parity Council State and Municipal Employment Commissions
Employment and Income Generation Programme (PROGER) (1995)	Generation of employment, income and work	Granting of productive credit and technical support to micro- and small-scale enterprises, cooperatives and own-account workers through the official bank network	Official financial institutions: BB, CEF, BNB, BASA, BNDES	CODEFAT: Tripartite and Parity Council and Employment Commissions
First Job Program (2003)	First job for young people	Promotion of entry for young workers in the world of employment, through vocational training, financial stimulus to hiring firms, partnerships for hiring apprentices and support for the establishment of collective enterprises for young people	NGOs	Consultative Council of the First Job Program
Solidarity Economy (2003)	Promotion of the Solidarity economy	Support for the formation and dissemination of solidarity enterprise networks, through direct promotion, direct mapping, review of experiences and setting up of incubators	NGOs	Consultative Council of the Solidarity Economy Program

Source: J.P.Z. Chahad, "Políticas ativas e passivas no mercado de trabalho: aspectos conceituais, a experiência internacional e avaliação do caso brasileiro", document prepared for the ECLAC/UNDP/ILO project, São Paulo, June 2006; Institute of Applied Economic Research (IPEA), "Desafios e perspectivas da política social", *Texto para discussão*, No. 1248, Anna Maria Peliano (org.), Brasília, December 2006; and *Boletim de políticas sociais: acompanhamento e análise*, special issue, No. 13, 2007.

in discrimination against workers. Lastly, the government authorities have also shown a lack of interest in maintaining the continuity of technical teams working on this issue in public agencies, thereby frequently allowing institutional memory to be lost.

The most important active policies in Brazil, as noted in table IV.1, are:

- The National Employment System (SINE): Instituted by Decree 70.403 / 1975, coordinated and supervised by the current Ministry of Work and Employment (MTE), the creation of which was inspired by ILO Convention 88. SINE actions are implemented in a decentralized way by the country's Federative Units and basically aim to enable workers and the unemployed to engage with the labour market. For that purpose, SINE provides a labour-market intermediation service, supporting the unemployed, generating labour-market information and advisory services on vocational training and labour-force qualification and skill development. It also participates to some extent in the supply of microcredit.
- Vocational training: Recently, Brazil has experienced two milestones in relation to workforce vocational training. The first was in 1996, when the National Vocational Training Plan (PLANFOR) was implemented during the first administration of President Fernando Henrique Cardoso. This ambitious plan aimed to train 5.0% of the workforce each year. From the labour-market standpoint, the plan had the following objectives: (i) improve the chances of finding work and generating or increasing income, by reducing levels of unemployment and underemployment. (ii) increase the chances of remaining in the labour market, by reducing risks of dismissal and turnover rates; and (iii) raise the productivity and competitiveness of firms and improve workers' incomes.

The second milestone in terms of vocational training policies was in 2003, at the start of President Lula's first term, when PLANFOR was replaced by the National Skill Development Plan (PNQ). This was instituted by Resolution 333/203 of the Deliberative Council of the Worker Protection Fund (CODEFAT), and involved closer monitoring and control of its actions, establishment of minimum working hours, prioritization of long-term courses, greater importance for occupational certification, development of labour-skill development methodologies, and mainly, a greater effort to integrate with other active and passive policies. From its inception, the concept of the PNQ moved along different paths than its predecessor, seeking

to fill gaps in areas such as social inclusion, educational shortcomings, the right to citizenship, community participation, and others that extend beyond vocational training.

- **Employment and Income Generation Programme (PROGER):** This policy was implemented through CODEFAT Resolution 59 of 25/3/94, with the aim of offering credit to the unemployed and workers intending to set up small enterprises, together with labour force vocational training and skill development programmes. Following its creation, there was a vigorous expansion of active policies to generate employment and income, all of which increasingly absorbed the resources of the Worker Protection Fund (FAT). This represented a major step forward in implementing ALMPs in Brazil, at least from a quantitative standpoint. Programmes and credit lines were rapidly created to finance projects in urban areas (Proger Urbano), for agricultural and rural regions (Proger Rural) and to provide financial support to small-scale farming and family businesses (Pronaf), among other programmes. The growth of FAT expenditure was not limited to supporting small-scale producers; it was also used for larger-scale enterprises with high potential for creating jobs and improving the quality of life of workers (Proemprego); and an offshoot of this programme, but only implemented in northeastern Brazil and to the north of the state of Minas Gerais, poor regions with a large contingent of unemployed and informal workers (Protrabalho).

The expansion of Proger and other FAT programmes also involved the microcredit area, releasing resources for the National Development Bank (BNDES) to lend as part of the Popular Productive Credit Programme (PCPP). This credit line aimed to set up a network of private institutions to finance small businesses. Within the microcredit line, in 2004 MTE itself instituted the National Targeted Productive Microcredit Programme (PNMPO), to provide incentives for job creation and income generation among low-income micro-entrepreneurs.

## **2. The trend of ALMP expenditure in Brazil**

Despite criticisms of active policies in Brazil, table IV.5 shows that expenditure has grown in relation to the country's GDP. ALMP expenditure represented 0.06% of GDP in 1995 and had risen to 1.08% by 2006. During this period, there seem to have been three distinct periods: very rapid growth until 1997, fluctuation between 1998 and 2003, and strong growth again until 2006.

This increase is illusory, however, both in terms of the balance of expenditure, and, particularly, in terms of policy coordination.

Expenditure on labour-market intermediation has decreased even in absolute terms since 1995, while the growth of expenditure on vocational training or skill development was compromised by being inefficiently used, displaying a drastic reduction that shows no sign of recovery, either qualitatively or quantitatively, on the scale needed to meet the country's productive requirements.

In fact, what has happened is that the entire expansion of ALMPs in Brazil involves the granting of loans under the widest variety of modalities within Proger, with the aim of generating employment, income and work. In 2002, intermediation and vocational training programmes still accounted for 10.0% of all ALMPs, but in 2006 these had practically disappeared, representing no more than 1.1% of total expenditure. At the present time, the actions of active policies in Brazil, in expenditure terms, are confined to large numbers of special loans in the form of credits and microcredits aimed at generating employment and income.

### **3. A balance sheet of ALMPs in Brazil**

The policy of labour-market intermediation through SINE suffers from excessive State intervention at all stages of service provision. While it guarantees some equality of access, it also seems to be a source of typical public-sector inefficiency. In terms of the chain that exists in the process of redeploying an unemployed worker (identifying a vacancy, registration of the unemployed worker, matching the vacancy to the worker, and sending the selected person to firms) the main difficulty stems institutional inefficiency at the stage of directing the worker to firms.

By nature, an identified vacancy is a highly perishable good (Barros and Carvalho, 2002, p. 70), and, once detected, the chosen worker must be sent immediately to occupy it. If the vacancy is identified after the unemployed worker has been registered, he or she must be called urgently. It is also essential for the unemployed worker to periodically return to the intermediation agency, given the perishable nature of any vacancy that matches his or her profile. These procedures are among the most costly in the labour intermediation process, and SINE has lacked resources ever since its inception. Moreover, bearing in mind the precarious nature of its premises and lack of quality human resources, the redeployment chain was never well implemented in terms of providing guidance to the unemployed worker.

Many criticisms have been made of vocational training and the old Planfor programme, but the most serious of these concerns selection criteria for courses and choice of clientele to be served. The plan's conception meant that the selection of courses responded to local demands

Table IV.5  
BRAZIL: EXPENDITURE ON ACTIVE LABOUR-MARKET POLICIES FINANCED WITH FAT RESOURCES: 1996-2006  
(Millions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
(1) SINE: Labour-market intermediation	229.5	67.0	73.4	107.9	60.7	76.7	77.0	39.7	39.2	32.1	37.4	38.6
(2) Vocational training: Planfor/PNQ <sup>a</sup>	47.5	647.8	767.2	768.4	382.8	410.7	360.2	66.2	18.8	29.5	37.6	38.7
(3) Job creation and income generation programmes <sup>b</sup>	778.9	4 028.2	4 072.0	3 011.0	1 495.8	2 990.4	4 654.9	1 961.8	3 014.3	4 557.0	9 051.4	11 695.4
3.1 - Proger urbano	178.3	422.1	526.7	298.9	117.7	456.5	751.6	291.9	761.5	1 653.1	2 751.2	3 439.6
3.2 - Rural area	520.2	1 223.4	2 224.6	1 536.0	618.5	976.7	1 730.5	617.8	543.4	378.8	749.0	840.5
3.3 - Other programs	80.5	2 382.7	1 320.7	1 176.0	759.5	1 557.2	2 172.8	1 052.1	1 709.4	2 525.1	5 551.1	7 415.4
(4) Total (1 + 2 + 3)	1 056.0	4 743.0	4 912.6	3 887.3	1 939.2	3 477.8	5 092.1	2 067.6	3 072.3	4 618.5	9 126.4	11 772.8
(5) (4) as % of GDP	0.06	0.27	0.29	0.25	0.18	0.35	0.60	0.36	0.43	0.56	0.95	1.08

Source: Ministry of Labour and Employment, *Boletim informações financeiras do FAT, exercício de 2007*, Coordenação Geral de Recursos do FAT, 2007; Ministry of Labour and Employment, *Série histórica das contratações de crédito - 1995/2005*, CODEFAT, Executive Secretary, 2006; Ministry of Labour and Employment, "Boletim Informe Proger: informes gerenciais dos programas de geração de emprego e renda", *Relatório de gestão, exercício de 2006*, special edition, No. 1, Brasília, 2006.

<sup>a</sup> FAT financial bulletins, fiscal 2007. MTE: Executive Secretariat, General Coordination of FAT resources.

<sup>b</sup> MTE / FAT Deliberative Council - CODEFAT, Executive Secretariat of CODEFAT: "Série Histórica das Contratações de Crédito - 1995/2005". 2006 data; MTE / FAT - Annual Report, Fiscal 2006; "Boletim Informe Proger: informes gerenciais dos programas de geração de emprego e renda", Special edition - Data for 2000-2006, No. 1, Brasília. MTE. See also the sources mentioned in figure 5.3.

as identified by employment commissions. Later, the courses chosen were handed over to a group of executing agencies which structured the supply; but the search for trainees failed because of inadequate publicity. To justify the supply of courses, the executing agencies filled available vacancies with their own demand, introducing a bias regarding the preferences of the target public.

The new PNQ programme appears to have been built on excessively broad foundations. It also seems more ambitious than its predecessor, because it goes far beyond providing vocational training to adapt the profile of the labour force to needs in the productive sector, either based on mismatches arising from structural unemployment, or as a result of the need for skilled labour arising from economic growth. More precisely, there is a notion that seems to be gaining ground in other social, cultural and mainly educational domains, which requires the formulators of these policies to have great understanding and make great efforts to avoid overlapping tasks, accumulation of functions, dual command and other inefficiencies that its predecessor, Planfor, despite shortcomings and recognized failings, did not commit.

The main specific limitation of the microcredit policy is well known, namely difficulties in identifying a supply of credit at reasonable interest rates and providing access to the poorest sectors in a developing economy, where credit is scarce and interest rates are high. As lending to such individuals is essential for them to be able to undertake their activity, the key issue is to clearly identify those that are really in a position to move out of poverty through this instrument.

On this basis, the framing and implementation of employment and income programmes are highly constrained by high interest rates, which causes a number of problems. The first is that the population actually does have limited access to credit institutions, which in part is due to the lack of a branch network of institutions that provide credit to micro- and small-scale entrepreneurs. The existence of entry barriers to private sector banks in the credit distribution network has greatly restricted the development of branches in the system and, hence, access for the agents that need them.

The second negative aspect is that it is impossible to implement a microcredit policy with market interest rates, because potential borrowers do not have enterprises with the capacity to pay excessively high interest costs. Only subsidized interest rates allow greater access to the credit available for micro- and small-scale entrepreneurs.

The third issue relates to the type of credit line that should be prioritized, i.e. to what point the opening of credit lines for working capital and consumption can or cannot contribute to the goals of creating employment and income and promoting greater social inclusion.

Traditional investment financing tends to have a greater and more lasting impact on employment; but, in a recessionary climate, the demand for investment tends to fall, and a lack of working capital can compromise the enterprise's existence and thus the maintenance of jobs.

The fourth factor that undermines Brazilian income and employment creation policies involving credit to the poorest sectors are beneficiary selection criteria. As this policy has been implemented by official bank institutions, which end up assuming the risk of the undertaking, they demand collateral based on the parameters used in the traditional credit market. But this has been shown to be incompatible with the profile of the workers that form their real clientele. In this regard, an expansion of these programmes to private banks will not necessarily have advantages, because the choice of clientele could be even more rigorous.

The main problem of ALMPs in Brazil, however, does not concern resources as such or limitations on their use, but highly inappropriate policies. There is also a problem that has been widely recognized since the implementation of the SINE in 1975 and adoption of unemployment insurance in 1986 and Proger in 1994: ALMPs are not coordinated either amongst each other or with passive policies. In other words, although the country has adopted ILO Convention 88 on Employment Services, it has never turned this into an "Interest of State" (*razão de Estado*) thus forcing the Brazilian federal authorities to take steps to implement it definitively.

#### **D. The attitude of the main Brazilian social actors towards the need for reforms in labour relations and social security**

To move towards a sound model of flexibility with security, with its own characteristics, Brazil needs wide ranging institutional reforms. This section summarizes attitudes among the leading social actors towards the need for such reforms, and the possibilities for changes in key elements of the "Golden Triangle" comprising the Brazilian model, to make institutions more efficient, improve workers' well-being and direct these institutions towards future adoption of the *flexicurity* model.

##### **1. The attitude of workers towards labour and union reforms**

The position adopted by Brazilian labour unions, particularly after entering the Federal Government in 2002, has been to oppose changes in labour legislation that seek to expand collective rights relatively to individual ones, even where this is done through collective bargaining. They have also prioritized union reform ahead of the reform of labour relations, and believe that many of the problems currently existing in

the Brazilian labour market can be overcome by strengthening the State inspection apparatus.

In brief, workers' attitudes towards the labour reforms recently proposed have been as follows:

- (a) Unionized workers have upheld the philosophy that the principle of "flexibilization" contained in the reforms would be a major defeat for the labour rights earned as a result of bitter struggles over the years. It would also undermine the very extensive protective system provided by the CLT. Moreover, in a country with weak unions, where only a few of the better organized economic sectors could respond to the economic pressure exerted by employers, it would be foolhardy to abandon workers to union entities lacking the minimal conditions needed to satisfactorily defend their interests.
- (b) They argue that proposals for "flexibilization" would run counter to various ILO Conventions ratified by Brazil, since collective labour agreements and contracts would have higher rank than those conventions. According to union leaders, if the labour "flexibilization" process becomes law, there would be a sharp reduction in the level of social protection as envisaged in the conventions ratified by Brazil.
- (c) Labour reform should be implemented to strengthen the Government's supervisory role, because the union movement believes that action by the Government inspection authorities (i.e. State control) is essential to prevent jobs being made more precarious by way of service provision contracts that have employment characteristics.
- (d) Any reform should aim to expand the labour rights contained in the Federal Constitution, which are viewed as a minimum platform for negotiation by Brazilian workers.

While workers have been passive towards the need for labour reform, while firmly rejecting any attempt to "flexibilize" or deregulate labour relations, which they see as a suppression of workers rights, they are moving towards a relatively more active approach towards discussion of the need for union reform. In fact they consider it essential to complete reforms to strengthen unions first, and then undertake a reform of labour legislation so as to extend rather than reduce established rights.

The key aim pursued by workers in any reform of union legislation has recently been regulated by the National Congress, i.e. legalization of union federations which previously were not part of the organizational structure of unionism in Brazil.<sup>10</sup> The promotion of such legalization

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<sup>10</sup> Brazil's large union federations were legally recognized when Law 11.648, passed on 31 March 2008, entered into force.

not only aimed at legitimization but also involved institutionalizing a trend of the Brazilian union movement, namely centralization. On the issue of union organization, workers seek a “soft amendment” of the current model: attempting to preserve the “old union monopoly” arising from the single-union structure applying to unions existing before the reform, while permitting the existence of another union in the same area, provided a representative group of workers in that economic category wants this. In both cases, the statutes need to be democratic and the emergence of a new union must be decided upon by a representative assembly.

Several other claims defended by workers are decisive for their participation in the discussion and future approval of any actual union reform. These include: (a) the right to collective bargaining for private-sector workers; (b) the right to collective bargaining and regulation of the right to strike in the public sector; (c) union membership for outsourced workers; (d) the right for workers to organize in the workplace, not only in large firms, but in all enterprises, and established by law; (e) measures against anti-union practices during strikes; (f) *ultratividade* or continued validity of national employment contracts; (g) job stability for union leaders; (h) procedural substitution, in which all workers of a given economic category can be represented, whether or not affiliated to the union, even if they have not been convened for this; and (i) ratification of ILO Convention 158.

Union reform for Brazilian workers also includes the defence of labour rights enshrined in Article 7 of the 1988 Federal Constitution, which they deem to be immutable clauses (*cláusulas pétreas*) and thus non-negotiable. In other words, they agree to the possibility of changing the union model as a precondition for labour reform, but this should be based on a minimum set of social and labour rights that cannot be negotiated, and others which can be augmented.

## **2. The attitude of employers towards labour and union reforms**

The Brazilian employer sector has a much more active approach to the need for reform of all labour and union legislation, which they blame for the high cost of labour and see as a source of the country’s social, economic and even cultural backwardness. In the strategic map of the productive sector, they consider adaptation of labour and union legislation to the requirements of international competitiveness as fundamental in a globalized world that demands rapid responses; and this is also seen as decisive in laying the foundations for sustainable development. In this context, worker protection should be based on a

minimum set of legally guaranteed rights and the social responsibility of actors at the time of negotiation (Godoy, 2005).

Why are Brazilian employers pressing so strongly for wide-ranging labour and union reform? The main arguments include the following:

(a) Excessive and overly detailed legal interference: The legal framework governing the employment domain is extremely wide ranging and growing on a daily basis. It currently consists of 46 constitutional provisions, 922 articles of the CLT, plus a 100 ordinary and complementary laws, 153 regulations issued by the Ministry of Work and Employment, and 68 ILO Conventions ratified by Brazil. In the judiciary sector, the Brazilian Supreme Labour Tribunal has handed down 363 rulings, 375 directives on jurisprudence, and 119 regulatory precedents regarding employment relations in the Brazilian labour market. This legalistic excess forms part of Brazilian culture and reflects a belief that only the law can protect the worker. Little value is placed on the contract between the parties, and a lot on the law.

(b) There is a mismatch between labour legislation and the changes unfolding in the world of work: As a general rule, labour laws are passed to protect industrial workers in a regime of subordination, which is still predominant but undergoing major change. While the labour market has diversified and is throwing up new situations, Brazil's labour legislation has remained totally static, covering only the traditional typical relation of subordination in which the protection system is tied to the employment relation rather than to the worker (Pastore, 2005, p. 105).

(c) The legislation does not protect new types of labour relations: Brazilian laws are doubly perverse, because they only protect workers in the formal labour market with a well-defined employment relationship (*insiders*), but not those who do not have a traditional relationship of subordination, are outside formal labour relations, or even unemployed (*outsiders*).

(d) There is a lot of legislation and little possibility for negotiation: The Brazilian Federal Constitution and the CLT allow for negotiation only on two workers rights: the wage and the share of profits and earnings. Working hours can only be negotiated through a series of legally established restrictions. All other employment provisions contained in a contract are fixed in laws and are thus non-negotiable.

(e) Much of the legislation causes high labour hiring costs: The excessive number of labour laws, combined with rigidity in negotiation, gives rise to a high and rigid non-wage labour cost (Fecomércio, 2006, p. 10).

Unlike workers, employers are against separating the discussion of changes in labour laws and the structure of union organization. They claim that discussing the two issues separately is very inefficient efficiency and a waste of effort. Giving precedence to union reform is at best illusory, or possibly even a strategy used by those who do not want change, because there is almost nothing to negotiate except the wage and sharing in profits and earnings, as noted above. Moreover, unions are not strengthened through reforms alone, but by making them negotiate even in conditions of change.

Employers believe that changes in labour laws should aim to reduce non-wage labour costs, allow for flexible management of the labour force at the firm level, and prevent labour legislation becoming a hindrance to enterprise competitiveness.

The employer sector also wants certain of the labour rights included in Chapter 7 of the 1988 Federal Constitution to be relegated to lower-ranking legislation, so that they can be negotiated with a view to customizing labour costs to each specific situation and moment in time. As the Federal Constitution contains a minimum level of labour rights that protect individuals, employers have argued for changes in the labour and union area to give “precedence to what is negotiated over what is legislated”. This reflects a belief that, having established the rules of negotiation, the parties best know what their common interests are, and there is no need for government interference.

On the issue of union reform, employers prefer minimum legislation and maximum negotiation. They propose new legislation to strengthen unions through representativeness, to make collective bargaining more effective. Along the same lines, they want to see the end of exclusive unions, abolishing the monopoly of union representation, and replacing it with a model that offers plurality, but without this degenerating into total union fragmentation.

In relation to funding, employers support a gradual elimination of compulsory union dues; and, with regard to dispute settlement, they do not accept that Labour Courts should continue to exercise regulatory power by handing down sentences in their rulings, to resolve conflicts of interest between mitigating parties.

### **3. The Federal Government and labour and union reforms**

During his electoral campaign, President Lula, who has a long personal history as a unionist, promised to reform labour legislation. As President-elect, he indicated that this would be accomplished by setting up the National Labour Forum (FNT), with aims including modernization of the institutions that regulate the labour market, particularly the

Labour Courts, and the Ministry of Work and Employment (MTE). The FNT also permanently works to promote tripartism and constructive dialogue between social actors, to ensure social justice in labour dispute settlement and union guarantees.

Its main specific mission was to undertake labour and union reform, but only the latter has become a proposal sent to the National Congress. It should be noted that the government's arguments for postponing labour reform and prioritizing union reform fully coincide with those indicated by workers, particularly the need firstly to strengthen the role of unions, and only then consider the reform of labour laws (MTE, 2005b).

Even so, although the government and workers have a great affinity with each other, since they are all unionists, and even with a union reform that emerged from a long process of discussion which also involved employers, there was no effort to follow through with the union reform after it had been sent to the legislature. The Federal Government seems to have limited interest in promoting a full-scale union reform and, in the case of changes in employment relations, it is in no way promoting a wide ranging labour reform. It has opted for a strategy that includes topical issues, based on the so-called "Provisional Measures",<sup>11</sup> an expedient that was widely condemned by unionists themselves before they came to power. Furthermore, along with workers, the Federal Government seems to have a passive attitude to changes in the labour domain, preferring to deny reality rather than confront it.

#### **4. Social actors and efforts to implement a public employment service in Brazil**<sup>12</sup>

Active labour-market policies in Brazil have always had the Federal Government as their main social advocate. Employment policies in Brazil have developed in a dispersed way, using Law 4.923/65 as an initial frame of reference. This called for the creation of an Assistance Fund for Unemployed Workers (FAD), mentioned the need for labour intermediation, and mooted the future creation of unemployment insurance. Following implementation of the SINE, these policies gained

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<sup>11</sup> The Provisional Measure (MP) is a legal instrument used to streamline Federal Government decision taking on issues of immediate national interest.

<sup>12</sup> Suggestions for implementing a public employment service in Brazil, sometimes identified as a public employment system, were frequently made throughout the 1990s, and were very clear about the need for such integration to improve the performance of the Brazilian labour market. See, in particular, Azeredo (1998) and Chahad (1999). Moreover, as part of the work of the former Ministry of Labour and Administration in 1992, an embryonic proposal for a public employment service was formulated, in which the present author participated; but this failed to prosper because of the serious political crisis that hit the Federal government. See MTA (1992).

their own space in the Brazilian labour-market scenario, but the range of alternatives finally opened up with regulation of the unemployment insurance programme and establishment of the FAT as its funding source in 1990.

Along the same lines, Law 8.900/94 amended Law 7.998/90 (which had structured the unemployment insurance programme and created the FAT) in relation to paragraph II of Article 2, specifying that:

*“The unemployment insurance programme aims to assist workers in job search, through comprehensive actions of guidance, relocation and vocational retraining.”*

This effort to integrate and articulate active and passive labour-market policies has gained renewed strength in President Lula’s administration, under the direction of the MTE. Thus, following two National Congresses on the Public Employment, Work and Income System, with participation from wide ranging segments of civil society, particularly workers, employers and members of the Federal Government, a number of resolutions were prepared, with a view to guiding the MTE itself and CODEFAT in constructing the so-called Public Employment, Work and Income System (SPETR).

Following wide-ranging debates directed by the MTE, in which consensus was reached among stakeholders, it was decided to adopt this SPETR, which is based on a wide range of general principles (see MTE, 2005a).

Unlike what happened in the areas of labour, union and social security reform, there is greater consensus among stakeholders on active policies, although the task of consolidating a genuine public employment service is still at a very embryonic stage. This is because, as occurred with previous governments, the decision to implement the public employment service was taken and the model was well designed, but official actions to implement have not been forthcoming.

## **E. The scope and limitations of the *flexicurity* model, in terms of strengthening the labour market and expanding protection for workers in Brazil**

This final section assesses the chances of adopting a *flexicurity* model, bearing in mind the improvement of the efficiency and effectiveness of the Brazilian labour market, expansion of social protection for workers and better quality of life for the population, in a world of employment characterized by greater numerical, functional and wage flexibility.

## 1. The need for reforms towards *flexicurity* aimed at social inclusion

### (a) Reforms in the labour and union areas

Brazil's labour market contains a major paradox: high levels of flexibility, despite very rigid labour legislation, in all senses. The labour market itself is flexible, but the employment contract is rigid. This generates high non-wage costs, which, combined with low productivity, generate high labour costs. It is thus a pernicious flexibility, because it arises to evade the laws, which end up giving considerable protection to a worker who is employed, but provides no guarantee of remaining in employment, and hinders the hiring of new workers.

This excess individual protection needs to be changed, by legally guaranteeing a minimum set of basic rights consistent with the ILO, and leaving other items of relevance for workers' well-being to collective bargaining. One objective of this change is clear, however: to reduce hiring costs, particularly for small businesses, by encouraging the productive sector to hire workers who enjoy a minimum standard of social protection. Another aim is to strengthen collective bargaining as a way to guarantee rights, with social dialogue as the way to settle disputes.

Fundamental basic rights would not be guaranteed for formal workers only, but also for the others in the informal sector, thus forming a universal social protection system. Achieving this requires reforming the system of access to *Previdência Social* for own- account and self-employed workers and extending basic social security benefits to them. Workers in the formal sector already have their social protection in traditional schemes of unemployment insurance and compensation for dismissal without just cause (FGTS); but in the Brazilian case, these benefits need to be consolidated to avoid the distortions they cause in the functioning of the labour market (Chahad, 2008).

Another immediate reform involves the structure and functioning of Brazilian union organizations. The corporate model based on union monopoly and public funding, implemented in 1930, has now been more than superseded; and it is clearly contrary to the type of modern unionism needed in a globalized, competitive and rapidly changing world. The reform broadly aims to increase competitiveness between unions, making them fight for their funding capacity if they want to remain outside the State apparatus, thereby guaranteeing their autonomy, liberty and other aspects of governance.

How representative is this in terms of social protection? Workers in the formal market are automatically protected by labour and social security legislation, either in the standard indefinite contract, or in

atypical contracts; but as they are formal they will hold a signed employment record booklet (*carteira de trabalho*).

### **(b) The changes needed in active policies**

Pursuit of the *flexicurity* model leads us to the element of the Golden Triangle that concerns the system of active compensatory policies in a flexible labour market. Brazil already uses these, but they suffer from a number of deficiencies. The amount of resources available is still relatively small for the size of the Brazilian workforce, the role of policies is very small, basically confined to three (job intermediation, vocational training and employment and income generation programmes); and, worst of all, these policies are poorly integrated amongst each other and are not articulated with employment insurance.

The main consequence of this framework is that active labour-market policies in Brazil are inefficient, ineffective, and do not promote equity as they should. Moreover, they fail to promote the “activation” needed in each case, thereby aggravating the negative behaviour of certain aspects of the labour market.

In the case of job intermediation, the reform starts by substantially increasing expenditure with a view to striking a better balance between labour supply and demand and serving informal workers, including investment in human resources and information technology; and it ends with major investments to increase the network of service branches. Greater competition is needed between SINE and private agencies; and the system for supervising the latter and promoting permanent evaluation of SINE needs improvement, comparing *ex ante* targets with results obtained *ex post*. The efficiency of the system depends on continuous monitoring, which does not happen today.

The key challenge for active policies is in the area of vocational training. The country has a very low average schooling level by international standards (roughly 5 years’ study), and the illiteracy rate is very high (11.0% in 2005). In conjunction with other educational shortcomings, this results in a low-skill labour force. A substantial part of this problem will need to be resolved through medium- and long-term policies implemented by the Education Ministry, as part of a wide ranging education programme to bring the Brazilian population up to the educational standards of more advanced nations.

Nonetheless, part of the improvement of labour skills involves the system of vocational training and human resource formation, and in the Brazilian case the challenge here is greater, because the numbers are dramatic; and basic education activities for the labour force, in the framework mentioned above, have been below expectations, not to say non-existent, in terms of quantity or quality.

Reform of the vocational training system should aim to considerably increase expenditure on the system with a view to improving job potential, for unemployed workers first and foremost, but also for those who are employed but need retraining or want avoid obsolescence. In any of these cases, it is essential for the productive sector to show interest in vocational training because it is the sector that provides employment after the training has taken place.

Here it is worth noting that the success of vocational training partly depends on its coordination with other active or passive policies. In particular, integration between training and labour intermediation clearly improves the chances of success in redeploying an unemployed worker; and coordination between training and the UI programme tends to have the same effect, both helping to reduce the open unemployment rate.

The other active policy that needs to be reformulated is the employment- and income-generation programme. Unlike other active policies, a review of this policy would suggest to a more judicious allocation of resources, compared to the situation prevailing today. As shown in table IV.5, nearly all resources destined for expenditure on active policies (99.3%) are channelled into employment- and income-generation programmes.

Over time, these resources, which have been lent in the form of microcredit, come to reflect political demands, with no commitment toward generating employment and income and no concern for evaluating loan results. This framework needs to be changed to put a lending policy in place that benefits the most needy workers, whether engaged in informal activities or atypical modes of production, so that the results of their enterprise, within specific evaluation standards for this type of loan, can be evaluated in terms of resource-use efficiency.

## **2. Obstacles, difficulties and bottlenecks for reforms to strengthen the labour market and expand social protection**

Apart from the intrinsic difficulties of formulating and implementing the reforms themselves, there are other shortcomings that obstruct the search for a labour-market and social protection model in the framework of Danish *flexicurity*, but with Brazilian characteristics. These are all hard to overcome, either because they mean changing habits, customs and cultural inheritance, or else because they require a long time to change, in the case of a model that requires all its elements to be fully balanced to function properly.

**(a) Lack of official leadership and little political will to impose a model leading to change**

Implementation of a *flexicurity* model with Brazilian characteristics, in which greater labour-market flexibility would have a counterpart in a more solid social protection system, needs official government support to turn it into an “Interest of State” (*razão de Estado*) thus making it a fundamental national priority, which would therefore have to be addressed. Experience shows, however, that this would be very hard to achieve in the current Brazilian reality. This reflects a lack of initiative not only on the part of the current Federal Government, but of Brazilian Governments generally, in which the predominance of economic issues has always been, and remains a major obstacle to development in other areas.

**(b) The interests of social actors in relation to the changes are highly antagonistic**

We have seen that the attitudes of workers and employers, the two main groups likely to suffer from the reforms needed for a new model, are highly antagonistic. This is particularly true in relation to labour and union reforms, whereas there is a certain convergence, but not consensus, on the changes needed in the area of active labour-market policies. There is also wide disagreement over the changes demanded in the social protection system for the unemployed.

Strong antagonism is natural; what is not normal, is that there is wide divergence, little detachment (*desprendimento*), a sterile dialogue and an apparent wish to leave the status quo unturned, to see whether a higher body will resolve the conflict. The outcome is that changes, when they do occur, are piecemeal; an obsolete model remains in place; and problems accumulate to be solved by a new model.

**(c) Incipient development of social dialogue and only recent emergence of suitable negotiation forums**

Despite gaining strength over time, social dialogue, of the form practised in more developed countries, has little tradition as a dispute settlement mechanism in the Brazilian political-labour-social scenario. This clearly imposes a major obstacle to the success of reforms aimed at implementing a labour-market model in which social protection is based on flexibility with security.

Social dialogue is still taking its first steps in Brazil, compared to the experience of other countries. Although already in practice, the culture of interlocutors still does not seem to include the idea of detachment or compromise, which significantly prolongs the

negotiations and makes them unsuccessful. Apart from that, the new forums that have arisen suffer from being new, and are not fully structured or consolidated, although they represent a new stimulus for social dialogue in Brazil.

**(d) The new model will have to respect the current role played by elements of the Golden Triangle in the Brazilian case**

Labour, union and active policy reforms, apart from other complementary measures, aimed at setting up a Brazilian *flexicurity* model, need a dual characteristic: attaining the goal of flexibility with security (social protection) and maintaining (or transferring) the function currently played by its institutional framework to solve problems in the labour-market or social protection system.

**(e) Public spiritedness as an obstacle**

One of the reasons for the success of the Danish model seems to stem from a high level of “public spiritedness” in relation to the moral issues generated by the generosity of the welfare state, or more specifically the unemployment insurance programme, which completes the Golden Triangle of *flexicurity*.

In the Brazilian case, there is already sufficient evidence of corruption, deceit and fraud in social security programmes. Nonetheless, moral issues arising from generous social security programmes are not exclusive to Brazilian or Latin workers, but form part of labour force behaviour in any country. In popular Brazilian culture the idea that the State should help in everything is widespread; it is the so-called “country of the poor”, especially because much of the labour force is unskilled, and a large proportion of the population lives on low incomes. Thus, a generous unemployment insurance or a welfare benefit paid for a long time is seen as an end in itself, apart from often making up a large part of the family income.

For someone who knows Brazilian culture and the behaviour of workers in relation to programmes in which there is little coordination, little activation, deficient supervision and risible sanctions, when they exist, this is an obstacle difficult to overcome. Poverty and low skill provide fertile ground for a lack of “public spiritedness”.

**(f) The financing and equilibrium of Brazilian public accounts**

The *flexicurity* model is expensive, because it offers wide-ranging social security and generous unemployment insurance, and spends

a lot of public money on active compensatory policies. It requires a country with public finances that are permanently in equilibrium, which is not true of the Brazilian public sector. Despite improvements in the revenue collection system and the management of public funds, public expenditure is still hard to control. This has implications for the Brazilian tax burden which is reaching high levels, but above all is highly inequitable.

Moreover, while funds are available to finance certain elements of the Golden Triangle, such as unemployment insurance or active policies, these have been used incorrectly, thus compromising their continued existence to implement a *flexicurity* model.

## Chapter V

# Flexibility, protection and active policies in Chile

*Mario D. Velásquez Pinto*

### A. Purpose

The purpose of this chapter is to identify the factors which determine the feasibility of systems of labour-market flexibility with protection, also known as flexicurity, taking into account the national particularities of Chile.<sup>1</sup> The Danish experience has been taken as a reference: it has been working for over a century and its effectiveness is founded upon the legitimacy which comes from a broad consensus among social actors.

This model is based simultaneously on three fundamental pillars: a flexible labour market; a social welfare system which supports labour-market reintegration for those who have lost their jobs and prevents falls in workers' living conditions; and active labour-market policies, including training, aimed strategically at providing qualifications for workers throughout their active lives.

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<sup>1</sup> See a more detailed version of this work in Velásquez (2009).

Experiences with flexicurity are specific and cannot be applied directly to the realities of different countries such as those of Latin America and the Caribbean. Nonetheless, analysing the components and interrelationships, as well as the functioning of labour markets and institutions, is a highly useful exercise in identifying ways of increasing employers' and workers' capacity for protected adaptation in response to changes, in accordance with each country's particularities and rhythms.

## **B. Methodology**

This chapter will initially consider the functioning of the labour market in accordance with the various regulatory frameworks which have existed since the 1970s, bearing in mind the degrees of flexibility or protection that were intended and the results achieved. Second, it will identify individual labour regulations and analyse recent changes in them in respect of both external (numerical and wage) flexibility and internal flexibility (wage and non-wage compensation systems, duration and organization of the working day). It will also consider collective labour regulations, particularly those relating to trade union organizations and collective bargaining.

The analysis of active policies is based on a public-spending series, to determine the scale and evolution of components in recent years. It is complemented by a study of the coverage of beneficiaries and some aspects of the design of the most important programmes. Lastly, it identifies the main positions of social actors, particularly entrepreneurs, workers and the State, based on important experiences of negotiation and social dialogue in this area.

## **C. Institutional frameworks: from deregulation to flexibility with protection**

Chile has a highly varied experience of labour flexibility, defined as the adaptability of the labour market and of labour as a factor of production. There have been a variety of institutional frameworks in the past 50 years, and various combinations of flexibility and protection have been imposed on the labour market. From 1979 to 1989, the *Plan Laboral* was in force. In practice, it sought to impose high levels of flexibility on labour relations with little protection of workers' rights, in the context of a military regime which repressed trade-union activities. That framework was modified substantially with the return to democracy from 1990 onwards; individual rights were restored and active policies were implemented to promote flexibility with protection.

Table V.1  
REGULATORY FRAMEWORKS FOR THE LABOUR MARKET AND MAIN TRENDS, 1973-2007

Period	Regulatory framework	GDP	Employment	Unemployment	Wages	Productivity
I Up to 1973	Complex legislation with high levels of protection	Low	Low	Low	Stable	Low
II 1974-1978	Deregulation in practice and repression of trade-union activities	Low	Low and increasing	High	Rising	Low
III 1979-1989	Plan Laboral: low levels of regulation and trade-union power	High during recovery	High	High and falling	Falling	Falling
IV 1990-1999	Labour reforms and restoration of rights	High, ending with a fall	High, ending with a fall	Low, ending with a rise	Rising, ending with a fall	Rising
V 2000-2007	New generation of labour reforms, higher protection and active policies.	Recovery and growth	Low, with upward trend	Persistently high, ending with a fall	Stalled, but ending with a rise	Rising

Source: Prepared by the author and P. Romaguera and others, "Reformas al mercado laboral ante la liberalización de la economía: el caso de Chile", *Informe estudio nacional*, Santiago, Chile, Economic Research Corporation for Latin America (CIEPLAN), 1994.

The results of a system with high flexibility and weak protection showed that it was not the way to achieve improved results in terms of growth, employment and working conditions. This strategy also proved not to be conducive to a sustained pattern of growth based on rising productivity, which is necessary in the framework of an open economy. From 1990, with the return of democracy, a model was established based on the exercise of workers' individual and collective rights, promoting participation and facilitating organization among social actors, oriented towards establishing a new system of labour relations founded upon dialogue and negotiation, and which has an active function in recovering the real value of basic parameters such as minimum wages and public-sector wages; this has led to increased growth and more lasting benefits, as well as a considerable rise in productivity.

The informal sector still makes up 32% of urban employment, however, although it has trended downwards in recent years. The informal sector is a major barrier to the development of a flexicurity system because its workers and enterprises function outside regulations, have no representation and are generally excluded from conventional social welfare systems.

## D. External flexibility

The Chilean labour market currently operates with considerable flexibility; thus, to a great extent, it meets one of the basic conditions for the flexicurity model. As for external flexibility, there are no regulations to prevent the hiring and firing of workers, and there is a wide variety of work contracts which are applicable depending on the type of productive activity involved. As for firing, in the absence of an open-ended contract, no costs are associated with termination of employment under normal circumstances. In 2006, 70% of wage-earners were employed under such a contract, but there has been a decline, as in 1998 these contracts had made up 81.2% of the total.

The high level of flexibility is reflected in a turnover rate standing at 26.2% of total employment; in international terms, this falls into an intermediate bracket. Nonetheless, there is a tendency to replace open-ended contracts with short-term ones. This may have negative effects in terms of protection, since it diminishes the number of workers having the kind of contractual arrangements that involve the strongest rights. It might be thought that this situation is partly due to a strategy of avoiding the costs related to dismissals, particularly if for operational reasons the business needs to modify some of the conditions of the work contract, and the worker does not agree. In this case, the only option would be to cancel the employment contract, pay the compensation and enter into a new contract; in practice, this leads to inflexibility.

The “Bustos law” obliges employers to complete social security payments in order to implement the dismissal of any type of worker, although the legislation permits the declaration and non-payment of pension contributions. In any case, there are no data concerning the impact of that law upon the capacity to dismiss workers.

Businesses may make use of outsourcing and temporary staff, which are extensive practices; some 42% of businesses use outsourcing (of those, 10% use temporary staff), and a third of companies outsource parts of their core operations. It would seem that outsourcing is not necessarily functioning as a tool of business specialization, but rather as a way of saving money on staffing. Labour legislation has recently been amended to rectify this type of distortion and regulate the provision of staff.

Recent years have seen a number of legislative changes in this area, although outsourcing is not a new practice; it often becomes difficult to identify the parties to an employer-employee relationship and, as a result, their responsibilities in terms of rights and obligations become unclear. Both employers and workers have consistently called for legal oversight of outsourcing, to determine whether workers

who are working together but are employed by different companies can negotiate collectively. There are similar issues in relation to work-related accidents and illnesses.

Legislation was adopted in 2003 in this area, but it failed to cover certain essential aspects such as the employer's residual liability. A new law came into force on 14 January 2007, requiring the principal employer to ensure compliance with the labour-law obligations of the subcontractor in respect of outsourced workers; if failure to comply is found, the principal employer is enabled to withhold payments to the subcontractor and even to fulfil those obligations in its place.<sup>2</sup> New requirements were also established in respect of safety and risk prevention. The principal employer must establish hygiene and safety rules in the workplace, compliance with which is compulsory for both sides.

The application of this law has led to improved levels of compliance with workers' obligations and has restricted the use of personnel supply services. In sectors where outsourcing is high, such as mining, agriculture, fisheries and forestry, progress has been made in identifying functions performed by outsourced workers which are similar to those of the workers of the primary employer, but with different working conditions, demonstrating the primary employer's obligation to hire workers directly.

Although primary employers accept direct hiring on the basis of identical functions, they defend their right to hire the worker of their choice; this may not be the person who was carrying out the functions while employed by the subcontractor. This has resulted in a jurisdictional dispute involving the Directorate of Labour and the employers, such as the Corporación Nacional del Cobre de Chile (CODELCO). The dispute was submitted to the Supreme Court, which found in favour of the employer and restricted the authority of the Directorate of Labour to supervise, penalize and impose corrective measures,<sup>3</sup> establishing that it did not have the authority to force the employer to hire a particular person or to be a party to the judicial process.

Compliance with employment-related obligations is provided for only in legislation, and the only references in respect of wages and other payments are the minimum wage and collective bargaining. That bargaining is required to take place at the level of each enterprise, but

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<sup>2</sup> Act No. 20,123 regulates outsourced labour, the functioning of temporary work agencies and work contracts for temporary services.

<sup>3</sup> A finding by the Directorate of Labour in December 2007 required CODELCO to hire directly 4,934 workers (equivalent to 27% of its personnel) who were working for subcontracting firms).

in the case of outsourced workers this is prevented in practice by the fact that they have organized themselves by sector.

Another important factor is the decentralization of production and employment processes, which allows for greater efficiency and lower costs. As a result, there may be different wages and conditions for similar jobs. Although it is agreed that this situation should be remedied, this does not mean that uniform wage levels are accepted, or that collective bargaining can be forced at levels other than those allowed by the country's labour laws.

Although some progress has been made, a much broader debate has opened up in respect of labour relations and the responsibilities of the various actors, including State institutions.

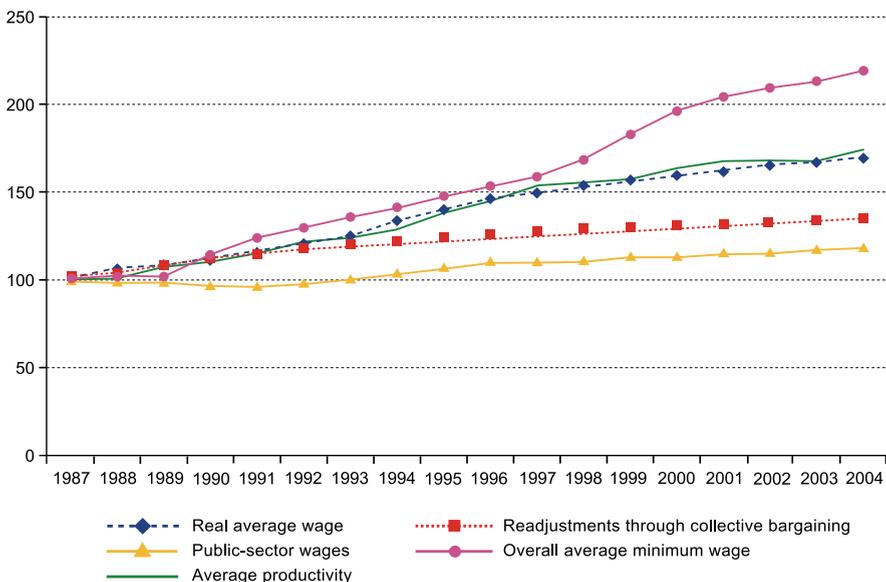
A further aspect relating to numerical flexibility is the fact that, although the public sector is characterized by stable employment, 46.6% of its staff are labour or service contract workers. This shows that, at least in theory, there is some flexibility in terms of adjusting the size of the workforce.

The present analysis also shows that in general terms, there is flexibility in terms of wages. Two experiences have undergone much analysis owing to their undesirable side-effects; they are currently part of the learning experience in this area. The first is the rule on complete indexation of wages to past inflation which was in force in the late 1970s and early 1980s. It proved to be highly dysfunctional at a time of deep recession, and played a large part in the job losses experienced at the time. The second, which is more recent, is the adjustment of the minimum wage which occurred in 1998-2000, leading to such a large real increase that not only was the minimum wage out of step with average productivity trends, but also that it influenced the overall adjustment in the labour market in the context of a recession resulting from the Asian crisis.

Analysis of the trend in average wages in the economy (see figure V.1) shows that there is still a close link to the increase in average labour productivity, as also occurred with the initial wage increase agreed during collective bargaining. This is significant in that it shows that wages have followed a sustained, stable growth trend, consistent with their linkages to productivity indicators in their variable components, as will be seen below.

Furthermore, future wage increases agreed during collective negotiations have stabilized at about 100% of the consumer price index (CPI), with an average periodicity of six months, indicating the presence of wage indexing for the duration of the contracts negotiated (which

Figure V.1  
TRENDS IN WAGES AND AVERAGE PRODUCTIVITY



Source: Prepared by the author on the basis of information from Central Bank of Chile, Directorate of Labour and National Institute of Statistics.

is set at two to four years by law). This applies to a universe of workers which has diminished over the years, both because collective bargaining involves only 7.9% of employed people, and also because that rule has been applied to an increasingly small proportion of those concerned by bargaining (65.3% of the total in 2004).

No calculations are yet available as to the indirect effects that wage indexing might have on the remaining companies not affected by collective bargaining, but in the context of falling inflation, it can be assumed that the trend in wages negotiated under that rule would be higher than that experienced by the economy's average productivity. In any case, it cannot be determined whether the above may constitute a cause of wage rigidity, because that would require knowing the relevant productivity and total wage trends, including variable components, which are generally associated with performance indicators.

Also, following the major recovery of the early 1990s, trends in real minimum wages have also been complementary to those of the growth of average labour productivity. Nonetheless, at the end of that decade,

owing to a three-year adjustment agreement, the real minimum wage recorded marked increases which did not take into account the impact of the Asian crisis on the Chilean economy. A balanced growth trend has been observed since then, and there has recently been a marked advance which ensures effective compliance, following the elimination of practices which had impeded it. At the latest negotiations, in 2008, a protocol was signed whereby the Government undertook to attach the highest importance to creating a law to equate the basic wage with the minimum wage, to put an end to the widespread practice of employment contracts with wages below the minimum wage, in which effective compliance was subject to workers' efforts to achieve targets, generally associated with predetermined sales figures. The National Congress adopted that draft legislation swiftly.

Lastly, the trend in average public-sector wages, measured from the general adjustment applied each year, shows a rate of growth lower than that of average wages in the economy as a whole. This view is only partial, however; given the lack of data, the above figures do not take into account the effects of the incentives agreed yearly under the Management Improvement Programme (PMG); these are subject to the meeting of targets, which are usually achieved.

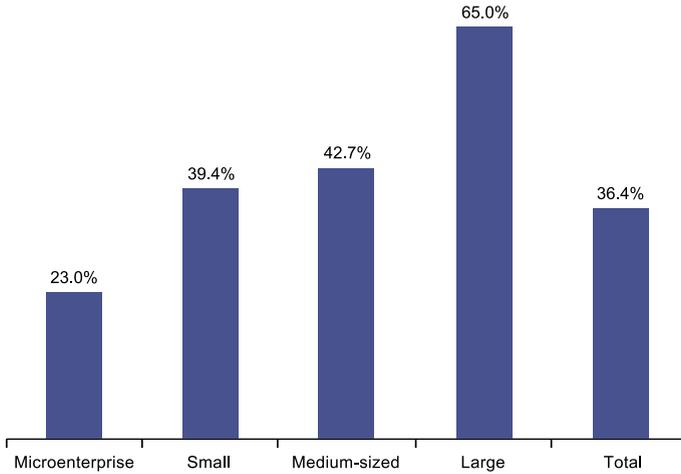
## **E. Internal flexibility**

Internal flexibility is also high; the available data show that the application of variable components is widespread in both public- and private-sector pay. Some 55% of businesses apply variable wages, rising to 80.2% in companies where a trade union is active. Furthermore, 36.4% of companies have created productivity bonuses, the use of which is even more common in large firms, 65% of which are using them (see figure V.2). The incentives are individual in the majority of cases, although some are associated with overall increases in a company's output or productivity.

As for profit-sharing schemes, 69.2% of companies have opted for a system which guarantees 25% of annual pay; 8% have chosen a system which distributes 30% of profits. In the public sector, the use of performance-related pay increases has expanded, and growing numbers of institutions are covered by the Senior Public Administration System.

As for the capacity to adapt working hours and organize the working day, many alternatives and regulations are available to permit the adoption of different systems according to employers' requirements. Maximum working hours have been reduced from 48 to 45 per week,

Figure V.2  
 BUSINESSES APPLYING SYSTEMS OF BONUSES, INCENTIVES AND AWARDS  
 FOR INCREASED OUTPUT OR PRODUCTIVITY



Source: Directorate of Labour, "Encuesta Laboral (ENCLA) 2006", Santiago, Chile, 2007.

and employers can establish part-time working hours, although in practice only 22.8% of them have done so, and these are relatively small companies. These working conditions facilitate labour-market entry for women and are applied more in those companies which have a high proportion of female workers.

Some 46.4% of businesses use overtime work, although this proportion has fallen as a result of reforms designed to restrict overtime work to unusual tasks. Firms can also adopt different combinations of work and rest hours, and different working days and shifts. As for the rules on Sunday rest, many businesses are exempt; 30% of firms make use of those exemptions for technical reasons or because they serve the public directly. Legislation on shift work is also very flexible, and the largest corporations are the ones which take advantage of this (66.7%). The law also allows for working arrangements which alter the usual distribution of work and rest days according to special modalities, and this provides additional flexibility.

In sum, the current legislation enables businesses to deploy a variety of alternative adjustments to organize the number and structure of working hours. Integrated strategies are applied in large companies, which tend to use different types of flexible arrangements simultaneously

in a given process and to the same workers; this gives them an adaptability greater than the sum of all the authorized alternatives.

Recent reforms in this area have sought to correct certain distortions such as excessive use of overtime work without truly justifiable reasons. The staff and management sides have reached no consensus, however, on initiatives which would make possible the following: agreements between management and union representatives, in each company, on calculating working hours on a monthly or yearly basis; wage adjustments where appropriate; and the possibility of suspending the employment contract with guaranteed access to social protection and subsequent rehiring. To date, the Government has not persisted in this attempt.

It is paradoxical that the absence of an organized workers' negotiating body and shortcomings in the full exercise of collective bargaining are factors which prevent better internal flexibility. This shortcoming makes it harder to achieve an optimal situation, since a collectively agreed flexibility within the enterprise, which by its nature would protect the interests of workers and employers, would be stronger than flexibility which is achieved only through legislation. This weakness, in turn, obstructs dialogue at the intermediate and enterprise levels and strengthens workers' perception of vulnerability in relation to employers.

## **F. Trade unions and collective bargaining**

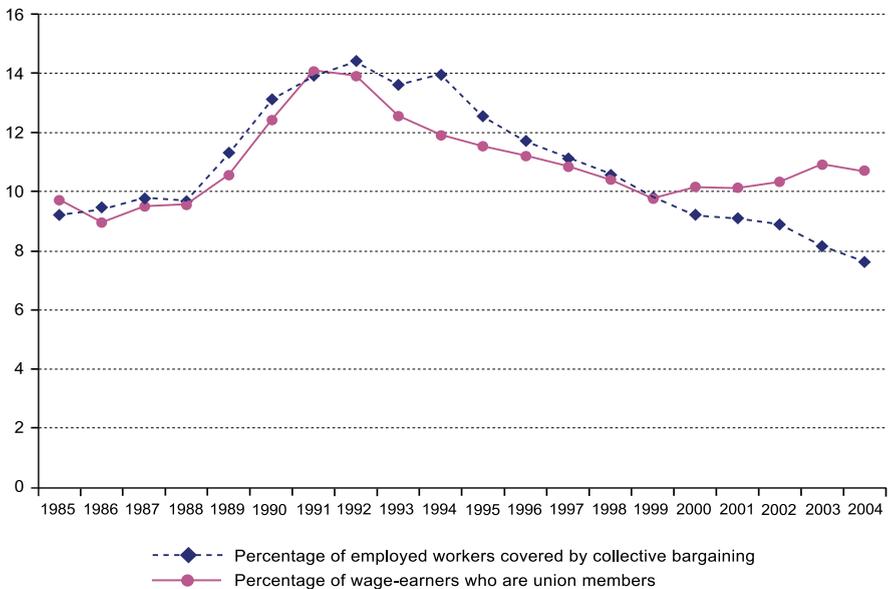
The existence of trade-union organizations whose membership represents a significant proportion of workers, the exercise and expansion of collective bargaining, and the practice of social dialogue as a permanent activity are central elements in the functioning of the flexicurity model; they have also been central in the design of democratic Governments' employment policies since 1990.

Nonetheless, the data reveal a considerable weakness in this area (see figure V.3). Trade-union membership is currently equivalent to only 10% of the workforce, and collective bargaining concerns only 7.6% of wage-earners despite the fact that a series of reforms have been implemented since 1990 to restore and expand collective rights and increase participation and extend the scope of collective instruments among the employed population. Furthermore, not only are the current indicators insufficient in relation to the proposed goals, but there has been a steady fall since the mid-1990s.

It is a complex issue, given that the reasons are varied: lesser trade-union activity in comparison with the period of restoration of

democracy, changes in the way in which production is organized, and high labour turnover (which would explain the reduction in enterprise-level unions with negotiating authority) and persistent complaints of anti-union practices. As for collective bargaining, it is likely that factors such as the employer's ability to extend benefits negotiated by the unions to the rest of the workers in an enterprise, the presence of replacement workers during strikes and the existence of parallel non-union negotiating groups all serve as disincentives to the unionization of workers. Furthermore, these developments mean that the reforms that have been achieved are insufficient from the viewpoint of the expectations of the union movement.

Figure V.3  
UNIONIZATION AND COLLECTIVE BARGAINING, CHILE, 1985-2004  
(Percentages)



Source: prepared by the author on the basis of information from the Directorate of Labour and the National Institute of Statistics.

Low levels of unionization and the limited scope of collective bargaining not only are an obstacle to the viability of a flexicurity system but also entail a greater risk, since conditions are being created for disputes over workers' claims to be dealt with on the margins of the regulations in force. In recent years, unions of temporary and self-employed workers and those which involve several companies have

gained in importance, despite the fact that in practice they experience severe limitations regarding their ability to conduct collective bargaining. With growing frequency, workers' unresolved claims have led to direct action such as official or unofficial strikes or workplace occupations in dynamic sectors, particularly export sectors, affecting groups of companies and moving labour disputes into the area of public order and security.

In the public sector, unionization and strikes are prohibited but the legislation is frequently infringed, with the signature of agreements and protocols which truly constitute collective contracts, and illegal strikes to put pressure on the authorities to meet workers' demands have become frequent. The essential difference compared with other sectors lies in the fact that the negotiators belong to strong organizations which have a long history in the union movement, and that the State is the employer.

## **G. Changes in social protection**

The ability of the social protection system to provide appropriate coverage in terms of health care, unemployment benefits and pensions is a fundamental issue. Recent years have seen reforms to the health-care system which have established a series of universal guarantees in case of serious illness, and the State has invested heavily in improving facilities for the poor. As for pensions, a structural reform was adopted in early 2008, leading to the creation of a solidarity-based pension system providing new benefits and rights for the poorest 60% of the population, and ensuring that even those who have never paid contributions will receive a pension. In both cases, the changes are aimed at guaranteeing that even the loss of a job does not mean exclusion from the services and benefits offered of those two systems.

The unemployment protection system and the recent changes to it are of great importance; it plays a central counterbalancing role in a system in which employers enjoy great flexibility in hiring and firing. Until 2002, when unemployment insurance was created, the main instrument of protection was a severance payment by years of service, under which a month's salary was paid for each year of seniority in the company up to the date of the lay-off. This type of instrument is generally intended to promote stable employment and worker protection and, in particular, greater importance is attached to the preservation of the job than to the protection of the worker's income when he or she loses the job. The system's effectiveness has, however, been questioned owing to its effects on the labour market.

This protection has limited coverage, restricted to workers with long-term contracts and lay-off which are due to the employer's needs. Companies are not required to set up a fund to cover such contingencies, so the payments are subject to the availability of liquidity. Since the amount to be paid is proportional to the number of years' service, employers have an incentive to shorten the duration of contracts.

In October 2002, unemployment insurance was implemented on the basis of an analysis which demonstrated the aforementioned shortcomings. The system combines workers' individual accounts with a solidarity-based unemployment fund which functions as a distribution fund. The system provides benefits based on the average salary for the year preceding the date of separation and which are financed from accumulated capital (from the individual account) and supplemented by the distribution fund. Funding is from three sources, and benefits are generated in all cases, financed from the individual unemployment accounts. The novel characteristics of its design have made it possible to: increase coverage, extending it to workers with temporary or piece-rate contracts; provide benefits regardless of the reason for termination of the contractual relationship; improve the balance between the compensation paid by the former employer and the saving in case of unemployment; and establish a direct relationship between the system, training policies, and employment information and labour intermediation services.

Improvements are still needed in some areas, however, such as access to the solidarity-based unemployment fund, generating larger benefits and increasing the coverage of beneficiaries. New instruments must be created to overcome the limitations of conventional protection systems which, in the presence of segmented labour markets like that of Chile, produce situations of exclusion among wage-earners or own-account workers in the informal sector, which includes almost 30% of the country's workers. Despite the progress made in recent years, the protection provided by the system is still incomplete, although it has the potential to be improved in the medium term.

## **H. Active policies**

Active policies make it possible to cover the population segments excluded from conventional protection systems, since the conditions for participation are not dependent on formal waged employment; indeed, they are specifically designed to favour workers who do not have such employment. These policies are one of the three fundamental aspects of the flexicurity model used for reference.

During the period covered, a series of labour-market policies were implemented, both active and passive, and considerable investments were made in institutional designs and the establishment of coordination among various Government bodies; jointly, they produced positive results and valuable experience for dealing with the difficulties imposed by low levels of employment growth.

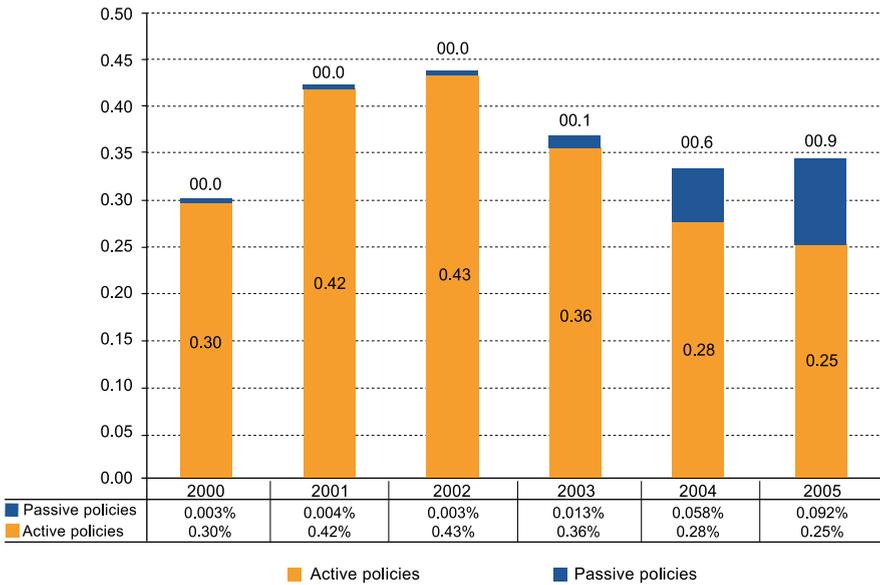
The instruments were designed to strengthen the supply of labour (through job training), strengthen vulnerable groups (through programmes to support the unemployed), increase demand for labour (through direct employment programmes or subsidies for the hiring of workers), and improve the functioning of the labour market (by developing information and labour intermediation services). As for passive policies, during the same period the unemployment insurance system was put in place, and will eventually replace the former unemployment subsidy system.

Figure V.4 shows the volume of investments made in implementing the aforementioned policies. Total spending on labour-market policies, as a percentage of GDP, showed a countercyclical trend during the period; while unemployment was relatively high, spending rose from 0.3% of GDP in 2000 to 0.44% in 2002, and declined to 0.34% of GDP in 2005. The latter was due to reduced spending on active policies, particularly the sustained falls in direct employment programmes and in investments in job training, through the use of tax concessions. Although total spending on those policies exceeds that recorded from 1995 to 2000, when it averaged only 0.17% of GDP, it remains well below the levels observed in industrialized countries, where it averaged 2.25% from 1990 to 2002, and in the economies in transition, where it stood at 0.66% in 1998.

The trend was different in terms of passive policies, with spending rising considerably from 2003 onwards; the launching of unemployment insurance was the main cause. This new instrument has had a considerable impact on coverage, compared with the slight level reached by the former unemployment subsidy; this, in turn, explains the slight increase in total spending recorded in 2005 compared with the previous year.

Despite the relatively satisfactory experience with the design and application of direct and indirect employment policies in recent years, there is no proper institutional framework to capitalize on the advances achieved. This relates to issues of design, coordination and, in general, development of appropriate technologies to improve effectiveness and efficiency in the administration of such a programme. Similarly, in relation to information and intermediation services, although their importance is

Figure V.4  
SPENDING ON LABOUR-MARKET POLICIES IN CHILE, 2000-2005  
(Percentages of GDP)



Source: Prepared by the author on the basis of Budget Department (DIPRES), Ministry of Finance, Chile.

agreed, coverage is somewhat below 10% of unemployed people, and there is no optimal design for improving its effectiveness, although there have recently been initiatives aimed at strengthening them, such as the programme linking them with private-sector services. Nonetheless, no political will has been seen in terms of promoting improvements in this regard, and this is clearly a significant disadvantage for the development of a flexicurity system in the country.

The most recent experience in this area, the pilot programme of public-private intermediation promoted by the Subsecretariat of Labour—consisting of intermediation services providing for a State-funded incentive equivalent to 50% of gross monthly wages for each worker placed, with a ceiling of 100,000 Chilean pesos—has been a complete failure, demonstrating once again the need to establish a public intermediation network targeting those who are unable to choose a market-based or private-sector solution for the provision of services of this type.

Training policies, an essential element for labour mobility and the adaptability of the workforce, target three population groups: employed workers, through tax concessions; unemployed people and vulnerable groups,

through social training programmes in general; and workers with incomplete training, through the Chilecalifica programme and others of a general nature.

As can be seen in table V.2, the trend in total training investment as a proportion of GDP was upward until 2002, and thereafter it diminished successively until it stood at 0.14% of GDP in 2005. This behaviour was due to lessening use of the tax concession because of the new provisions applied since 2002, which aimed to ensure correct use in smaller enterprises. In any case, investment in training followed a procyclical trend, with employers, faced with situations of uncertainty, reluctant to invest in training; if, in addition, their sales fall, they will have greater liquidity problems and will therefore tend to postpone decisions on training.

Table V.2  
COVERAGE OF PERSONS TRAINED AND INVESTMENT IN TRAINING

Programme	2000	2001	2002	2003	2004	2005	Percentage of economically active population (EAP) (2005)
<b>Workers trained (percentage of total)</b>							
Tax concession	92.2	94.1	95.7	94.4	93.1	93.8	58.6
Scholarship with tax concession	1.6	1.6	1.5	2.1	3.1	3.3	9.2
Social programmes	6.2	4.4	2.9	3.5	3.8	2.9	
<b>Investment in training (percentage of total)</b>							
Tax concession	82.8	82.1	83.0	86.8	84.4	86.7	--
Scholarship with tax concession	2.5	7.0	7.5	3.8	4.7	3.9	
Social programmes	14.6	10.9	9.5	9.4	10.9	9.4	
- National Scholarship Programme	0.00	0.00	5.5	3.3	7.6	6.1	
Total investment (percentage of GDP)	0.17	0.22	0.24	0.20	0.15	0.14	--

Source: National Training and Employment Service (SENCE), Statistical yearbooks, various years.

The tax concession is the main programme in terms of both the number of persons trained and the amounts involved, and it benefits wage-earners in formal enterprises, especially medium-sized and large ones. The State encourages the implementation of training activities through that means, offering a discount on the annual amount of corporate income tax in accordance with the investments made in training workers, up to a maximum of 1% of annual payroll. This is therefore a tax concession for expenditure already incurred.

This tax concession also funds "tax concession scholarships", financed with carry-overs from the contributions of companies affiliated to the intermediate technical training bodies (OTIC) that have not been used during previous financial years. The programme benefits workers who are relatively unskilled or unemployed and persons covered by the

public social network. There has been an upward trend in the coverage of beneficiaries, from 1.6% in 2000 to 3.3% in 2005, exceeding the number of persons trained under social programmes. Funds are also being reallocated through the programme for beneficiaries excluded from the normal use of the tax concession, particularly women. Its resources amount to around 4% of the total investment training of the National Training and Employment Service (SENCE), equivalent to less than half the total for social programmes.

Programmes designed to help the unemployed and vulnerable groups to reintegrate themselves into the labour market are funded by the National Training Fund (FONCAP), and come under the heading of social programmes. As can be seen in table V.2, the numbers of people benefiting from that programme have diminished and it represents less than 10% of total training investment. Only the National Scholarship Programme, designed to provide training in trades for waged or own-account work, has shown signs of growing, although in absolute terms it is on a small scale.

It is also important to contrast the numbers of beneficiaries of training programmes with the target population. In 2005, 93.8% of those receiving training were waged workers in enterprises which used the tax concession, while the remaining 6.2% were trained under special programmes for the unemployed and vulnerable groups. Comparison of these proportions with the percentages of waged workers and unemployed persons in the workforce—58.6% and 9.2%, respectively—shows that the percentage of employed waged workers is too high, that of unemployed persons too low, and almost a third of the workforce is outside the target population of the training policies.

In fact, the reason why about a third of the workforce is outside the target population of the current programmes is they are self-employed workers or workers in the informal sector; this poses additional funding problems for the implementation of specific programmes. Extending the target population to include those groups is clearly a public-policy challenge, and the implementation since 2005 of the training programme for micro-entrepreneurs and own-account workers is an example of public policy in that area.

Seeking optimal and sustainable financial solutions is a central requirement, since the associated cost of training a worker in the social programmes is much higher than that obtained through the tax concession. The average cost of training through the National Scholarship Programme is 6.8 times higher than through the tax concession, owing to the low levels of human capital, general or specific, among the workers trained under the special programmes. Consideration should be given to

redesigning the training, first of all by reorienting it towards a competence approach, coordinating it with a national certification programme which is currently going through the legislative process. This initiative has great potential to promote investment in training and bring about a significant increase in levels of coverage.

There are two other approaches which may produce better results in the future, with the prospect of a training system which can offer opportunities for qualifications and continuing education. On the one hand, recent experience has shown that the impact of training in terms of employment and income is stronger when accompanied by systems such as hiring incentives. Thus, the integrated training policies for the beneficiaries of Chile Solidarity take on particular importance, since they are incorporated into the instruments designed to tackle the structural unemployment associated with poverty among particular groups.

It should also be noted that direct employment programmes are currently managed by SENCE, and a similar trend can be seen in indirect programmes. Given that SENCE is also responsible for most job training programmes and that information and labour intermediation services are also part of its mandate, this adds up to a picture in which coordination between complementary services can take place with greater facility than in the past, since the coordination will take place within a single institution.

## **I. Actors and social dialogue**

Since the restoration of democracy, social dialogue has been seen as both an objective of employment policy and a means of reaching staff-management agreements. Following a long history of disagreements and disputes, it has been an essential task for every Government since 1990 to achieve national social agreements leading to a climate of cooperation and understanding between workers and employers. The intention to create such a process, which had no precedent in Chile, was based on the belief that the institutional framework set up by the military regime had evident drawbacks in terms of labour representation, social protection and the promotion of equitable development. At the Government level, institutional reform in the field of employment clearly required commitment from both workers and employers and, on that basis, work began on negotiating agreements to promote cooperative relations, reform labour laws and strengthen enforcement, develop job training and improve the social-security system.

In 1990, the Confederation of Production and Commerce (CPC) and the Amalgamated Workers' Confederation (CUT) adopted a Frame of Reference for Dialogue, stating that economic development meant growth, finding new

markets, increased savings and investment and rising levels of employment and wages. They added that the functioning of the labour market must be efficient and competitive and subject to regulations in order to achieve equitable and just distribution of wealth, protect the weakest groups, eradicate poverty and promote full employment. This led to the signing of a tripartite framework agreement entitled “Chile, a historic opportunity”, the impetus of which led to the adoption of further agreements on more specific matters between 1991 and 1993.

After four years, however, this process began to show signs of exhaustion. Business leaders became reluctant to take part in new agreements for the adjustment of the minimum wage, arguing that they were not relevant to their companies and that they were not prepared to recognize the trade unions as important negotiating partners. Trade union leaders also changed their attitude to negotiation. In 1994, when the second Concertación Government had just been formed, the unions called for new labour reforms and faster growth in wages and benefits. They argued that, although there had been advances during the first Concertación Government, they had not lived up to expectations, and that the inequalities in the model of economic growth meant that the trade-union movement must be strengthened before it could take part in new negotiating mechanisms, which the unions saw as imbalanced and unproductive.

In 1994, the new Government restarted the social dialogue, creating a new tripartite body at the national level, the Productive Development Forum, where a variety of issues could be discussed, including employment and social protection. Within that framework, the National Centre for Productivity and Quality (now known as Chile Calidad) was set up, with a tripartite structure and with the objective of promoting and strengthening dialogue, research and the sharing of information and experience in the area of competitiveness, but the participants failed to achieve consensus either on a new set of reforms in the area of collective bargaining and the expansion of trade-union rights and freedoms, or on the creation of unemployment insurance.

The next new Government established a Council for Social Dialogue in 2000, inviting the principal actors from the world of employment to take part in tripartite technical committees and, at the same time, to tackle the issue of creating unemployment insurance. The positions taken by the employers’ and the workers’ sides remained far apart in areas such as multi-company negotiations and the elimination of the use of temporary workers during strikes, which were fundamental issues for the trade-union side. The Government decided that the draft law would deal with only those matters on which agreement was most likely to be achieved. In 2001, new labour reforms were adopted, and in 2002 unemployment insurance was instituted even though the employers’ organizations did not support it and the workers’ organizations remained unsatisfied.

Since then, there has not even been any concrete initiative in this area through the tripartite national social dialogue body. In recent years, Governments have opted for presidential advisory councils (for instance, for reforms to pensions and education and in relation to employment and equity issues), made up of experts or representatives of various social groups and designated by the Government. Their recommendations are not binding on the executive branch of Government.

Social dialogue and consensus seem to have functioned well only in the early days of the restoration of democracy, when there was much uncertainty about the country's economic and social future. The unusual agreements reached in the early 1990s are to a great extent explained by the recognition of social consensus-building as a collective good which would yield highly positive results for parties having different interests. It was considered that this would ensure stability in the economic system and give reality to postponed demands for greater protection and sharing in the benefits of growth, and that all this would permit the new authorities to ensure a successful transition process. That would also explain the emphasis on the medium term and the national characteristics attributed to the agreements.

Since that experience is basically due to the unusual circumstances of the early stages of transition to democracy, it is not surprising that the process lost its early vitality once the main uncertainties and nervousness had dissipated, particularly in terms of national agreements. All it takes to stop the process is for one of the parties to change its mind as to its usefulness.

Even if perceptions of social consensus-building remain positive, there is a further problem which arises out of the degree of decentralization and the competition for leadership among institutions which represent labour and business interests. In such circumstances, which do seem to prevail in the context of Chile, there is no guarantee that agreements reached at the leadership level will in fact be applied at the decentralized level. This can be even more significant if the terms of general agreements do not bring direct socio-economic benefits and if the authority of the signatories is doubtful.

## **J. Gradual but steady progress towards flexibility with protection**

Nonetheless, progress has been made through gradual institutional reforms in the field of employment, new unemployment protection instruments have been created and active policies have been established, all of which are central to a flexicurity model. The determination of successive Governments to bring about change in that direction has been a decisive source of effectiveness.

The Chilean experience shows objective changes in improvements to employment protection and the creation of new instruments designed to facilitate labour-market adaptation; this has made it possible to transform the regulatory framework inherited from the military regime. These transformations, which some consider insufficient and others inappropriate, have been characterized by their gradual and steady nature, but they have been no less effective for that, and they have avoided excessive or drastic changes.

As could be expected, changes in individual and collective employment regulations have been actively promoted by labour organizations, whereas the interests of workers and employers have coincided a great deal in the design of new employment-contract modalities. Businesses have also contributed actively in less controversial areas such as reform of labour justice and improvements to training systems, partly because those did not entail changes to employment legislation and because they are mostly State-funded.

The role of Government has not been neutral; all the reforms have been consistent with the design of employment policies oriented towards developing flexibility with protection; improving the protection of individual rights in labour relations and re-establishing basic guarantees for the exercise of collective rights strengthens the ability of the parties to conclude agreements; this also complements the existence of appropriate and effective labour justice. The reforms for the creation of new employment modalities seek to provide security in terms of the rights and obligations of the parties and, by improving employability and protection for those who lose their jobs, contribute to developing better adaptability among both workers and employers.

In Chile, the legislative initiative lies solely with the executive power when fiscal resources are involved, but in other cases also its support is decisive. Lack of consensus does not paralyse negotiations, however, since they are transferred to Parliament where the differences between the parties are reproduced and new agreements are reached, although in such cases a greater diversity of interests is taken into account.

All this helps to explain the limitations and the practical usefulness of social dialogue, since workers' and employers' organizations are aware that their differences will ultimately be taken up in Parliament. The accompanying risk lies in the fact that, if certain issues are not satisfactorily resolved or their consideration is constantly postponed, they will take on great significance and may encourage the parties to set aside existing institutions. This is the case, for example, of restrictions on collective bargaining or the exercise of the right to strike and, more recently, disputes arising out of new rules on outsourcing.

## K. Conclusions and recommendations

The following is a series of proposals designed to eliminate the current obstacles to the development of a flexicurity system.

- (a) To improve the relationship between flexibility and employment protection, progress could be made through improved protection in case of job loss, through two main approaches:
- *Improvements to employment insurance.* Through improved parameters relating to the design of the insurance, such as the requirement to pay 12 consecutive premiums in order to have access to the benefits of the solidarity-based unemployment fund (which is currently under-used), among other things, greater effectiveness could be achieved by increasing the current level of replacement of severance payments by greater employers' contributions to the system. This would counteract the current tendency to move away from long-term contracts because of the cost of separation and, in turn, new resources would be made available to fund greater job-loss compensation or extend the duration of protection.
  - *Extend long-term unemployment coverage.* The existing conventional unemployment protection systems, which are basically contributory, are particularly appropriate for situations of cyclical unemployment and restrict the duration of benefits to the average period of unemployment. For cases of longer-term unemployment there should be a State-funded unemployment assistance mechanism, which would come into play when the unemployment insurance benefits expired. The payments would be granted in return for regular participation in active labour-market programmes.

In that regard, the Government has placed before Congress a proposed reform of the unemployment insurance system. Among the proposed changes are the inclusion of workers with temporary or piece-rate contracts among the beneficiaries of the solidarity-based unemployment fund, establishing new requirements for their access. The goal of reducing the conditions for access to benefits from the fund is also dealt with: it is proposed that workers with short-term and long-term contracts should both have to make 12 contributions in the last 24 months, with the last three being consecutive and with the same employer. As for the benefits themselves, it is proposed that in cases of high unemployment, additional benefits should

be paid to the beneficiaries of the fund. In the case of workers with long-term contracts, the sixth and seventh months of benefits will be funded with replacement ratios of 25% and 20%, respectively, and for workers with temporary contracts the replacement ratio for the additional payments will be 30%.

(b) There are three ways of improving the effectiveness of active policies. Given that direct and indirect employment programmes, information and labour intermediation services and the main job training services currently come under the authority of SENCE, priority should be given to investing in all aspects of its institutional development, to ensure efficient functioning based on objective quality standards.

- *Information and labour intermediation services.* Political will is needed in order to intervene decisively in their development, to eliminate ambiguities in relation to its administrative dependency and to invest in efficient design and management models, achieve close cooperation with the funding of unemployment insurance, establish systems for assessing its results in comparison with quantifiable goals and, on the basis of the above, to significantly increase the allocation of fiscal resources towards those goals.

The recommendation that particular importance should be attached to the monitoring and assessment of new initiatives designed to encourage participation by private-sector entities in the provision of those services, such as the pilot programme in public-private intermediation promoted by the office of the Under-Secretary for Labour, has taken on great significance. That experiment was a complete failure, demonstrating once again the need for a public-sector intermediation network for those who cannot afford to use a market-driven or private-sector means of obtaining services of that type.

- *Employment and labour reintegration programmes.* Such programmes not only are important in response to high levels of unemployment resulting from crises, but are also an effective tool for dealing with long-term problems of imbalance in the supply of labour. They also help to extend the scope of protection to segments of the workforce which are usually excluded from conventional systems of protection, such as workers in the informal sector and other groups which are highly vulnerable because they are difficult to employ. Optimal techniques of intervention must be developed, which could be achieved by establishing permanent mechanisms

and monitoring and assessment goals for their impact, and by creating budgets funded from the general State budget to allow for medium- and long-term planning, to boost efficiency in the use of resources by coordinating complementary programmes targeting properly identified groups of beneficiaries.

- *Work training policies.* Since training policies depend to a great extent on the use of tax concessions, which causes a bias in favour of workers in medium-sized and large enterprises, an incentive system is needed in order to expand the quantity and extend the use of tax-concession carry-overs, to help greater numbers of workers who are neither affiliated to nor contributing to the Intermediate Technical Agencies for Training (OTIC). This area has high potential for concluding national tripartite agreements—as in the developed countries—and this could help to rectify the current shortcomings in the coverage of vulnerable beneficiaries who are least well protected because they are the most difficult to employ. Activities funded by the National Training Fund (FONCAP) should be developed and, if justified by periodic impact assessments, they should be reinforced by more generous budgetary allocations.
- (c) Given the setbacks identified in the coverage of the trade-union movement and in collective bargaining and, consequently, in the ability to collectively represent workers' interests, new formulas are being sought to eliminate the obstacles to better exercise of the unions' role, since they are the fundamental basis for the development of collective autonomy. This may make it possible to prevent future progress from being subject to the will of the Government in power.
- (d) *Social actors and dialogue.* From the viewpoint of the flexicurity model, the advances achieved have taken place in the absence of an institutional framework to promote and develop tripartite dialogue at the national level, as a valued and permanent practice. Despite various initiatives taken by all Governments since 1990, the experience has not been a spectacular success. Nonetheless, the strategy of promoting dialogue concerning regional problems or on specific issues seems to have the potential to generate progress with the passage of time, although it is a very complex problem and the results will become clear only in the medium and short term.
- (e) Lastly, the inflexible positions taken by the workers' and employers' sides, preventing consensus being reached on an effective flexicurity

system, is an obstacle which crops up regularly at the national level. That rigidity is reflected, for example, in repeated calls for measures to improve labour-market flexibility, which not only are recognized in current regulations but also are widely used. In addition, the failure to reach agreements on the institutional framework for social dialogue and the right of the unions to represent workers in collective bargaining, as well as recognition of its full exercise, an issue considered recently by the Presidential Advisory Council for Employment and Equity, only serve to reveal the magnitude of the challenges remaining to be dealt with.



## Chapter VI

### **Mexico: the dimensions of labour flexicurity<sup>1</sup>**

*Clemente Ruiz Durán*

#### **A. A flexible, segmented market under demographic pressure**

With an economically active population of 45.4 million people and an economically inactive population of 31.5 million, the Mexican labour market is the second largest in Latin America. Having grown at an average annual rate of 1.2% since 1995, the total population of the country reached 106.5 million in 2008. In the same period, the economically active population expanded 2.0% as the young people born during

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<sup>1</sup> This document draws on the material presented at the seminars held in February and August 2008 at ECLAC headquarters in Santiago and the comments made by Jürgen Weller, Ruperto Patiño, Graciela Bensusán, Gerardo Fujii and Mateo Lejarza. Manuel Haro Zepeda, Carmen Hernández Lara, Marco Merino, Víctor Osorio and José Segura Álvarez also worked on the editing and preparation of the database. The Secretariat for Labour and Social Security provided essential support, and through the General Directorate of Labour Research and Statistics, headed by Roberto Fausto López Esquinca, processed the homogenized data of the National Occupation and Employment Surveys of 1995-2007 and the National Survey on Employment, Wages, Technology and Training in the Manufacturing Sector of 2005. Despite these valuable contributions, the author is solely responsible for the contents of this chapter. For an extended version, see Ruiz Durán (2009).

the demographic explosion of the 1960s, when population growth had been over 3%, joined the workforce. The population aged 14 and over is expanding by 1,199,019 people each year. Of these, 863,740 enter the labour market, which obviously puts huge pressure on that market, while 157,622 join the ranks of the economically inactive population. Members of the economically inactive population are classified as either available (4.7 million people) or unavailable (26.7 million people). The available economically inactive population comprises people who neither work nor seek work because they do not believe they will be able to find a job. Although they do not refuse to work as such, their behaviour can be viewed as passive because they make no attempt to join the labour market. The unavailable economically inactive population consists of people who have absolutely no interest in joining the labour market or are unfit to work (INEGI, 2005, p. 10). It should be said that the line between the economically active and the economically inactive population is a thin one and is often crossed when seasonal changes in labour demand (such as the holiday season at the end of the year) encourage economically inactive members of the population to temporarily become economically active.

In the last 50 years, population growth has been affected by the migration (primarily to the United States) of people who could not find quality jobs in Mexico that would enable them to attain adequate living standards. According to the National Population Council, about 9.6 million Mexicans emigrated between 1990 and 2008, and a report published by the United States Bureau of Labor Statistics states that 19.8 million members of the civilian population in the United States in 2007 were of Mexican origin and 14 million of them were members of the work force.<sup>2</sup> Migration has altered the composition of the Mexican labour market. The economically active population currently faces a range of options: finding a job in the formal sector or in the informal sector; being self-employed, underemployed or unemployed; or emigrating abroad. The final decision usually depends on the social group to which a person belongs.

In 2008, of the 45.4 million members of the economically active population, 43.8 million were employed, and 1.6 million were unemployed. Being employed has several different meanings in Mexico. The Political Constitution of the United Mexican States classifies workers into different categories according to the job they hold in the labour market and the economic sector in which they work.<sup>3</sup> Public- and private-sector workers are treated differently. Exceptions

<sup>2</sup> Estimates are based on the basic demographic indicators of the National Population Council available [online] at <http://www.conapo.gob.mx/00cifras/00indicadores.htm>.

<sup>3</sup> See article 123 of the Political Constitution of the United Mexican States.

are established for those working for the State, while more general rules apply to labour relations in the private sector.

Of the 43.8 million people employed, 22.1 million work in companies, 12.0 million in the informal sector,<sup>4</sup> 5.2 million in public institutions, 1.8 million in paid domestic service, 1.4 million in subsistence farming, and 876,000 in private institutions.<sup>5</sup> Although the different segments of the labour market are classified and covered by regulations enshrined in constitutional law, the uneven application of the law has fragmented the institutional framework.

The employed are divided into two large groups according to the position they occupy in the labour market: subordinated workers and independent workers. Subordinated workers are in turn divided into paid and unpaid workers. Paid subordinated workers include wage workers and those who obtain some other form of remuneration. Unpaid subordinated workers (who are divided into family workers and non-family workers) are people who receive no payment (in money or in kind) although they might receive some type of benefit. Independent workers encompass both employers and own-account workers. In 2008, subordinated workers numbered 31.8 million, and independent workers 12 million. Between 1995 and 2008, the average annual growth of the segment of subordinated workers was 2.6% compared with 1.7% for independent workers, this resulted in subordinated workers accounting for 72% of the employed population at the end of the period.

Of the 31.8 million subordinated workers, only 14.8 million have a written contract, however, which further segments the labour market. Although workers without contracts can take employers to court in the case of a conflict, they are at a disadvantage when they try to do so because the non-wage benefits they may have received will not have been duly recorded. Articles 35, 36 and 37 of the current Federal Labour Law establish that, in principle, all labour relations, except those covered by temporary contracts or contracts for a specific job, are considered to be for an indefinite period.

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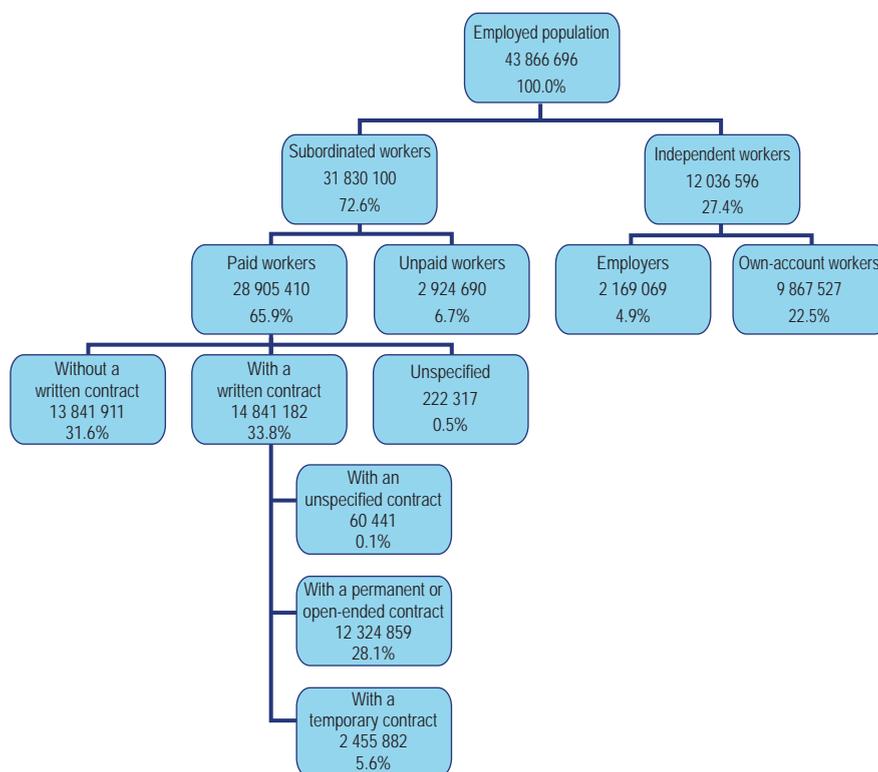
<sup>4</sup> The National Institute of Statistics, Geography and Informatics (INEGI) defines the informal sector as all economic activities that operate out of the home without a company being set up that can be recognized as independent of the home.

<sup>5</sup> INEGI defines private institutions as economic units devoted to the provision of educational, social assistance and health services (regardless of the type of organization) and any other institution that operates as a civil association, regardless of the type of service it provides.

Diagram VI.1 presents the segmentation of the Mexican labour market and shows that the situation of a large proportion of the employed population in that market is highly precarious even when article 26 of the Federal Labour Law stipulates that the non-existence of a written contract does not deprive the worker of the rights derived from labour regulations or the services provided because responsibility for the lack of a formal contract is imputed to the employer.

One of the most controversial issues in labour relations recently has been the redefinition of the place of work. One way to approach the issue is to examine the type of establishments in which people work. Data shows that two thirds of subordinated workers with written contracts work in medium-sized or large establishments or for the Government, while 60% of subordinated workers without written contracts work in microenterprises, which is where the informal labour market is largely concentrated.

Diagram VI.1  
MEXICO: BREAKDOWN OF THE EMPLOYED POPULATION BY EMPLOYMENT SITUATION, 2008



Source: Prepared by the author.

Table VI.1  
MEXICO: PAID WORKERS, BY CONTRACTUAL STATUS, PRODUCTION SECTOR  
AND WORKPLACE, 2008  
(Percentages)

	Total	With a written contract			Unspecified type of contract	Without a written contract	Unspecified
		Subtotal	Temporary contract	Permanent or open-ended contract			
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agricultural sector	7.4	1.0	1.1	1.0	0.7	14.2	3.1
Unspecified	2.7	2.9	4.3	2.6	28.2	2.0	27.3
Non-agricultural sector	90.0	96.0	94.6	96.4	71.2	83.8	69.5
Large establishments	13.6	24.9	21.2	25.7	12.5	1.7	6.7
Medium-sized establishments	14.9	24.5	26.0	24.3	18.5	4.6	14.6
Small establishments	21.6	27.6	27.6	27.6	22.5	15.2	23.2
Microenterprises with an establishment	14.6	5.1	5.2	5.1	5.6	24.8	15.8
Microenterprises without an establishment	10.3	0.3	0.6	0.2	2.1	21.2	2.4
Government	7.5	13.2	13.4	13.2	9.9	1.4	4.8
Other	7.4	0.4	0.5	0.4	0.0	15.0	2.1
Microestablishments and small establishments	46.6	33.0	33.4	32.9	30.3	61.2	41.4

Source: Prepared by the author on the basis of national occupation and employment surveys.

A breakdown of employment by workplace also reveals that although a large proportion of workers work in establishments, there is a subgroup of workers who work from home (14% of paid workers in 2008) or are itinerant workers (5%) and another segment who work in the installations of other companies or institutions (this is the case, for example, of many subcontractors (3%)).

Subcontracting is most common in the manufacturing sector, especially in the base metal, chemical, food and beverage, plastic, and non-metallic mineral industries. It is mainly used in large and medium-sized industry and only to a lesser extent in small and microindustry (National Survey on Employment, Wages, Technology and Training in the Manufacturing Sector –ENESTYC, 2005).

The Mexican labour market has thus become highly segmented, and only a limited number of workers have obtained quality jobs, while the rest find themselves in increasingly precarious situations. One of the reasons behind the increasingly precarious nature of employment is the inability of the institutional framework to provide broad social security coverage that guarantees all Mexicans a minimum standard of living throughout their lives. The shortcomings of the social security system

paved the way for informality, encouraged non-compliance with the law and generated structural problems in the institutions that were meant to provide coverage. This triggered a financial crisis which has been tackled with only modest reforms.

In addition to the problems stemming from the structural weakness of the social security system, the low-wage-cost schemes adopted in the last few decades have kept wages down, which has weakened the domestic market and produced an economic slowdown. In the pursuit of a market solution to the employment problem, the concept of the workplace has been redefined, which has generated greater flexibility in the labour market. A wide array of working arrangements have emerged: microenterprises and small enterprises (and especially the new hiring schemes they use) have become increasingly important, and subcontracting has also increased.

## **B. Labour-market regulations: characteristics and recent changes**

Mexico's labour legislation has been in force since 1970 and has never undergone any substantive reform. Inspired by social rights, its approach has been to defend the rights of workers. It is grounded in article 123 of the Constitution, which states that: "Every person has a right to work in a dignified and socially useful way. In order to enforce such a right, both job creation and labour organization shall be promoted in accordance with the law". The article has been modified thirty-one times since 1917. The Federal Labour Law, which regulates employment relations, classifies these relations into two broad categories: individual employment relations and collective employment relations. It also covers labour inspection activities, which are meant to ensure that companies comply with existing legal provisions.

### **1. Individual employment relations**

The rules governing individual employment relations are set out under the second heading of the Federal Labour Law. The key elements are:

- **Article 20.** An employment relationship is deemed to exist, irrespective of the act from which it originated, wherever a person renders personal services to another person or entity, subject to the authority and direction of the other person or entity, in exchange for remuneration. An individual employment contract is any type of contract whereby a person undertakes to provide services to another person or entity, subject to the authority and direction

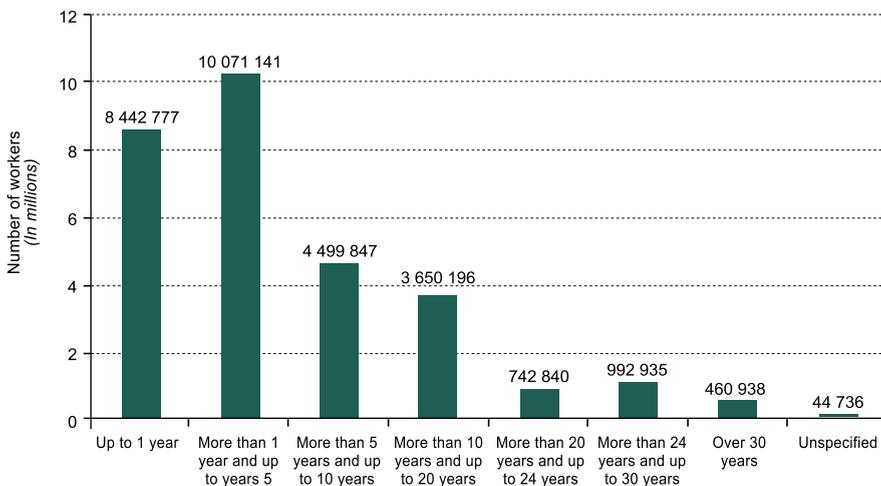
of the other person or entity, in exchange for remuneration. The provision of a service as referred to in the first paragraph hereof and the contract that is entered into have the same effect.

The aspects of individual employment relations that have been modified at some point are presented below:

- **Child labour** (article 22). The minimum working age was raised from 12 to 14 years. According to the National Occupation and Employment Survey for the second quarter of 2008, this meant that 4.5 million children were protected and would be able to complete the basic education cycle (six years of primary schooling and three years of secondary schooling). The goal of the reform was to redefine child labour. To date, however, some 2.4 million children are estimated to be working, which shows that although the law was reformed, no mechanisms were set up to enforce the law.
- **Written contracts** (article 24). This article stipulates that the employment relationship and how it will be handled to protect the worker against abuse must be stated in writing. However, as mentioned in section A above, barely 33% of the working population have a written contract.
- **Job stability** (chapter II of heading II). This chapter of the Labour Law is one of the most controversial because, in principle, article 35 states that the duration of employment relations can be for as long as it takes to complete a specific project, for a specified period of time or for an indeterminate period of time, and that unless stated otherwise, the relationship shall be considered to be for an indeterminate period of time. In practice, however, workers are usually hired for specific periods of time (even though this is supposed to be the exception), and companies often hire new workers under “probationary contracts”, which undermine workers’ job security. Nor is it rare nowadays for subcontractors and outsourcing companies to evade their labour obligations and violate the principle of job stability.
- It should be noted that “probationary contracts” are not enshrined in Mexican law, whether for a specific project, a specified period or an indeterminate period. There is an ongoing debate, however, about whether what is not explicitly prohibited is permitted. Some legal experts have used this premise to validate “probationary periods”. This not only paves the way for workers to be hired without being guaranteed the benefits to which they are legally entitled, it also undermines the principle of job stability.

As regards subcontracting, the Federal Labour Law defines an intermediary as “a person who hires or intervenes in the hiring of one or more persons for the furnishing of services to an employer”. The Law also establishes the principle of shared responsibility, whereby the corporate clients of job placement agencies are jointly responsible for the labour obligations towards workers hired through such agencies. Not all workers’ rights are protected in this form of hiring, however, especially as regards job stability, because the workers are often moved from company to company and find themselves being hired under one temporary contract after another without ever having the security of a permanent job. According to the findings of the National Occupation and Employment Survey of 2008, of 28.9 million wage earners, 18.5 million (in other words, 64.1%) remain in the same job for less than five years (see figure VI.1).

Figure VI.1  
MEXICO: JOB STABILITY  
(Years in the same job)



Source: Prepared by the author, on the basis of data from the National Occupation and Employment Survey of 2008.

- New forms of individual contracting have emerged that do not establish any employment relations with the company. In the *Petróleos Mexicanos* service stations, for example, people can work under the “right to work the floor” modality whereby they

do not receive any wages for dispatching petrol or providing other services to the customers who come to the station and obtain their income solely from the tips they receive.

- Wal-Mart de México has introduced another form of individual contracting whereby workers are associates of the company rather than employees, which means that the employment relationship is different from the one stipulated in the Federal Labour Law.
- Working for honorariums that can be assimilated are a limited form of contractual hiring. Part of the wages or salary in these arrangements is paid in keeping with labour legislation and affords the full benefits established by law, while the largest portion of the remuneration is paid in honorariums, in other words, outside the employment relationship.
- The same employment relationship can undergo a series of changes which, in terms of job stability, are at times more favourable for the parties involved than others. One of these changes is the temporary suspension of employment relations which ends the reciprocal obligation of the worker to provide the service and of the employer to pay the wage. Article 42 of the Federal Labour Law establishes seven grounds for the suspension of employment relations, including the illness, arrest or detention and subsequent acquittal of the worker. Once the temporary causes of suspension have disappeared, the employment relationship is resumed and the principle of job stability is thus respected. On other occasions, employment relations are not just suspended, they are terminated because a situation arises which prevents the service from continuing to be provided. According to article 53 of the Federal Labour Law, grounds for terminating employment relations include: mutual consent; the death of the worker; the completion of the project; and the worker's physical or mental incapacity, which renders performance of the work impossible. In these cases, the relationship is terminated owing to natural causes that are not imputable to either of the parties, and the principle of job stability is therefore not violated.
- A worker may also rescind the employment relationship without liability. Article 51 of the Law establishes nine grounds for a worker to end the relationship without liability. In these cases, it is the employer who breaches the contract by violating the principle of job stability. The grounds include: lack of probity on the part of the employer; the lowering of the worker's wages;

and the employer's failure to pay wages at the established place and time. The worst and least desirable change in the employment relationship is dismissal. Dismissal is a unilateral act whereby the employer ends the employment relationship, citing serious non-compliance on the part of the worker as just cause. A worker can be dismissed when the worker fails to comply with the contract by incurring in one of the 15 faults established in article 47 of the Federal Labour Law, without the employer being responsible for the non-compliance. The following are some of the grounds for dismissal, in other words, for the employer to end the relationship: the worker disobeys the employer; the worker is absent without justification three times within a period of 30 days; lack of probity on the part of the worker; and showing up to work inebriated. Workers can be dismissed for economic reasons but only with the authorization of the labour authority. In the case of unfair dismissal, the worker is given three months' wages plus 12 days' wages for each year of service when the worker has the right to be reinstated but does not exercise that right, and three months' wages plus 20 days' wages for each year of service when the worker does not have the right to be reinstated (the worker receives accrued outstanding wages). In the case of dismissal for economic reasons, the indemnity is four months' wages, 20 days' wages for each year of service and a seniority bonus of 12 days' wages per year of service (this bonus cannot exceed twice the minimum wage).

## 2. Collective employment relations

Collective employment relations are covered under heading seven of the Federal Labour Law, which regulates the relations of organized workers. The key elements are:

- **Level of unionization.** A key problem in this area has been the lack of encouragement for the organization of workers; hence the low level of unionization in Mexico. According to the National Occupation and Employment Survey, only 4,507,154 of the country's workers (10.3% of the occupied workforce) are members of a union. In the manufacturing industry, union membership is highest in large enterprises (70% had unions in 2004) and practically non-existent in microenterprises (National Survey on Employment, Salaries, Technology, Wages and Training in the Manufacturing Sector (ENESTYC), 2005).
- **Ineffectiveness of collective bargaining.** The unions' passive attitude is reflected in extremely low wage increases. The agreements signed between 2000 and 2006 achieved an accumulated real wage

increase of only 3% over the whole period. Wages in real terms actually fell in the case of workers in the public sector.

- **The right to strike and economic stabilization.** One of the key elements of collective bargaining is the use of the right to strike as a means of enforcing workers' rights (heading eight of the Federal Labour Law). In Mexico, strike action has been an extremely important mechanism when companies refuse to acknowledge workers' rights to better standards of living. In Mexico, inflation topped 100% after the external debt crisis and was only reigned in as of 1987 with the establishment of a tripartite agreement, known as the Economic Solidarity Pact, among workers, the business sector and the Government. The Pact stipulated that companies would not raise prices if workers did not ask for wage increases above the expected level of inflation. This policy successfully brought down inflation but did so at the expense of the improvement of workers' purchasing power, which debilitated the domestic market. In fact, the policy constituted a new mechanism for controlling collective bargaining and consequently constrained strike action because the possibility of striking was left in doubt in the successive pacts that were entered into as well. Table VI.2 shows that the number of strikes fell gradually between 1989 and 2007 first as a direct result of the Pact and subsequently thanks to the increased stability of the Mexican economy.
- **Work-related risk.** The provisions under heading nine on work-related risk constitute a key aspect of Mexican labour legislation. They were used as the basis for drawing up a detailed risk scheme and setting up occupational health and safety commissions in companies. The incidence of work-related illness, accidents and deaths has fallen in the past few years as a result.
- **Negotiation of sectoral contracts to increase the flexibility of labour.** In legislative terms, the union movement has made labour more flexible because it has not established specific sectoral agreements. Gabriel Pérez (2002) notes that the new forms of labour organization that have emerged and the maximum and moderate flexibility, which are found in different regions of the country. Maximum flexibility is characteristic of the export companies of the North that have introduced unilateral policies and new forms of organizing labour and have passive unions. Only a small proportion of the workforce belongs to labour unions or works under collective contracts in this region because industrialization is a relatively recent phenomenon there. State policy therefore revolves around attracting investment on

Table VI.2  
MEXICO: STRIKES RECORDED BY THE CENTRAL UNION

Period	Total	Members of the Labour Congress							Independent of the Labour Congress	Unspecified
		Subtotal	Confederation of Mexican workers (CTM)	Revolutionary Confederation of Workers and Peasants (CROC)	Regional Mexican Labour Confederation (CROM)	Other organizations of the Labour Congress <sup>a</sup>	Autonomous national unions and autonomous syndicates			
1989	118	94	71	9	5	5	5	4	23	1
1990	150	129	100	13	5	5	6	5	20	1
1991	136	114	87	8	7	5	5	7	22	0
1992	156	136	99	16	5	3	3	13	20	0
1993	155	144	98	22	12	5	5	7	11	0
1994	116	94	57	16	10	6	6	5	22	0
1995	96	83	50	13	6	11	3	3	13	0
1996	51	42	27	6	4	4	1	1	9	0
1997	39	34	22	4	2	5	1	1	5	0
1998	33	27	15	7	2	3	0	0	6	0
1999	32	25	16	2	5	2	2	0	7	0
2000	26	22	8	5	2	4	3	0	4	0
2001	35	30	12	9	6	2	1	1	5	0
2002	45	37	19	7	3	1	7	8	8	0
2003	44	39	16	8	4	7	4	5	5	0
2004	38	30	13	4	1	5	7	8	8	0
2005	50	42	22	5	5	4	6	8	8	0
2006 <sup>b</sup>	55	47	27	9	5	4	2	8	8	0
2007	27	21	14	3	0	1	3	6	6	0

Source: Secretariat of Labour and Social Security and Federal Arbitration and Conciliation Board.

<sup>a</sup> Includes the following autonomous organizations: COR, CGT, CRT, COCEM, CTC, COM, COS, FAO, FNUITEP, FROT, FNC, FST, FSTSGEM, FSTRM, FEOPCDF, UNFOSIT and UNO.

<sup>b</sup> Preliminary figures from this date forward; figures may therefore differ from those found in other publications.

passivity of the unions in general are fundamental aspects of labour flexibility. He also identifies two types of flexibility, the basis of low wages and labour flexibility. Moderate flexibility can be found among the old industrial sectors that underwent reconversion and the para-State sector and is based on passive and independent unions. State policy in these regions is less rigid than in the regions of maximum flexibility because the workforce is more experienced and more involved in union activity. The automobile industry and banking are two clear examples of this type of flexibility. In the automobile sector the transformation of labour relations was accepted relatively easily. The changes involved the cheapening and intensive use of the workforce, the reduction and flexibilization of collective bargaining, the flexibilization of the market and de-unionization. It has been impossible to enhance productivity through the union-employer relationship in the banking sector, however (Pérez, 2002).

- **The unions play a key role in labour flexibility.** Companies and unions need to enter into pacts that encourage the active participation of workers in decision-making and the organization of the company's work. Without agreements between companies and workers, it will be impossible to change the conditions and structure of the workforce. Labour flexibility requires restructuring the organization of capital and labour. As far as the structure of labour is concerned, new forms of contracting are needed, as well as new types of remuneration schemes and a more open attitude among unions towards negotiations. Article 386 of the Federal Labour Law defines a collective agreement as an agreement concluded between one or more workers' unions and one or more employers or one or more employers' unions, for the purpose of establishing the conditions under which work should be carried out in one or more companies or establishments.<sup>6</sup> Collective agreements do not usually contain specific clauses on the organization of labour as they tend to focus on topics such as wages, benefits and working hours. One negative aspect of the collective agreements in Mexico is that they are often negotiated by the large central labour organizations and do not, therefore, take into account the differences between one branch of industry and another. If the contracts were signed on the basis of the activities of the

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<sup>6</sup> The contracts of *Petróleos Mexicanos*, the Federal Electricity Commission and the Autonomous University of Mexico are exceptions.

companies involved, they would better respond to the needs of each sector and labour flexibility would increase. In addition to changing the organization of work, labour flexibility requires the modification of relations within unions and between unions and the central labour organizations. At the moment, the decisions taken by the central organizations do not take into account the relationship between workers and where they work, and unions adhere to the central organizations' rulings without being able to negotiate directly with the companies, which limits labour flexibility. It should be pointed out that some unions do not abide by the decisions taken by the central labour organizations, as is the case of the telephone operators' union and the union of *Petroleos Mexicanos*.

- **Attaining numerical flexibility.** This consists of making changes in the organization in order to increase the quota of variable capital mobilized in the production process. If there is numerical flexibility, a company can adjust the number of workers in line with demand for its products. The variation in the number of permanent and occasional workers in an industry determines the numerical flexibility of that industry. In the manufacturing sector, for example, the textiles and apparel segment has the greatest numerical flexibility, while the food, beverages and tobacco segment has the least. This difference reflects the type of demand there is for each sector's products: in relation to income, demand for food and beverages is more rigid, while demand for textiles and clothing is more elastic.
- **From numerical to functional flexibility.** Companies take advantage of the functional flexibility of their employees to have them work in different stages of the production process. Having functional flexibility means that a worker can function in different shifts, schedules, departments and positions. Just as numerical flexibility responds to final demand for the company's products, functional flexibility depends on technological changes. Changes in the scheduling of the working day and in the number of workers that can perform each job in a company are indicators of functional flexibility. Constant man-hour levels in the manufacturing sector reflect a lack of functional flexibility.

### 3. Labour inspection

The Federal Labour Inspectorate was set up as a core institution for enforcing labour justice, and a chapter is devoted to this subject in the Federal Labour Law. The chapter in question specifies that

the mission of the Labour Inspectorate is to: ensure compliance with labour standards; facilitate technical information; advise workers and employers on how to effectively comply with labour standards and notify authorities of any non-compliance or infringement of labour standards in companies and other places of work; and perform studies and collect data as requested and deemed convenient by the authorities for ensuring harmonious relations between workers and employers. The Labour Inspectorate was established in Mexico in 1931 for the specific purpose of overseeing compliance with labour and occupational health and safety standards and providing training to workers.

The Inspectorate's responsibilities are divided between the Federal Government and the state governments. The Federal Government is responsible for inspection in key industries (textiles, electricity, cinema, rubber, sugar, mining, metallurgy and iron and steel, hydrocarbons, petrochemicals, cement, quarries, automobiles, chemicals, pulp and paper, fats and vegetable oils, food, beverages, railways, basic wood, glass and tobacco), as well as for inspecting compliance with occupational health and safety standards, while state governments are responsible for training and, in some cases, occupational safety. The main problem facing the Labour Inspectorate is that although the Federal Government has set national labour standards, the same parameters have not been instituted at the individual state level (especially in the relatively less-developed states), which means that inspection capacity is extremely limited. This has resulted in huge disparities in the enforcement of labour standards within the country.

In addition to disparate standards, Mexico has only a small number of labour inspectors: 0.8 inspectors per 1,000 workers (Romero Gudiño, 2008). Inspection activities are further weakened by the low budget that they are granted at the federal level. According to a study conducted by the Secretariat of Labour and Social Security, the budget for 2007 was around US\$ 500,000, which reflects the low priority awarded to labour inspection. Table IV.3 shows that inspection has decreased in the last few years, as a result, it would seem, of the introduction of two programmes under the 2000–2006 administration: the Occupational Health and Safety Self-Management Programme (PASST) and the Electronic Employment Declaration Programme (DECLARE). Both of these initiatives aim to promote self-regulation although the declared objective is not to eliminate traditional inspection but to complement it and thereby increase inspection coverage, which at the moment is barely 3%.

Table VI.3  
MEXICO: AN OVERVIEW OF LABOUR INSPECTION

	Inspections performed	Causes of inspection				Workers involved
		General working conditions	General health and safety conditions	Extraordinary situations	Steam generators	
2000	35 879					1 388 474
2001	35 203	7 798	7 676	14 965	4 764	1 422 594
2002	32 818	6 001	5 879	16 456	4 482	2 504 976
2003	31 211	6 551	6 453	14 956	3 251	2 532 969
2004	28 635	5 221	5 251	14 737	3 426	2 232 624
2005	26 122	4 643	4 440	13 666	3 373	2 378 699
2006	23 976	4 234	3 911	12 748	3 083	2 398 573
2007	24 981	...	...	...	...	2 291 691

Source: Secretariat of Labour and Social Security, Mexican Social Security Institute, on the basis of data obtained from the Coordinating Office for Occupational Health and the Safety and Social Services Institute.

### C. Characteristics and recent changes in active labour-market policies

This section examines active labour-market policies in Mexico, which range from employment services (such as assistance in finding employment and job brokerage services) to training and job creation through wage subsidies, direct hiring programmes and loans to microenterprises. According to the International Labour Organization (ILO), active labour-market policies refer to specific, selective government intervention aimed at increasing the efficiency and/or equity of the labour market by acting directly or indirectly to provide jobs and increase the possibilities of certain disadvantaged groups of people finding employment (Auer, Efendioglu and Leschke, 2004). The amount spent by industrialized countries on active labour-market policies has remained relatively constant, but the strategies, design and implementation of active labour-market policy measures have changed substantially over the past decade. These changes obviously vary from country to country, but the three presented here are common to most.

- **Growing emphasis on support for jobseekers.** This support has involved greater control over, and stricter requirements regarding, job seeking for those receiving unemployment benefits.
- **Integrated services (one-stop windows) so that clients can obtain information, advice and services from a single source.**
- **Heavier dependence on the private sector to provide employment support services** (for example, training, employment services and public services). The State's role has been limited to establishing priorities, guaranteeing quality and providing financing, especially to ensure equity.

Table IV.4 shows that although the structure of spending on labour-market programmes is similar in the industrialized countries, the amount devoted to active labour-market policies varies considerably from one group of countries to another. The European countries spend more as a proportion of GDP, while the countries of Asia and North America (and most notably among them, Mexico), allocate only a small budget to labour-market policies. The European labour market also tends to provide more protection to its members, possibly as a result of the more comprehensive social policies adopted by the European countries. How resources are channelled also differs considerably from one group of countries to another. The emphasis on training found in most countries contrasts sharply with the support given to direct job creation programmes in others, and this contrast is notable among and between the Asian and the European countries and between Canada and the United States. Mexico is the only country in which microenterprises have much weight, while the United States, the Republic of Korea and Sweden allocate a significant portion of resources to employment programmes for the disabled or similar programmes.

Table VI.4  
SPENDING ON LABOUR-MARKET PROGRAMMES  
(Distribution and as a percentage of GDP)

	Public employment services	Training	Employment incentives	Direct job creation	Microenterprises	Other programmes, including jobs for the disabled	Total	Total as a percentage of GDP
North America								
Mexico	42.28	8.80	0.00	40.50	7.82	0.61	100.00	0.03
United States	23.08	38.46	0.00	7.69	7.69	23.08	100.00	0.13
Canada	50.00	26.67	3.33	6.67	6.67	6.67	100.00	0.30
Europe								
Spain	16.67	20.51	42.31	10.26	7.69	2.56	100.00	0.78
Germany	31.76	38.82	7.06	10.59	10.59	1.18	100.00	0.85
France	26.37	31.87	13.19	20.88	0.00	7.69	100.00	0.91
Sweden	16.79	24.09	42.34	0.00	2.19	14.60	100.00	1.37
Asia								
Japan	66.67	19.05	4.76	0.00	0.00	9.52	100.00	0.21
Republic of Korea	20.00	33.33	20.00	6.67	6.67	13.33	100.00	0.15

Source: Prepared by the author on the basis of data from OECD Employment Outlook 2008; for Mexico, on the basis of the 2007 Federal Public Finances Account, the Information Bank, Secretariat of Labour and Social Security.

In Mexico, active labour-market policies target people participating in the formal labour market, as well as job seekers and the unemployed. People in the informal market, especially youth, are sometimes included among the jobseekers and the unemployed. This scheme forms part of a global job placement and permanence strategy

promoted by the National Employment Service, which was set up in 1978 under the reform of the Federal Labour Law. The Secretariat of Labour and Social Security, through the General Employment Directorate, provides the State-Level Employment Services with standards, manuals, methods, procedures, technical assistance and resources for their activities, and controls, monitors and evaluates the programmes. The National Employment Service has two main lines of action: the job placement service and employment support programmes. Two million people participate in these schemes, and approximately one quarter of them find jobs, especially those who use the job placement service. The proportion is smaller in the case of the programmes for the unemployed.

The job placement service is based on the thinking derived from the work of Jan Tinbergen (1969) on the role played by information gaps (what in neoclassical literature is known as asymmetric information). Various job placement services have been set up to address this issue.

Table VI.5  
MEXICO: NATIONAL EMPLOYMENT SERVICE

Year	Total, National Employment Service		Employment support programme		Local development programme (microregions)		Job placement service	
	Persons served	Persons placed	Persons served	Persons placed	Persons served	Persons placed	Persons served	Persons placed
1989-1994	2 429 498	283 650	459 762	...			1 969 736	283 650
1995-2000	7 071 898	2 190 685	3 172 017	962 506			3 899 881	1 228 179
2001	1 382 903	510 626	396 974	229 240			985 929	281 386
2002	1 549 201	540 820	312 897	193 274			1 236 304	347 546
2003	1 908 443	531 249	308 255	195 762			1 600 188	335 487
2004	2 037 827	587 094	300 550	199 293	13 498	7 011	1 723 779	380 790
2005	2 111 177	591 438	386 981	211 932	11 557	4 366	1 712 639	375 140
2006	2 086 140	549 437	301 285	165 428	12 362	6 262	1 772 493	377 747

Source: Secretariat of Labour and Social Security.

The National Employment Service has organized a number of initiatives to match jobseekers to jobs in the labour market. In addition to creating the labour exchange, it has set up: job fairs and workshops for jobseekers; state-level employment systems, as well as the Chambatel telephone and Chabanet Internet job information services (“chamba” means job or work in Mexican Spanish); various job brokerage centres; the employment programme for the disabled entitled “Opening up spaces”; and a labour observatory for regional markets that consists of a system of information on demand for jobs. Tables VI.6 and VI.7

Table VI.6  
MEXICO: JOB PLACEMENT SERVICE

	1989-1994	1995-2000	2001	2002	2003	2004	2005	2006
Job placement service	1 969 736	3 899 881	985 929	1 236 304	1 600 188	1 723 779	1 712 639	1 772 493
Persons served	283 650	1 228 179	281 386	347 546	335 487	380 790	375 140	377 747
Persons placed	1 926 498	2 753 480	521 755	570 548	592 414	644 209	638 644	665 778
Labour exchange of the National Employment Service	2 509 974	879 694	173 429	183 456	175 099	190 493	188 521	193 690
Persons served	43 238	922 422	281 347	305 603	293 890	328 755	297 828	259 513
Persons placed	3 417	309 506	79 071	84 777	76 404	92 569	90 200	76 838
Job fairs								
Workshops for jobseekers		223 979	60 633	58 932	70 854	76 631	85 801	77 800
Persons served		...	...	16 235	20 612	25 712	25 965	25 337
Persons placed								
Temporary farm workers programme (Mexico-Canada)			13 035	12 586	14 450	8 445	10 614	11 283
Persons served	29 259	38 979	10 529	10 681	10 595	9 287	9 363	10 555
Persons placed								
Meetings of the State Employment System				30 957	36 144	36 458	45 843	43 842
Persons served				10 848	10 203	12 762	16 317	19 100
Persons placed								
Telephone-based national employment service			17 700	29 584	26 510	27 923	14 228	11 899
Persons served								
Persons placed								
Internet-based national employment service				50 793	189 240	197 121	260 984	357 179
Persons served				10 764	13 077	16 549	20 339	28 985
Persons placed								
Job brokerage centres				145	6 953	19 478	24 934	42 177
Persons served				0	439	1 861	2 875	5 015
Persons placed								
"Opening up spaces" programme			4 777	8 503	15 901	29 978	32 537	26 267
Persons served		...	657	1 201	2 548	3 634	7 332	6 328
Persons placed		...						

Source: Secretariat of Labour and Social Security.

Table VI.7  
MEXICO: EMPLOYMENT SUPPORT PROGRAMMES

	Year	1989-1994	1995-2000	2001	2002	2003	2004	2005	2006	2007 <sup>a</sup>
Employment support programme	Persons served	459 762	3 172 017	396 974	312 897	308 255	300 550	386 981	301 285	172 728
	Persons placed	...	962 506	229 240	193 274	195 762	199 293	211 932	165 428	106 998
BECATE programme	Persons served	459 762	3 172 017	396 974	230 185	214 931	198 330	207 118	164 285	76 366
	Persons placed	...	962 506	229 240	166 507	154 888	135 881	112 815	93 953	60 135
Formal employment	Persons served				40 485	55 678	58 117	118 425	63 062	44 500
	Persons placed				12 997	22 077	43 015	65 018	34 576	24 394
Internal labour mobility	Persons served				35 106	31 015	34 959	47 936	61 871	43 465
	Persons placed				8 811	12 166	13 204	20 547	25 100	14 910
Migratory jobs	Persons served				3 106	2 460	3 368	2 093	1 671	1 605
	Persons placed				1 822	2 006	1 417	2 261	2 172	2 140
Promotion of self-employment	Persons served				7 121	6 631	5 776	8 838	6 882	2 952
	Persons placed				4 959	6 631	5 776	8 838	6 882	2 952
Jobs for returnees	Persons served							144	1 463	1 975
	Persons placed							26	694	602
Promotion of second-generation self-employment	Persons served							2 427	2 051	1 865
	Persons placed							2 427	2 051	1 865

Source: Secretariat of Labour and Social Security.

<sup>a</sup> Figures correspond to January-July.

show that the most successful job placement instrument has been the National Employment Service's labour exchange, which manages to place over 50% of the people served by the job placement services. The job fairs have also been effective; they help about 90,000 people find a job each year.

Training is provided under the employment support programme to all the State-Level Employment Services so that they can point jobseekers towards vacancies, help companies cover their staffing needs and provide guidance and training to the unemployed and thereby improve their possibilities of finding work or becoming own-account workers. The State-Level Employment Services address the following in their activities (in order of importance): the volume and characteristics of the unemployed and underemployed population that meet the job and skills requirements of the corporate sector; investment and the creation of new sources of employment; opportunities for own-account work; and the characteristics of available training supply.

Even though the number of subprogrammes increased during the 2000-2006 administration, the number of people served and the number of people placed fell. The BECATE (grants for job training) programme (the Spanish acronym also means "get a grant") achieved the most permanent placements in different fields; however, its impact waned after 1995-2000, and the other, low-profile programmes never managed to offset this decline.

All the programmes have been redesigned, especially the job training programmes, with a view to increasing their effectiveness. BECATE was altered to change the programme from a general training scheme to one that targets specific groups. This change has meant a long period of adjustment because in the 1990s the programme was fundamentally training-based, while now it provides seven types of grants and has introduced a new training voucher system that is currently being piloted. The outcome of these changes is presented in table VI.8.

The 2006-2012 administration has also implemented the so-called First-Job Programme, which aims to create permanent, well-paid jobs in the formal sector and which functions alongside support programmes for young entrepreneurs and small and medium-sized enterprises. Under this programme, the Federal Government will help people and companies to create new, permanent jobs by subsidizing part of the obligatory payments that employers must make when registering workers with the Mexican Social Security Institute (IMSS). This government incentive stems from the idea of creating jobs by lowering costs for companies in order to encourage them to hire more people. The mechanism also increases the number of workers covered by social security and fosters the creation of formal jobs. In 2007, the First-Job Programme had a budget of 3 billion Mexican pesos for subsidizing, for a period of up to 12 months, part of

the payments that companies have to make to IMSS when they hire new workers. The size of the subsidy is calculated according to the base salary rate of the new worker: ranging from 100% for workers with a base salary rate of less than 10 minimum wages, and then progressively downwards to 10% for workers with a base salary rate of over 20 minimum wages. In order to participate in the scheme, the workers must be hired for at least nine continuous months. When this criterion has been satisfied, the subsidy is received for 12 months.

Table VI.8  
THE BECATE PROGRAMME: GRANTS BY TYPE

	Total	Training-based	Mixed			Local employment initiatives	Own-account employment	For labour skills	Piloted training voucher schemes
			Subtotal	Micro- and small enterprises	Medium-sized and large enterprises				
1985	27 540	...	...		...				
1990	64 139	61 581	2 558		2 558				
1991	49 203	45 966	3 237		3 237				
1992	42 136	38 282	3 854		3 854				
1993	46 612	37 266	9 346		9 346				
1994	198 864	160 779	38 085		38 085				
1995	412 318	205 455	58 507		58 507	74 104	72 257	1 995	
1996	544 026	166 187	70 155		70 155	65 090	235 960	6 634	
1997	563 652	189 924	95 964	15 478	80 486	90 694	174 999	12 071	
1998	506 660	125 388	181 857	103 999	77 858	69 647	116 278	13 490	
1999	552 186	121 533	230 686	136 254	94 432	48 892	142 848	8 227	
2000	593 175	133 723	267 228	167 598	99 630	34 113	137 576	20 535	
2001	396 974	68 707	183 503	106 476	77 027	45 890	98 874	0	
2002	230 185		136 722	62 359	74 363		62 355	14 222 16 886	
2003	214 931		139 633	70 180	69 453		54 736	3 040 17 522	
2004	207 239		129 915	61 936	67 979		62 627	14 697	
2005	214 185		109 425	64 032	45 393		85 547	19 213	
2006	106 551		56 558	33 035	23 523		41 355	8 638	

Source: Prepared by the author.

Table VI.9  
SUBSIDY PAYMENT MECHANISM OF THE FIRST-JOB PROGRAMME

	Months												Base salary rate <sup>a</sup>	Maximum subsidy (Percentages)						
	1	2	3	4	5	6	7	8	9	10	11	12			13	14	15	16	17	18
Nine continuous months in order to be eligible for the subsidy	Payment of the subsidy in 12 monthly quotas												Less than 10 minimum wages	100						
													10 to 14 minimum wages	60						
													15 to 19 minimum wages							
													Over 20 minimum wages	20						
Keep the eligible workers' social security payments up to date													10							
Know the fiscal obligations assumed under article 32D of the Fiscal Code of the Federation																				

Source: Prepared by the author.

<sup>a</sup> Minimum wages refer to the minimum wages in the area in question.

This support did not fulfil expectations because businesspeople thought the mechanism was too bureaucratic and very few companies applied to participate in the scheme. In 2007, the programme promoted the creation of 7,000 jobs, and the corresponding subsidies used the equivalent of 16% of its budgeted resources. The Federal Government has insisted that this mechanism can work and issued a decree at the end of 2007 whereby people who have already been employed and registered with IMSS will also be able to participate in the First-Job Programme, provided that the period during which they have been employed previously does not exceed nine consecutive months with the same employer.<sup>7</sup>

An examination of the country's active labour-market policies shows that a new approach needs to be adopted to guarantee the transition of the Mexican labour market from a segmented one to an integrated one.

- It should be borne in mind that active labour-market policies affect only a small proportion of the economically active population as they are not geared towards regularizing the informal markets; they are designed to lower unemployment. In the last few years, approximately 4.25% of the economically active population has received support through these policies at a time when the informal labour market accounted for over 27% of jobs.
- The unemployment programmes were designed along the same lines as the programmes implemented in countries with structured labour markets. Those aiming to help people find new jobs, however, have not managed to bring the open unemployment rate below the historically high levels it has been at thanks to the combination of a rapidly expanding economically active population and slow growth in labour demand.
- The instruments used to reduce open unemployment need to be revised and the more successful job placement instruments, the labour exchanges and job fairs, need to be strengthened and developed. They should also be allocated more public resources.
- To date, the shift from a broad training-based grant system to a decentralized one has not proved to be more effective. The existing schemes need to be evaluated with a view to identifying which form

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<sup>7</sup> According to the decree published in the Official Gazette on 17 December 2007, which modified the decree establishing the general directives for compliance with the First-Job Programme published on 23 January 2007.

of training is the most effective and would make it possible to reach more people.

- Making small adjustments will not transform the labour market because the critical problem in Mexico is the informal labour market which creates economic, political and social problems, hampers the development of the domestic market, foments anti-democratic processes and generates conflict among the various agents operating in the labour market.
- The only solution that will be sustainable in the long run, as far as reducing informality is concerned, is to establish clear operating rules for the labour market and to increase its capacity to generate jobs. Policymakers must realize that the low generation of productive jobs stems from the low level of investment in the country compared with its main competitors. Mexico's active labour-market policies must therefore be framed within a the context of high levels of gross fixed capital formation. Mexico's goal should be to raise the level of investment to at least that of Spain, even though in order to remain competitive its investment levels should approach those of the Asian countries.
- From the public-policy perspective, a programme to regularize the informal market needs to be implemented, and labour-market programmes in general need to be adequately funded. To date, little effort has been made to ensure that labour policy is sufficiently backed by resources to be able to improve the job situation for subordinated and own-account workers. Only 28 Mexican pesos (two United States dollars) for each member of the economically active population were allocated to labour policy in the 2007 budget.
- The structure of the Mexican labour market will only be changed if the real political will to make the changes is there because the characteristics of the market are largely determined by developments in other areas, especially in production. Reform must therefore modify and expand the notion of the workplace. The main task is to bring about changes in companies so that the generation of value added is increased. For that to happen, microenterprises need to become small enterprises, small enterprises need to become medium-sized enterprises, and medium-sized enterprises need to become large enterprises. This will require the support of an industrial policy that assembles and develops a science- and technology-based production platform. If production is headed in that direction, consideration needs to be paid to the technical training of the workforce. Different

skills will be needed, and random training programmes will not suffice; instead, permanent training mechanisms that can transform the skills of labour will have to be established.

- It short, it could be said that the future of active labour-market policies in a country like Mexico will depend on the country's capacity to transform the production apparatus because each country's basket of products determines its competitiveness in the global market, which in turn determines the quality of its production. This hypothesis has been defended by several authors, including Dani Rodrik (2007), who argues that in the case of China, for example, the success recorded in employment and its redistributive effects are the result of the change in the basket of goods the country produces. What is needed then, according to this line of thinking, is a strong industrial policy because the market, on its own, is incapable of bringing about change. Moreover, if the market is left to its own devices, the proportion of informal labour will increase and the segmentation of the market with it.

## **D. Analysis of the position adopted by the most important actors**

In the past 15 years, the different stakeholders in the labour market have all fought for comprehensive labour reform. The main elements of the debate are presented below together with a comparison of the position adopted by the Government of President Felipe Calderón and that of other sectors.

### **1. The Government's position: introduce more flexibility**

The Government has sought to flexibilize individual contracting by legalizing some of the actions that companies currently take illegally: allowing probationary contracts; reducing training requirements; flexibilizing collective bargaining; and curtailing the mechanisms that workers may use to pursue equity (such as the right to strike). A summary of the Government's proposal (known as the Sector Initiative) is presented below. This proposal was endorsed by the Labour Congress, the umbrella association of the unions that generally support the Government's position.<sup>8</sup>

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<sup>8</sup> This summary is based on the presentation made by Dr. Álvaro Castro Estrada, Deputy Secretary of Labour, Safety and Social Security of the Secretariat of Labour and Social Security at the seminar on the Panorama for Labour in 2007-2008, held in Mexico City on 21 November 2007.

- **New types of individual employment contracts.** New types of individual employment contracts, such as probationary contracts and initial training contracts, would be established. Seasonal work, whose existence is only inferred in current legislation, would be regulated. Probationary contracts could have, in general, a maximum duration of 30 days, and in the case of managerial posts or specialized professional or technical positions, a maximum duration of 180 days, which would expand hiring possibilities. Through initial training contracts, workers would be able to acquire the skills or knowledge needed to perform a particular job while receiving a wage in keeping with the position held. Initial training contracts would be able to have, in general, a maximum duration of three months, and in the case of managerial or administrative posts or specialized professional or technical positions, a maximum duration of six months. The aim of these kinds of contracts is to break the vicious circle of “no job without experience, no experience without a job”.
- **Distribution of the working day.** Employers and employees would be able agree to extend the working day and arrange for the monthly accumulation of hours (in other words, set up an “hours bank”) to allow workers to take the accumulated rest days as a continuous period, without this constituting a violation of article 123, section XXVII, paragraph a, of the Constitution.
- **Simplification of employers’ training obligations.** The chapter on worker training and skills-building would be completely revised and renamed “on worker productivity, training and skills-building”. Only companies with over 20 employees would have to participate in the mixed productivity, training and skills-building commissions. Several obligations would be rescinded, including most notably: the obligation for training and skills-building programmes to be registered with the Secretariat of Labour and Social Security; the obligation for institutions and schools wishing to provide training to be authorized by, and registered with, the Secretariat; and the obligation for labour skills certificates to be registered.
- **Measures to increase the country’s productivity and competitiveness.** Promotion on the basis of seniority would no longer be automatic. Skills and training as opposed to seniority would be the main criterion for promotions to vacant or newly created posts. Workers with multiple skills would be able to receive higher wages. In other words, arrangements

could be made for workers to perform tasks that are related or complementary to their core job, provided that they receive the corresponding salary adjustment.

- **Union registration.** The Sector Initiative includes the possibility of union registration being cancelled if the union does not notify labour authorities of its activities and of changes in its membership on a six-monthly basis. Upon the request of one or more members of the union or of any interested party, the corresponding Conciliation and Arbitration Board would examine the cancellation of the union's registration.
- **Requirements for the signing of collective employment contracts.** Under the proposal, if a union intended to sign a collective employment contract, it would have to submit a written request to do so that contained the signatures of the union representatives and the represented workers. The request would have to be accompanied by valid registration certificates issued by the registering authority. Otherwise, the collective contract could not be legally filed and registered.
- **Improving the justice system for labour.** The principle of conciliation would be specifically incorporated into the handling of labour-related proceedings. Throughout a legal procedure and right up to the moment the verdict is issued, Conciliation and Arbitration Boards would try to have the parties settle the conflict through conciliation. Conciliation officers would be appointed to provide assistance in this task as part of the legal staff of the Conciliation and Arbitration Boards. Members of the legal staff would have to hold a recognized law degree and be certified to practice law, have specialized in labour law, and have a good reputation. The transitory articles of the Sector Initiative stipulate that members of the legal staff of the Conciliation and Arbitration Boards who do not hold a law degree and are not certified to practice law would have five months in which to obtain these qualifications commencing on the date in which the reforms enter into force.

## 2. The position of the independent unions and some political parties

The independent unions and some political parties presented an alternative proposal to the Government one. This proposal focuses on the strengthening of collective bargaining; the removal of the discretionary nature of some aspects of labour law; the elimination of the divide

between the labour regulations for public-sector workers and the labour regulations for private-sector workers; the preservation of the right to strike; and the modernization of agencies such as the National Public Registry of Union Associations and Collective Contracts and the National Institute of Minimum Wages, Productivity and Profit Sharing. The basic elements of this alternative proposal are:<sup>9</sup>

- **Preservation of existing guarantees and guaranteed participation of workers in collective bargaining processes through meetings at which at least one third of workers are present.** This proposal is being channelled through the National Public Registry of Union Associations and Collective Contracts, a neutral, professional organization headed by prestigious figures who review proposed collective contracts and guarantee that the rights of other union organizations that also wish to sign the collective contract are respected. In the case of a dispute, the workers are consulted to determine which of the contracts represents the largest number of workers. These consultations take place in very short and specific deadlines and culminate with the notification of the call to strike. The intention of the proposed modification is twofold: to prevent the signing of the so-called “protection contracts” that do not reflect the will of the workers; and to ensure that the will of the majority and of those who do not wish to belong to a union are respected, which would prevent unsupported calls to strike action being made that jeopardize jobs. The goal is, above all, to strengthen legitimate collective bargaining as a fundamental instrument for achieving consensuses between employers and workers. The Public Registry occupies a key position in this proposal because a neutral and effective body for settling union disputes is necessary to guarantee that collective bargaining works as it should from the beginning, as this will benefit both employers and workers.
- **Preservation of the right to strike.** The proposal aims to establish a procedure whereby strike action can be taken provided it has the real support of the workers and the call to strike is first submitted for consideration by a labour judge. The right to strike as it stands today is upheld, with the guarantee that it may not be used to blackmail companies or simulate strikes, as happens in practice when employers sign collective contracts without the knowledge or support of workers (the so-called “protection

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<sup>9</sup> These basic elements are taken from the legislation proposed by the National Union of Workers and a group of parties represented in the Chamber of Deputies to reform various provisions of the Federal Labour Law.

contracts”) simply by buying off a union leader who signs the contract or the call to strike without the knowledge of the workers. This proposal aims to establish an efficient procedure for recognizing the right to sign contracts as belonging to those who represent the majority and to improve upon current practice which results in lengthy court proceedings and often involves violent incidents during the consultation processes as well as blatant partiality in the Conciliation and Arbitration Boards where the defending employers and union leaders tend to be both judge and party to the dispute.

- **Cancellation of union registration.** No new grounds are established for annulling the registration of a union. The right of association is respected through a simple registration procedure at the National Public Registry of Union Organizations and Collective Contracts thus sidestepping the current requirement that unions must have a legal personality. Only in the case of a dispute does it become established procedure to consult workers through a universal secret ballot held under the impartial supervision of the National Public Registry.
- **Right to determine unions’ scope of action.** Article 470 of the Federal Labour Law stipulates that unions have the right to determine freely their scope of action, as recommended by ILO. This is in accordance with the right to freedom of association established in article 123 of the Constitution.
- **Severance of labour relations.** The proposal consists of upholding current dismissal regulations and establishing the sexual harassment as additional grounds for dismissal. It is important to note that current regulations in this regard were drafted in keeping with the protective goals of the Federal Labour Law, and any modification would therefore be against workers’ interests.
- **Establishment of working hours.** Current regulations would be upheld. They are already sufficiently flexible for working hours to be distributed across various days to allow workers to take the required rests. Article 65 of the Federal Labour Law would be expanded to include the possibility of a labour judge intervening to prevent working hours and days being established that might be harmful to workers’ health.
- **Labour standards.** A rewording of the current text is proposed to improve upon the current definitions with a view to regulating all the different labour relations that employers currently establish through

service companies or subcontractors or similar arrangements in an attempt to evade their responsibilities as employers.

- **Labour stability.** The established principles regarding job stability are upheld, including the stipulations in article 38 of the Federal Labour Law that employment for an indeterminate period can be continuous or not, and if not, such employment is permanent, seasonal or for certain periods of year, depending on the nature of the work in question. In these cases, workers employed for indeterminate periods will have the same rights and obligations as workers employed for determinate periods on a continuous basis, in proportion to the time worked.

It is clear that these two proposals do not complement one another and in fact point in different directions. One aims to strengthen individual employment relations as a means of flexibilizing labour; the other aims to strengthen collective employment relations. The debate has been under way for some time, and an agreement may still be a long way off. In the meantime it is hoped that neither party will try to impose its position by force.

## **E. Conclusions: moving towards the point where the flexicurity philosophy improves the dialogue in labour relations**

The Mexican labour market has suffered from low levels of job creation, and the number of jobs available is insufficient to absorb the expansion of the economically active population and provide it with decent work. The lack of demand has made the domestic labour market increasingly precarious and has fuelled emigration to the United States. The low level of job creation can be attributed to two basic factors:

- **The low level of investment in the economy**, which resulted in slow growth in the production sector and consequently in employment. This has been the situation for the past 20 years. No scheme has managed to boost economic growth since the unfolding of the debt crisis, which put an end to the profit-making arrangements that had driven economic growth prior to then.
- **A weak institutional framework**, which generates uncertainty in the labour market because employers do not have rules that allow them to benefit from flexible contracting and workers do not have rules that guarantee them stable incomes.

These two factors mean it would be possible to develop a labour programme around the concept of flexicurity. After all, without more

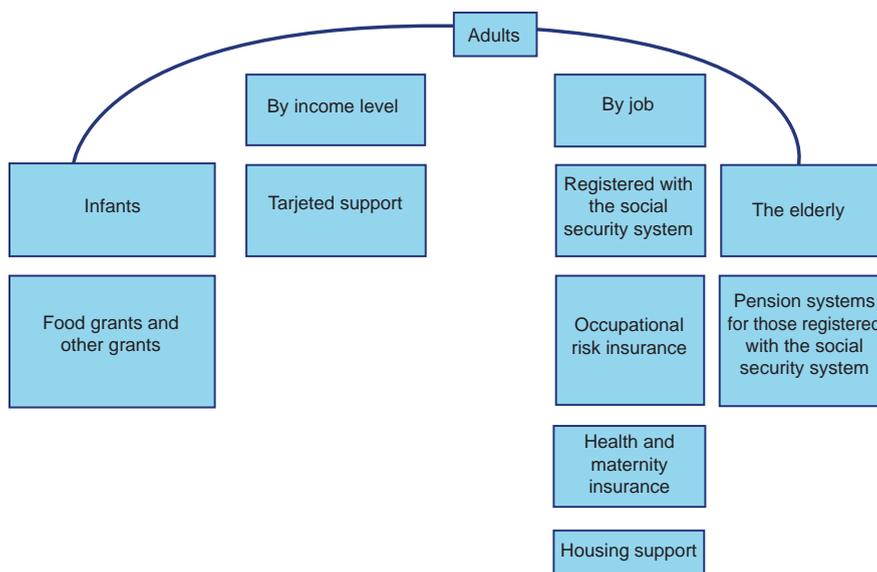
job creation, it will be impossible to reorder the labour market; and without a suitable institutional framework, too much flexibility might be introduced and end up harming workers' interests. Some elements that could be included in such a programme are presented below:

- **New job creation policies.** Up till now, public labour policies have consisted of establishing job placement and training programmes and providing support for entrepreneurs and small subsidies to lower initial hiring costs, as outlined in the section on active labour-market policies. To all intents and purposes, however, these policies have been inadequate, and the labour market has, as a result, become increasingly segmented, with the informal sector now accounting for 30% of the employed population. The job creation problem cannot be solved in the labour market because it is the product of what happens in the whole economy. What is needed is high aggregate demand, a certain level of integration in the domestic market, technologies that favour the use of human capital and institutional agreements in the labour market that encourage job creation. Employment subsidies are irrelevant if there is no aggregate demand to make businesspeople invest and create jobs. The best job creation policies are those that stimulate the sustained growth of the economy as has been shown in the emerging economies of Asia which have recorded the highest levels of job expansion in the world. The Asian countries implemented industrial policies that made it possible to construct growth scenarios for periods of up to at least twenty years which provided the business sector with the certainty it needed in order to invest: hence the high level of job creation. Job creation is a task that should be undertaken by the State, and the whole public apparatus should be focussed on coordinating policies to promote investment and jobs. The public sector needs to become the major coordinator of the various activities involved and to use its budget to generate new jobs. The State is the best-equipped agent to achieve this. In industrialized countries such as the United States, companies are encouraged to carry out projects for the Government. This induces small businesses to become State suppliers, and some US\$ 300 billion a year is spent on Government contracting in addition to funds spent on a host of incentives for setting up new companies and supporting those already in existence.<sup>10</sup>

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<sup>10</sup> Federal Procurement Data System-Next Generation, *Federal Procurement by State: Summary, Fiscal Year, 2006*.

Diagram VI.2  
MEXICO: THE SOCIAL SECURITY SYSTEM OVER THE COURSE OF LIFE



Source: Prepared by the author.

- **Redesigning social security.** The institutional framework needs to be overhauled in countries with segmented labour markets because informality is the result of non-compliance with the law. In order to be enforced, the law needs to be coherent and be designed to create a sense of security for the participants in the market. This requires rethinking and modernizing the social security system and the protection is provides from cradle to grave. Social security reform should encompass an overall view of the life cycle, family benefits from childhood, a poverty line that determines the income supplements that need to be provided, an insurance system that covers occupational risk, illness, maternity and disability, housing support, unemployment insurance and a citizens-type pension system.
- **Strengthening of workers' organizations.** A disperse labour market generates few agreements on productivity, and unionization of workers therefore needs to be promoted.
- **Establishment of an economic and social council to promote dialogue among stakeholders.** An economic and social council could promote dialogue leading to agreements that further a defined set of social policies to safeguard living standards. This could replace the mechanism whereby agreements used to be

established through pacts among the different sectors of society, which in their moment managed to stabilize the economy. The current institutional setup seems to have outgrown its usefulness: the role of the Secretariat of Social Development has become limited to the implementation of targeted schemes, and the Secretariat of Labour and Social Security seems to be mainly in charge of maintaining social calm. There is a patent need for a more extensive institutional framework that is capable of performing an ongoing assessment and classification of living standards and of reforming the whole social security system.

- **Combination of public and private schemes for establishing minimum living standards.** The modification of the labour market will require a collective effort. The shift from non-compliance with the law to total compliance will not occur by decree. Alliances need to be forged and new instruments need to be designed that are in keeping with a new culture of welfare, the basic component of which is social solidarity that manifests itself in public-private agreements that guarantee minimum living conditions for all. One way to promote this would be through the creation of a citizens' pension scheme that is complemented by personal pension funds which encourage citizens to save more, something that is not promoted by the current system.
- **Strengthening of public finances to address the problems of the labour market.** In Mexico, the leading role of the public sector has been undermined by the lack of resources. With tax revenues accounting for only 12% of GDP, the State's capacity for social management has ended up being a good intention that can not be put into practice. The fiscal reforms approved in 2007 are patently insufficient for meaningfully restructuring the institutional framework, and the State now limits itself to managing a segmented society without pursuing a clear vision for the welfare of its citizens in the future.
- **New legislation for the new institutional arrangement.** If a new institutional framework is to be constructed, current legislation will have to be adapted according to the principles of labour flexicurity, which would be in keeping with the new paradigm of economic, political and social development.



## Chapter VII

**Challenges involved in the introduction  
of flexicurity in Peru<sup>1</sup>**

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with Victoria Rosas Chávez and Marta Tostes Vieira*

**Introduction**

Peru shifted from a highly protective system of labour relations with job security and worker participation in enterprises, in which management did not have much say (1980s), to a less protective system with a corresponding increase in managerial authority (1990s).

There were two high points in the process of labour deregulation in Peru —which the International Labour Organization (ILO) actually described as fierce— as two waves of legislation aimed at flexibilizing labour relations so as to provide a suitable framework for private investment. Between 1991 and 1992, a series of reforms were introduced in the existing labour legislation, and the changes in the labour model reached a climax in 1995 and 1996. The Peruvian labour flexibilization process involved deregulation (as opposed to a reform consisting of adaptation with social dialogue and arrangements to offset government withdrawal from the regulation of labour relations), introduction of flexibilization mechanisms both of form (withdrawal of heteronomous

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<sup>1</sup> For a fuller version of this chapter see Toyama Miyagusuku, Rosas Chávez and Tostes Vieira (2009).

legislation) and of substance (significant lack of labour oversight) and, lastly, both internal flexibilization (with implications for working conditions) and external flexibilization (affecting hiring procedures and termination of the employment contract).

In other words, the labour reforms followed a trend towards flexibilization or deregulation starting in the early 1990s and peaking in 1995 and 1996. Reforms then continued until early 2001. Unfortunately, the result was not optimal. Rates of suitable employment fell steadily and, while the unemployment rate did not fall much, levels of social protection (workers with labour and social coverage) and staff earnings did.

Partly in reaction to this result, a trend started in 2001 towards more labour regulation (although of course nowhere near the levels of regulation found in the 1980s).

This chapter reviews the options for implementation of a system of flexicurity in Peru. It first considers active labour-market policies, as well as the legal system governing individual and collective labour relations. The second section contains an analysis of the impact of the labour reforms, the positions of the social actors and the effectiveness of the legal system, in the context of a high degree of informality. This is followed by a discussion of actions pending for the establishment of an institutional framework for labour that combines an efficient labour market and greater social protection, and the fourth section presents the conclusions of this chapter.

## **A. Policies and regulatory framework**

### **1. Labour-market policies**

The labour-market policies pursued have not achieved significant progress, except for the Programa de Capacitación Laboral Juvenil - PROJOVEN (Youth Labour Training Programme), which made great strides in the training and advancement of young people in Peru. The other programmes have not made a big difference and have not had an important impact on labour relations in Peru.

As regards policies affecting the labour market, under the third strategic policy in the National Human Rights Plan, 2006-2010, entitled "Ensuring full respect for comprehensive human rights", the Peruvian State is adopting measures concerning work, labour rights, trade union rights and social security. In addition, Supreme Decree No. 027-2007-PCM adopted the ninth National Policy on employment and micro- and small enterprises, concerning: (a) pursuit of policies geared to the creation of

decent work; (b) promotion and strengthening of managerial capacities in micro- and small enterprises; and (c) promotion of participation by micro- and small enterprises in government procurement.

The programmes created by the Peruvian State include:

- Programmes for the creation of temporary jobs through public works such as *Construyendo Perú*, and those resulting from direct action by the Peruvian State, such as ProEmpleo (active job-creation measure), PROJOVEN, Red CIL ProEmpleo (providing vocational training, labour-market information and placement), elder centres (positive State action to help the elderly), and vocational rehabilitation centres (positive action by the State to help persons with disabilities).
- The *Mi empresa* programme, promoting new ventures and competitiveness, and formalization and development of micro- and small enterprises.

However, these programmes have not had a major impact on workers as regards access to social benefits and social security.

## 2. Private sector: the legal system

### (a) Individual labour relations

#### (i) Sphere of application of the protection system

In accordance with Supreme Decree No. 003-97-TR, Single Amended Text of Legislative Decree No. 728, Labour Productivity and Competitiveness Act (LPCA), the sphere of protection governed by labour standards covers all subordinate workers providing personal services and receiving remuneration in return, whether under an indefinite, fixed-term or part-time contract. In the latter case, there are some restrictions on benefits. It also covers cases in which none of these contracts exist or others (of a civil nature) exist and these three elements are verifiably present, in accordance with the primacy of reality principle.

#### (ii) Job security as regards hiring and firing (atypical contracts).

##### *Job security (hiring)*

For direct labour hiring, the work contract may be indefinite, fixed-term, temporary or part-time (averaging less than four hours a day).

As a general rule, hiring should be for an indefinite period and may be effected orally or in writing. It is assumed, in the absence of evidence to the contrary, that an employment contract for an indefinite period exists for any remunerated and subordinate services rendered personally.

Temporary work contracts must be in written form and must be registered with the Labour Authority. These are:

- Contracts for start-up or expansion of activities: required for the commencement of a productive activity, for the subsequent creation or opening of new establishments or markets, for the launch of new activities or for the expansion of existing activities. Their maximum duration is three years.
- Contracts to meet market requirements: concluded for the purpose of dealing with cyclical increases in production, duly verified and caused by substantial variations in market demand, including regular work that is part of the normal activity of the enterprise and that cannot be performed by permanent staff. Their maximum duration depends on the specific need, and they may be renewed for successive periods not exceeding a maximum of five years.
- Contracts for restructuring of the enterprise: concluded when the activities performed by the enterprise are replaced, expanded or modified and, in general, when there is any alteration of a technical nature in machinery, equipment, facilities, means of production, systems, methods and productive and administrative procedures. Their maximum duration is two years.
- Casual contracts: concluded for the purpose of meeting temporary needs different from the normal activity at the work site. Their maximum duration is six months per year.
- Replacement contracts: concluded for the purpose of replacing a permanent worker whose labour relationship is suspended for some legally justified reason or because of contractual provisions applicable at the work site. They last for as long as they are required.
- Emergency contracts: concluded to meet needs created by an unforeseen event or *force majeure*. Their duration is that of the emergency.
- Contracts for the performance of a specific piece of work or service: concluded for a predetermined purpose and for a duration that depends on the requirements for completion of the piece or work or the required service.
- Intermittent contracts: designed to meet the needs of enterprise activities which, by their nature, are ongoing but not continuous.
- Seasonal contracts: concluded to meet needs specific to the line of business of the enterprise or establishment, to be met only at certain times of year.

Indefinite and temporary contracts give workers the same rights and benefits as are provided for labour relationships, except that temporary contracts may be validly terminated upon their expiry.

Part-time employment contracts must be written, although the only requirement for their validity is that the average time worked daily must not exceed four hours, taking into account the regular workday at the work site concerned. Such contracts do not confer entitlement to certain legal benefits enjoyed by other workers. Part-time workers are entitled to only six vacation days and receive no Compensation for time of Service (CTS) or severance pay. They may be concluded for an indefinite period or a fixed term and must be submitted to the Ministry of Labour and Employment Promotion for approval and registration.

Training agreements are another hiring possibility. Although personal, subordinate and remunerated services are provided, these are viewed as being outside the sphere of labour because of the emphasis on vocational training, as shown below:

Table VII.1  
WORKER TRAINING SYSTEMS

Benefit	Labour contract	Training system
Minimum monthly salary	550 nuevos soles; for a shorter workday, the salary is proportionately less	550 nuevos soles; for a shorter workday, the salary is proportionately less (Labour reinsertion: 1,100 nuevos soles and interns have a special reduced workload)
Maximum workday	8 hours per day or 48 hours per week	8 hours per day or 48 hours per week (pre-professional practicum: 6 hours per day or 30 hours per week). Internships: special workload
Vacations	30 days	15 calendar days (no fractions)
Weekends	Yes	Yes
Official holidays	Paid leave	Subsidized leave
Bonuses	One month's salary every six months	One half month's subsidy per six months completed
Compensation for Time of Service (CTS)	1.17 months' salary per year	No
Family allowance	10% of the minimum wage (MW)	No
Profit sharing	Yes, varying percentages	No
Severance pay	1.5 years' salary (maximum 12)	No
Life insurance (EsSalud law)	Premium paid to insurance company 9% of monthly salary	No Illness and accident insurance: EsSalud or Health Providers (EPS)
EsSalud subsidy	Yes	No
Pension Fund Administration (AFP) /State Pension Fund (ONP)	Compulsory	Optional
Income tax withheld	Yes, if over seven Tax Levy Units (TLUs) a year	No

Source: Prepared by the author

### *Job security (firing)*

Under Peruvian law, workers enjoy job security: they are entitled to keep their jobs and cannot therefore be dismissed without just cause expressly provided by law (article 27 of the Political Constitution of Peru).

The LPCA implements this constitutional provision by regulating cases in which the employment contract is terminated. An employer may dismiss a worker by following the procedure established by law (written advance notice of serious misconduct, with at least six days for rebuttal and written notice of dismissal) if just cause exists for this under Peruvian law. In such cases of dismissal with cause, the worker has no right to compensation or to any reinstatement.

Dismissal without cause or arbitrary dismissal occurs when the worker is not alleged to have committed any misconduct, when the alleged misconduct is not covered under the law, when the legally prescribed procedure for dismissal has not been followed or when the alleged misconduct cannot be proved.

If an employer dismisses a worker on grounds prohibited by the labour standards (such as race, gender, trade union activity), the dismissal is invalid. In this case, the worker may initiate judicial proceedings in order to seek reinstatement at the work site and payment of wages owed.

The Constitutional Court has completely overhauled the legal system described above, with the following result:

Table VII.2  
SYSTEMS OF PROTECTION IN CASE OF DISMISSAL

Type of dismissal	Description	Existing law	Constitutional Court
Dismissal without cause	Oral or written dismissal without statement of legal cause	Arbitrary dismissal: compensation	Reinstatement
Fraudulent dismissal	Abusive dismissal on a pretext	Arbitrary dismissal: compensation	Reinstatement
Invalid dismissal	Discriminatory or retaliatory dismissal	Invalid dismissal: reinstatement	Reinstatement
Dismissal with violation of a fundamental right	Privacy, religion, expression, etc.	Arbitrary dismissal: compensation	Reinstatement
Dismissal for serious misconduct	Commission of serious misconduct: due process is respected but the labour misconduct is not proved in court	Arbitrary dismissal: compensation	Compensation

Source: Prepared by the author

### (iii) Labour intermediation and outsourcing

In Peru, labour intermediation and outsourcing are governed by special regulations. Their main features are described in the following table:

Table VII.3  
INTERMEDIATION AND OUTSOURCING

Topic	Intermediation	Outsourcing
Type of service	Only provision of workers	Full service (may include staff)
Management authority	The user enterprise retains management and oversight of staff	Only coordination. There is no management authority over the outsourcing entity's staff
Type of activity subcontracted	Complementary (totally accessory) Temporary principal (replacement or occasional) Highly specialized activity	Any activity; principal or complementary, temporary or permanent
Type of personnel	Only workers of the intermediation entity	May or may not be workers of the outsourcing entity
Organizational arrangements	Activity strictly limited to labour intermediation	Assets, services and/or financial movements supporting enterprise activity
Liability	Joint and several liability	Joint and several liability
Laboralization in the main enterprise	In the event of non-compliance with regulations	In the event of non-compliance with regulations

Source: Prepared by the author.

So far the Government has placed considerable limits on outsourcing (subcontracting) in Act No. 29245 of 24 June 2008 governing outsourcing, Legislative Decree No. 1038 specifying the scope of Act No. 29245 on outsourcing services and the Regulations enforcing that Act approved by Supreme Decree No. 006-2008-TR of 12 September 2008, as indicated in the following table:

Table VII.4  
NEW OUTSOURCING STANDARDS

Outsourcing entities providing staff on a continuous basis	
Requirements	Features
Autonomy and independence: they act on their own behalf and at their own risk, assuming responsibility for the results of their operations	Have several clients (exceptions may be made in some cases)
Have their own material, financial and technical resources	Equipment owned or rented by them or managed by the main enterprise
Have people working under their exclusive organization, direction and supervision	Pricing arrangements
Registration + written contract indicating the purpose and place of the service	Capital investment Specialization, scope of services, remote site, skills, know-how

Source: Prepared by the author.

#### (iv) Workday, working hours, and vacations

Workers have a normal workday of eight hours or a work week of forty-eight hours. Overtime is voluntary for workers and for the employer and an extra 25 per cent of the normal hourly wage is paid for the first two hours

of overtime and an extra 35 per cent for the remaining hours. Atypical or extended workdays may be established provided that the limit of 48 hours a week is respected.

This workday limitation does not apply to persons in managerial, unsupervised posts and to those providing intermittent, surveillance and standby services. In the case of continuous work, the meal break may not be less than 45 minutes and is not counted as part of the working hours or workday.

With respect to time worked, there are two additional formal obligations. The employer must, firstly, keep a record of overtime worked and, secondly, announce on notices prominently displayed in the establishment or by any other appropriate method the starting and finishing times of the workday and the time of the meal break.

Workers in Peru have 30 days' vacation per calendar year starting in the first year of employment, and the timing of vacations is decided by the employer. If there is no opportunity to take vacation, the worker is entitled to two months' wages.

#### (v) Salaries and minimum wage

Wages include the totality of what workers receive for their services, in cash or in kind, in whatever form or denomination, provided that it is freely available to them, except as expressly excluded by articles 19 and 20 of the Act on Compensation for Time of Service. In addition, workers receive the following benefits:

- Profits: workers in enterprises engaged in third-category revenue-producing activities (including trade, mining, industry) which are subject to the private sector labour regime are entitled to a share of the annual revenue before tax under a system of profit sharing. Enterprises employing less than 20 workers are not obliged to make this payment.
- Family allowances: private sector workers whose wages are not set by collective bargaining are entitled, if they have dependent children under 18 years of age or children up to 24 years of age receiving higher education, to a monthly family allowance equal to 10 per cent of the minimum wage (550 nuevos soles).
- Bonuses: workers subject to the private sector labour regime are entitled to two additional months' wages a year, one in July and one in December, as bonuses for Independence Day and Christmas respectively.
- Life insurance: employers must purchase life insurance for their employees with more than four years of service and pay the related premiums (0.53 per cent of the monthly wage for office workers and 0.71 per cent for manual workers).

- Vacations: workers are entitled to 30 calendar days of statutory annual vacation with pay.

### *Minimum wage*

Under the 1993 Constitution, the minimum wage is regulated by the State. Until September 2007, the minimum wage was 500 nuevos soles. However, it has been increased by 50 nuevos soles, of which 30 were to be paid starting in October 2007 and the remaining 20 were starting in January 2008, making a total of 550 nuevos soles.

#### (vi) Leave with and without pay

The legislation provides for absolute suspension of labour (leave without pay) and relative suspension of labour (leave with pay). According to the legislation, possible causes of suspension are:

- temporary disability;
- certified illness and accident;
- maternity (pre- and post-natal);
- vacation;
- performance of civic duties and compulsory military service;
- performance of trade union functions;
- disciplinary measures;
- exercise of the right to strike;
- arrest of the worker, except when there is a sentence of deprivation of liberty;
- administrative or judicial disqualification for a period not exceeding three months;
- leave granted by the employer;
- accident and *force majeure* (absolute suspension for up to 90 days without prior authorization);
- other causes expressly established in regulations.

### **(b) Collective labour relations**

#### (i) Legal regime governing trade unions

The 1993 Constitution deals with trade union rights in article 2.13 on the fundamental rights of the individual and article 28 on social and economic rights.

By including trade union rights among the fundamental rights of the individual, the Constitution shows that trade unionism is a type of association. A minimum of 20 workers is required to form a trade union and 9 per cent of the economically active population in the formal sector is currently unionized.

(ii) Collective bargaining regime

Collective bargaining has not yet reached the stage of providing adequate coverage to workers in a situation of government deregulation.

The range of demands goes beyond the traditional requests concerning salary increases and better working conditions. To an increasing extent, requests concern participation in the management of services to workers, correct treatment of staff of labour intermediation enterprises, social investment, productivity and vocational training. The Ministry of Labour and Employment Promotion receives a growing number of trade union requests for financial reports on enterprises in bargaining processes.

Collective bargaining in Peru usually takes place at the corporate level and also in smaller units, such as categories (office staff/manual workers) or the establishment. Currently, the only active collective bargaining other than that conducted at the corporate level is by branch of activity in the construction industry. However, a recommendation of the Ministry of Labour and Employment Promotion (currently under discussion by the Judiciary) and a draft law would require collective bargaining by branch of activity in the port sector.

In the private sector, Peruvian legislation provides that the outcome of the process of collective bargaining will be the conclusion of a collective agreement or the handing down of an arbitral award. Exceptionally, there will be no outcome when no agreement is reached or when the workers decide to strike but, despite the strike, no collective agreement is concluded and the employer does not agree to arbitration.

In most cases, collective agreements simply improve the content of the workers' agreed financial benefits. Bargaining seldom deals in any detail with the financial situation of the enterprise or its productivity on the market. It is also unusual to find clauses on training or benefits other than financial benefits for union members.

The regulatory reform of the 1990s resulted in the replacement of a highly protective system, with job security and worker participation in the enterprise, by a system characterized by stronger managerial authority. As a result and because of other social factors and of the failure of trade union organizations to adapt to new production systems, workers' individual and collective bargaining ability declined steadily.

It is to be hoped, however, that Congress, the Judiciary, the Constitutional Court and the Government itself will continue to provide more space for collective bargaining, with a view to meeting workers' expectations and claims that have their immediate origin and basis in the reform of the 1990s.

### **(c) Social security**

Peru currently has no unemployment insurance providing financial benefits. The possibility has been studied of providing this social benefit (envisaged in ILO Convention No. 102 [Social Security (Minimum Standards) Convention]) ratified by Peru but there was no favorable decision, mainly because of Peru's large informal labour sector.

However, as part of the labour relationship, the employer is required to deposit in a banking or financial institution selected by the worker a percentage of the remuneration approximately equivalent to 1.17 times the monthly wage for each year of service. This benefit is known as Compensation for Time of Service (CTS) and is equivalent to the worker's regular monthly wage plus the six-month average of the most recent legal bonus for each year of service.

Although CTS may be discontinued only when the worker leaves his job, its purpose is not to cover situations of unemployment, as it has been distorted over the years, since workers have always been able to access up to half of the funds, which can be used for repayment of debts and for housing.

### **(d) Occupational safety and health**

Since October 2007, Supreme Decree No. 009-2007-TR has provided general regulation of occupational safety and health, requiring phased compliance with the obligations and working conditions to which workers are entitled. Previously, only certain sectors such as mining and industry had been regulated. This Supreme Decree adopts a preventive approach, seeking to promote a culture of prevention of occupational risks, with the participation of the State, employers and workers.

### **(e) Micro- and small enterprises (MSEs)**

Prior to the entry into force of Act No. 28015 (Act on the Promotion and Formalization of Micro- and Small Enterprises), enterprises were classified according to the number of workers employed. Micro-enterprises had between two and nine workers; small enterprises between 10 and 49 workers; medium-sized enterprises between 50 and 99 workers; and large enterprises 100 or more workers.

Following the entry into force of this Act on 4 July 2003, a combination of two special characteristics determines whether productive units are considered as micro- or small enterprises: number of workers and annual sales turnover.

Thus a micro-enterprise has between one and ten workers and a maximum annual sales turnover of 150 Tax Levy Units (TLUs)<sup>2</sup> and a small enterprise employs up to 50 workers and has an annual sales turnover of between 150 and 850 TLUs.

Peru has recently had a second wave of legal reforms. By Legislative Decree No. 1086, the Executive Branch radically modified the definition of micro-enterprises (up to 10 workers and maximum sales of 150 TLUs) and small enterprises (up to 100 workers and maximum sales of 1,700 TLUs). There are two major changes. Firstly, the State partially subsidizes contributions to the social security schemes (health and pensions), creating a system of basic or minimal insurance. Secondly, a new labour system is created for enterprises employing between 1 and 100 workers, with an average reduction of 50 per cent in the employment benefits established for the general system.

There are thus three categories of enterprises: micro-enterprises (employing up to 10 workers), small enterprises (employing up to 100 workers) and other enterprises:

Table VII.5  
DIFFERENT CATEGORIES OF ENTERPRISE ESTABLISHED UNDER LEGISLATIVE DECREE N° 1086

Enterprise size	Number of workers	Maximum sales
Micro	1-10	150 annual TLUs
Small	1-100	1,700 annual TLUs
Medium-sized and large	Over 100	No limit

Source: Prepared by the author.

Individual and collective labour rights were treated differently in the first and second periods. In the first period, a special temporary labour regime<sup>3</sup> was created for micro- enterprises and in the second period this was replaced by a special permanent regime<sup>4</sup> for micro- and small enterprises. Thus the situation has changed and it is now possible to identify substantial differences for micro- and small enterprises, as shown below:

<sup>2</sup> Currently 3,500 nuevos soles (approximately US\$1,186.45).

<sup>3</sup> The temporary regime was established for a period of 10 years as from the entry into force of the law, i.e. until 4 July 2013.

<sup>4</sup> Article 7 of Legislative Decree No. 1086.

Table VII.6  
HIRING CONDITIONS AND EMPLOYMENT AND SOCIAL BENEFITS UNDER  
DIFFERENT LABOUR LAWS

Topic	General regime	Act No. 28015		Legislative decree No. 1086	
		Small enterprises	Micro-enterprises	Small enterprises	Micro-enterprises
Probationary period	3 months	Same	Same	Same	Same
Compensation for arbitrary or unjustified dismissal	Indefinite contract: 1½ remuneration per complete year	½ annual remuneration	½ annual remuneration	20 days' remuneration per complete year	10 days' remuneration per complete year
	Fractions paid in twelfths and thirtieths Maximum: 12 remunerations	Fractions paid in twelfths Maximum: 6 remunerations	Fractions paid in twelfths Maximum: 6 remunerations	Fractions paid in twelfths Maximum: 90 days' remunerations	Fractions paid in twelfths Maximum: 90 days' remunerations
	Fixed-term contract: 1½ remunerations for each complete month remaining Maximum: 12 remunerations	Same	Same	Same	Same
Special compensation	2 remunerations per year No maximum. For workers covered by the general labour regime who have been replaced by workers covered by the special labor regime for micro- and small enterprises.	Applied to workers subject to the general labour regime	Same	Same	Same
Remuneration and workday					
Minimum wage	550 nuevos soles	Same	Same	Same	Same A lower monthly wage may be set with the agreement of the National Labour and Employment Promotion Council
Workday	8 hours per day or 48 hours per week	Same	Same	Same	Same
Payment of overtime	25% over and above the hourly rate for the first 2 hours of overtime. 35% over and above the hourly rate for additional hours of overtime.	Same	Same	Same	Same
Night work	Minimum wage plus 35%.	Same	Not applicable at work sites where the normal working day occurs during night hours	Not applicable	Not applicable
Weekends and public holidays	24 consecutive hours of rest each week	Same	Same	Same	Same

Table VII.6 (continued)

Topic	General regime	Act No. 28015		Legislative decree No. 1086	
		Small enterprises	Micro-enterprises	Small enterprises	Micro-enterprises
Labour and social benefits					
Paid vacations	30 calendar days for each complete year. Sale of vacation days: 15 days	Same	15 calendar days for each complete year. Sale of vacation days: 8 days	15 calendar days for each complete year. Legislative Decree No. 713 applies, where relevant. Sale of vacation days: 8 days.	15 calendar days for each complete year. Legislative Decree No. 713 applies, where relevant. Sale of vacation days: 8 days.
Family allowance	10% of minimum wage	Same	No	No	No
Bonuses	1 month's wages in July and December	Same	No	1/2 month's wages in July and December	No
Profit sharing	Applicable to enterprises with over 20 workers which make a profit.	Not applicable to small enterprises with 20 workers or fewer	No	Not applicable to small enterprises with 20 workers or fewer	No
Compensation for time of service	Equivalent to one month's wages for each complete year. No maximum. Fractions paid in tenths and thirtieths.	Same	No	Equivalent to 15 days' wages for each complete year, with a maximum of 90 days' wages.	No
Life insurance	For workers with 4 years of service (between 0.53% and 1.46% of wages)	Same	No	Yes	No
Supplementary insurance for dangerous work	Variable percentage for high-risk activity	Same	Same	Same	No
National Apprenticeship and Labour Service (SENATI) (industrial sector)	0.75% of monthly wages for workers in industrial enterprises	Not applicable to enterprises with 20 or fewer workers	No provision	Not applicable to enterprises with 20 or fewer workers	No
Collective rights					
Collective rights	Trade unions may be formed by 20 workers	Collective rights may be exercised through workers' representatives	Collective rights may be exercised through workers' representatives	Trade unions may be formed by 20 workers	Collective rights may be exercised through workers' representatives
Health					
Health insurance	9% paid by the employer (EsSalud)	Same	Same	Same	Micro-enterprise workers and managers covered by this legislation will be affiliated to the special partially subsidized health scheme, with access to the priority list of health care interventions.

Table VII.6 (concluded)

Topic	General regime	Act No. 28015		Legislative decree No. 1086	
		Small enterprises	Micro-enterprises	Small enterprises	Micro-enterprises
					The employer pays half of the contribution and the State pays the other half.
Pensions					
Pensions: funded by the worker	Workers contribute an amount that varies depending on whether they are affiliated with the national scheme (13% of monthly wage) or the private pension scheme (variable rates with an average close to 13% of their monthly wage).	Same	Same	Workers in small enterprises are required to be affiliated with either the National Social Security Pension Scheme or the Private Pension Fund Administration Scheme.	Micro-enterprise workers and managers may be affiliated with any of the following schemes: - National Social Security Pension Scheme, - Private Pension Fund Administration Scheme - Social Pension Scheme. (In order to join this scheme, they must not join another scheme).

Source: Prepared by the author.

In addition to the three schemes described above, the government payroll is being formalized. Starting in the early 1990s, the Government began to employ workers without any social protection. The situation of these workers has recently been formalized, but only with access to social security benefits and 15 days of vacation, with no other rights or fringe benefits, so that these are the workers with least protection in Peru (even the staff of micro-enterprises have more rights). The Government has again created a system providing peculiar treatment: hardly any labour costs and very few social rights and benefits.

These arrangements are summarized in the following table, showing monthly costs:

Table VII.7  
SOCIAL BENEFITS AND TAXES UNDER DIFFERENT LABOUR LAWS

Social benefits and contributions	General regime	Micro-enterprises (10 workers + 150 annual TLUs)	Small enterprises (100 workers + 1,700 annual TLUs)	Government administrative contracts
Contributions to EsSalud	9.00 %	15 nuevos soles <sup>a</sup>	9%	9% (maximum 94.50 nuevos soles)
Compulsory life insurance <sup>b</sup>	0.53%	0%	0.53%	0%

Table VII.7 (concluded)

Social benefits and contributions	General regime	Micro-enterprises (10 workers + 150 annual TLUs)	Small enterprises (100 workers + 1,700 annual TLUs)	Government administrative contracts
Contribution to the National Apprenticeship and Labour Service (SENATI) <sup>c</sup>	0.75%	0%	0.75%	0%
Statutory bonuses (2 salaries)	16.67%	0%	8.4% (15 days)	0%
Compensation for time of service (CTS) (1.17 salaries)	9.72%	0%	4.17% (15 days) with a maximum of 90 days	0%
EsSalud on bonuses	1.50%	0%	0.75%	0%
Vacations (30 days)	8.33%	4.17% (15 days)	4.17% (15 days)	4.17% (15 days)
EsSalud on vacations	0.75%	0.38%	0.38%	0.38%
Dangerous work insurance <sup>d</sup>	1.89%	0%	1.89%	0%
Profit sharing	Variable	0%	Variable	0%
Severance pay (on monthly wages)	1 1/2 per year, with a maximum of 12 months	1/3 per year, with a maximum of 3 months	2/3 per year, with a maximum of 4 months	0%
Other: family allowance (55 nuevos soles) and night differential (35%)	Applicable	No	No	No
Enterprise subtotal	49.14% + variables	4.55% + EsSalud contribution	29.98% + variables	13.55%
Category 5 tax (worker)	Variable	Variable	Variable	Variable
Pension Fund Administration (AFP)/ Office of Provisional Standardization(ONP) (worker) <sup>e</sup>	Compulsory, 13.00%	Optional, half of it paid by Government	Compulsory, 13%	Compulsory, 13% <sup>f</sup>
Totals	62.14% + variables	4.55% + 15 nuevos soles + variables	42.98% + variables	26.55% with maximum limits

Source: Prepared by the author

<sup>a</sup> The State pays a subsidy of 15 nuevos soles a month to cover the cost of full health insurance.

<sup>b</sup> From the fourth year. For manual workers, 0.71 per cent.

<sup>c</sup> Applicable to manufacturing industries.

<sup>d</sup> Average applicable to hazardous activities.

<sup>e</sup> Average for AFP. For ONP, 13 per cent.

<sup>f</sup> Voluntary for existing staff.

## (f) Social dialogue

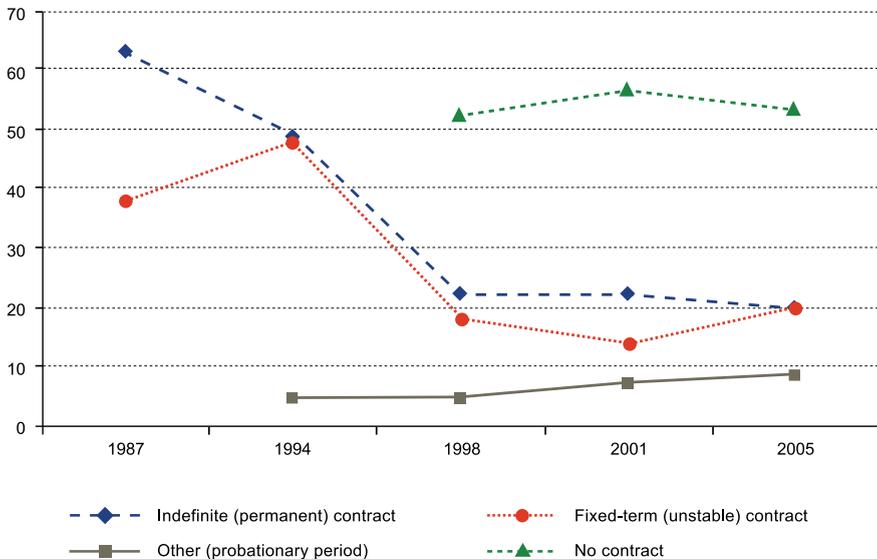
In the outline of social and labour policy for 2008-2011, the Ministry of Labour and Employment Promotion gave priority to the promotion of dialogue between the social actors most representative of Peruvian society in the sphere of labour and State employment, with participation of social organizations. The social dialogue in Peru has been institutionalized by the creation of official forums for consultation such as the National Labour and Employment Promotion Council, Acuerdo Nacional, the National Competitiveness Council, the National Council for the Development of Micro- and Small Enterprises, and the Social Covenant.

## B. Impact, efficiency and positions regarding the regulatory framework

### 1. Evaluation and impact of labour reforms

The labour reforms described above did not have a significant impact on the labour market. Informality and underemployment figures are alarming (among the highest in the region) and, despite the efforts being made, no improvement is foreseen in the medium term. The following figure shows the complex situation of the Peruvian labour market:

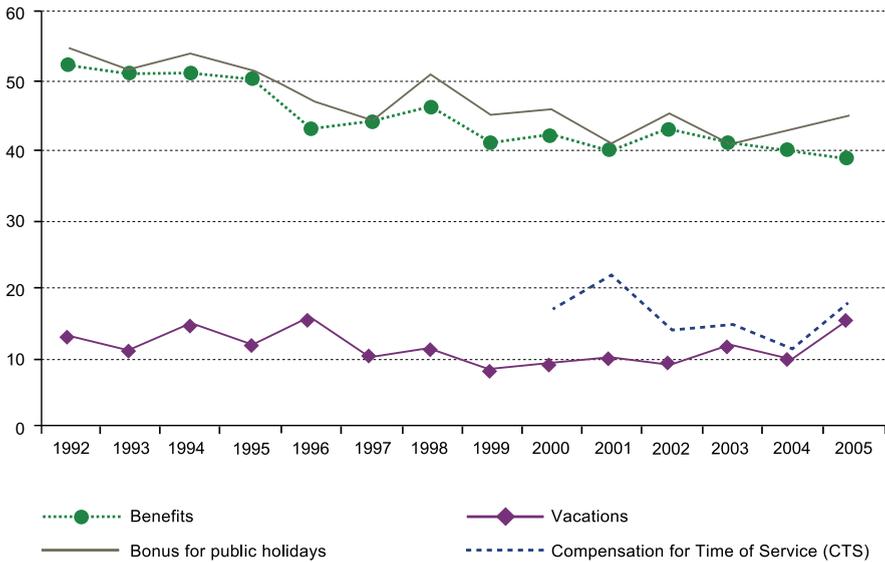
Figure VII.1  
LIMA: ECONOMICALLY ACTIVE POPULATION (EAP) IN THE PRIVATE SECTOR  
BY TYPE OF CONTRACT, 1987-2005  
(Percentages)



Source: Prepared by the author, on the basis of official figures.

The labour reforms introduced since 2001 for the purpose of regulating labour relations have had no impact on the recovery of formal employment levels, as shown in the preceding figure, or on access to social rights and benefits, as can be seen from the following figure:

Figure VII.2  
 LIMA: ECONOMICALLY ACTIVE POPULATION (EAP) IN THE PRIVATE SECTOR BY COMPLIANCE  
 WITH CONTRIBUTIONS AND BENEFITS, 1992-2005  
 (Percentages)



Source: Prepared by the author, on the basis of official figures.

Earlier and current labour reforms did not bring any major improvement in working conditions and levels of employment: underemployment reached unusually high levels among the countries of the region and labour productivity declined in the period under consideration. Consequently, and contrary to expectations, labour reform has not made the labour market more dynamic.

Two clear trends are apparent: (i) a movement towards informalization of the formal sector (a stable post is replaced not by another in a similar category but by a temporary post or other contractual arrangement); and (ii) an increase in flexible hiring systems, i.e. temporary contracts. The second trend reflects enterprises' staff reduction policies, high staff turnover (on average, a person changes jobs in Peru every four years), the preference for systems of decentralization and externalization of labour services (labour intermediation, outsourcing, subcontracting).

## 2. Efficiency of formal rules

The main obstacle to more institutionalized formal labour is precisely the highly informal character of Peru's productive structure

and labour market. Few workers have access to social and employment benefits. People have work but do not enjoy welfare benefits such as social security (health and pensions), minimum wages, extra work (overtime) and social benefits (Compensation for Time of Service, bonuses, etc.). After the reform of the 1990s, not enough was done to improve the low rates of access to social and labour benefits.

According to the National Household Survey for the fourth quarter of 2002, persons working in enterprises not legally registered or not having an accounting system, or unpaid family workers, were considered to be working in the informal sector. Of a total of 4,301,132 informal workers, only 4.2 per cent have health insurance and 4.7 per cent are covered by the pension system (Gamero, 2004, p. 23).

The urban informal sector is composed mainly of micro-enterprise workers and non-professional self-employed workers (79 per cent of this sector), whereas the rural informal sector is composed mainly of unpaid family workers and non-professional self-employed workers (82 per cent).

The effectiveness of the formal rules in the formal sector itself depends on three factors: (i) at the administrative level, the supervision and oversight function performed by the Labour Inspectorate; (ii) at the judicial level, the action by courts and labour chambers to resolve disputes that could not be settled using other individual or collective mechanisms; and (iii) the effects of the Free Trade Agreement with the United States.

The Government's greatest achievement in recent years was probably the upgrading of the labour inspection process. There are now inspection regulations providing for a fast procedure and giving inspectors important functions; the number of inspectors and the budget for inspection have been increased. In addition, the involvement of the Ministry of Labour and Employment Promotion in almost all economic sectors is encouraging the trend towards labour formalization.

There is currently a heavy workload preventing prompt attention to labour demands, although the Judiciary has adopted administrative rules designed to reduce this workload.

Peru and the United States have concluded a Free Trade Agreement, which contains a social clause. Such clauses are usually part of trade agreements and are an indirect way for States to undertake to respect certain social rights. This is a way of harmonizing regulations so as to avoid comparative advantages that might result from low production costs connected with less favorable working conditions.

### **3. Positions of the main actors in the labour market**

The position of the employers' associations was influenced by the regulations of the 1970s, particularly the labour stability law and the system of sharing in the ownership, management and profits of the enterprise. They have thus been supportive of the reforms geared to employment flexibility and labour cost reduction.

The trade union organizations never fully recovered from the crisis of the 1990s. The principal union leaders have a confrontational approach designed to demonstrate their drawing power and promotion of social mobilization, with the aim of tipping the balance of power in their favour during bargaining.

The political parties have expressed their views on the proposals for flexibilization of labour institutions. However, participation by political organizations is limited to current issues.

Civil society has not been – and still is not – very involved in the formulation of labour proposals at any level (regulations, policies, etc.). The social demand is clear. The country's main problem is unemployment (according to 53 per cent of those surveyed by APOYO Consultoría), although what is being called for is the “decent work” advocated by the International Labour Organization (ILO) (since the unemployment rate is 8 per cent) – in other words, inclusion on payroll, enjoyment of social benefits and social inclusion.

## **C. Flexicurity and pending actions**

### **1. Flexicurity as a strategy for preventing sectoral distortion of the reforms and for offsetting ideological shifts in market policies**

Situations such as those described require a proactive approach by the social and democratic State, in which the rule of law prevails. This includes adopting measures to ensure appropriate investment in the individual, so as to enable him to remain in the labour market and so as to develop a comprehensive strategy for reducing and eliminating the negative effects caused by the flexibility introduced or the deregulation scenarios.

Flexicurity should therefore be a strategy for developing rules to modify certain rigid aspects of labour legislation and to enhance basic labour protection by means of oversight, thus mitigating the effects of market segmentation and the negative consequences of flexibility.

The four basic components of flexicurity to be incorporated are: (i) reforms of the rules relating to the labour regime; (ii) a reliable and

adaptable system of vocational training; (iii) flexible social protection schemes meeting the needs of people who change jobs or leave the labour market temporarily; and (iv) active labour-market policies.

## **2. Pending debates**

### **(a) Sufficient flexibility, sufficient security**

A comprehensive approach requires a combination of flexibility and security, in a relationship of interdependence. Both must be part of the solution – each to the appropriate extent – so that enterprises can adapt efficiently to market needs, without leaving workers bereft of security. In our view, a reform of this type, unprecedented in Peru, could enhance the quality of the labour market.

The flexible component would focus on allowing individual dismissals for financial reasons, modifying certain labour benefits (which are comparatively generous) for new workers and granting an amnesty for payrolling of informal workers, with lower labour costs that will gradually reach the level applicable to all labour relations (solution proposed by the Government for the formalization of the public sector).

Protection, for its part, would concentrate on improving the geographical coverage of labour oversight, reducing the tax burden when enterprises recruit for an indefinite period and on a full-time basis, favouring procurement bids from good employers, granting advantages to enterprises that focus on labour productivity and training and establishing social protection systems for self-employed workers.

In other words, the goal is regulation geared to balance and equity in labour relations (in which workers, employers and the Government derive more advantages than disadvantages), based on technical and objective studies of the labour market that benefit from the experience of other countries and the important social dialogue in the National Labour and Employment Promotion Council.

Flexicurity ultimately involves opting for normative regulation and a government role that differs from the traditional vision: not the flexibility of the 1990s alone and not only the protective regulation of the 1980s.

### **(b) Critical evaluation of collective bargaining as an instrument of change**

In the 1990s, the flexibilization policy, the bargaining power of employers' associations and the internal fragmentation of the trade unions as a balancing social force weakened the strength of collective bargaining as an instrument of change.

Although it is important for trade unions to resume the role of balance and counterweight in promoting negotiated and lasting solutions, there is also a need for them to rethink their ideology, organization, goals and unity, because of the need for “a mechanism that is useful in processes of trade union unity in its various possible forms, ranging from unity of action on specific goals to processes of reconciliation of differences and of contradictions between unions. Trade union unity must therefore be viewed as a form of pluralism” (Mariucci, 2005).

Without strong trade unions with legitimacy and capacity, collective bargaining cannot be used to introduce long-term changes. Unfortunately, the present situation of trade unionism is the result of the individualization of labour relations in pursuit of the flexibility which it was thought would solve the labour-market problems, causing the effective dismantling of the collective relations subsystem. Thus the employer’s decision-making authority was enhanced, at the expense of the balance which should exist in collective bargaining, since the increase in the employer’s regulating powers reduced the demand for services in the area of collective relations. However, trade union membership increased (in 2007, slightly over 5,000 workers were unionized); trade unions have ways of exerting commercial pressure and are better organized to promote their interests and even adopt policies of social responsibility.

The importance of collective bargaining must therefore be recognized, in order to enhance it and promote its use. Collective bargaining can regulate and establish suitable measures in the existing context, in which enterprises operate in more than one country, labour migration is increasingly frequent and government regulation is losing ground.

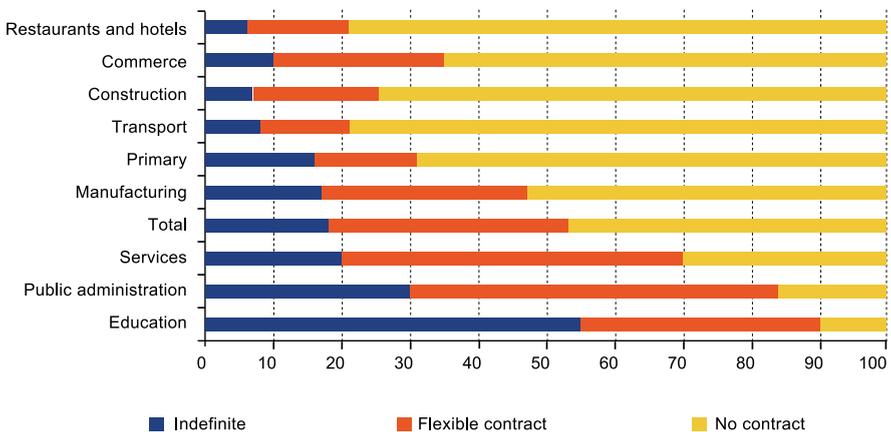
### **3. Viability and tools for ensuring flexicurity**

Before describing the actions based on this strategy, four aspects should be mentioned:

- The Peruvian social, political, economic and cultural reality must be recognized.
- Work must be done with vulnerable groups needing access to employment.
- Obstacles to competitiveness, and particularly formalities and red tape, must be eliminated or reduced.
- Policies must be introduced to deal with the social pressures affecting labour relations.

Informality concerns all sectors of the working population, and affects 50 per cent of services, construction, industry and transport. It can be deduced from this structure that levels of social protection such as health and pensions and access to labour benefits are minimal. Only 25 per cent of the economically active population (EAP) are on payroll and have access to social and labour benefits. In addition, in the urban sector, levels of informality are alarmingly high, as shown in the following figure:

Figure VII.3  
PERU: URBAN DEPENDENT EMPLOYMENT BY SECTOR AND TYPE  
OF EMPLOYMENT RELATIONSHIP, 2006  
(Percentages)



Source: National Household Survey, 2006 and APOYO Consultoría.

### (a) Social dialogue

Social dialogue is an essential instrument that must be promoted more forcefully by the State and by labour authorities, so as to ensure that any rule or general policy adopted has been the subject of prior discussion, notification or negotiation with enterprises and workers.

However, the National Labour and Employment Promotion Council has still not fully imposed itself as the body defining the general directions of labour policy and as the meeting point for all sectors involved. In the present circumstances, all bodies participating in this Council – and other sectors that may become involved, with the support of the Ministry of Labour and Employment Promotion – must make every effort to ensure that the Council becomes an influential institution to be consulted before any decision is taken.

The question is whether labour dialogue is possible in this situation and whether the social dialogue can result in labour standards. The parties

involved of course have opposing interests; however, by following specific guidelines and directions, it is possible to reach general agreements that can subsequently be moved through Congress and Government. For example, the validity of the observations of the International Labour Organization (ILO) on the Act on Collective Labour Relations was more or less accepted by the parties, as was the need to bring the employment situation in Peru into line with the ILO observations in order to meet the concerns of Democratic Party members of the United States Congress as a prerequisite for conclusion of the Free Trade Agreement. These and other examples can be followed in order to achieve more agreements as tangible results of the social dialogue.

In any case, it is important to bear in mind the basic distinction between political and technical issues. Although regulations are part of the political structure of the State, they cannot exist without a favorable technical analysis.

This shows that there are challenges to be faced, such as involving truly representative organizations of employers and workers on an equal footing, giving them the necessary support to access ongoing training and expressing a strong interest on the part of Government in making social dialogue a reliable tool for establishing and enforcing rules with flexicurity.

## **(b) Actions to guarantee the durability of reform**

### **(i) Reforms of regulations concerning the labour regime**

Labour reforms must embody flexicurity and have a suitable combination of flexibility to promote formal hiring and protection to reassure workers that labour regulations will be respected.

First of all, there must be a viable social, labour and technical plan that has the support of society. Labour reform must envisage, on the one hand, an increase in labour compliance, oversight and supervision mechanisms (the country's labour compliance levels are among the lowest) and, on the other, a review of costs that create distortion in a globalized market (according to the World Bank, Peru is one of the 20 most protectionist countries in the world) and promotion of investment in education, technology and innovation.

The debate on the need for labour reform should no longer be based on labour law (regulation of those who have work) but should concentrate on the right to employment (access to decent work), since the former governs workers on payroll, while the latter covers all workers regardless of whether they are subordinate (on payroll) or not (fees), as well as persons in neither of these categories (self-employed, underemployed as regards hours and earnings). The right to employment also involves

mechanisms for the creation, promotion and preservation of suitable employment, labour insertion, encouragement of best labour practices and creation of suitable conditions for a minimum level of compliance with and oversight of labour obligations.

Reforms should focus on the following aspects:

- Allowing enterprises (after certification by a report from an authorized auditing firm) to process individual lay-offs for economic reasons. Today an enterprise in financial difficulty cannot use this as a reason to lay off a worker, unless it dismisses ten or more workers (Toyama and Yamada, 2007, p. 22).
- Adapting some benefits for new workers (for example, reducing vacations), in such a way that the acquired rights of existing workers are not affected.
- Using atypical contracts without committing fraud or violation of social and labour regulations.
- Introducing measures of two-way flexibility (Almeda Castillo, 2007, p. 123) that allow workers to choose from a larger number of options with regard to working hours, such as time banks, production demands and compensatory time off, and to achieve a better balance between family life, work and education.<sup>5</sup>
- Encouraging further debate on the draft General Labour Act, which is designed to balance labour relations following the reforms of the 1990s.

(ii) Components to be provided for training

- System of vocational training.
- System of standardization, certification and accreditation.
- Measures to link education supply with labour demand.
- Measures to encourage private investment in worker training and thus enhance productivity and employability.
- Suitable targeted rules on training arrangements so as to provide skills training for work, in the context of the rights recognized by the Constitution.

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<sup>5</sup> It should be noted that in Europe the share of total employment represented by workers differing from the classic contractual model and own-account workers increased from over 36 per cent of workers in 2001 to almost 40 per cent of EU-25 workers in 2005. For more information, see Commission of the European Communities, 2007a, p. 8.

Lastly, the main obstacle is that training is considered as a cost to enterprises, since the benefits are always reaped in the long term. In order to overcome this obstacle, a strategy of lifelong training should be devised for persons with jobs and unemployed persons.

- The State must play the role of trainer for the unemployed or subemployed sector either directly or indirectly (by delegating to vocational training centres), engage in regional training activities in the light of the needs, attitudes and aptitudes of applicants, and devise labour reconversion programmes.
- The employer bears the main responsibility for providing training as a means of increasing productivity and thus improving the enterprise's competitiveness. If campaigns are conducted on the importance of human capital as a value added for the enterprise and if training is considered as an investment, enterprises will be supportive. The State can help in this regard by giving bigger tax breaks for existing programs or granting certifications to enterprises which provide training that sets an example to others.

### (iii) Social security

Because social security is so inadequate, a radical reform is needed to achieve social inclusion in Peru, concentrating on the following aspects:

- Development of social protection systems to support potential worker mobility, ensuring workers' advancement and versatility in the labour market.
- Implementation of suitable social protection measures for atypical labour relations, in which payment of monthly contributions is impossible because of the nature of the labour provided, so that protection is geared to the worker as a person providing labour and not to the actual occupation.

### (iv) Active labour-market policies

Policies must be devised to tackle the problems caused by the amount of informality, underemployment and unemployment. These should include:

- Policies on informality that achieve the gradual objective of formalizing employment already existing.

In the labour sector, the goal is primarily to show the benefits of formality as regards training, financing and technical assistance, not forgetting the role and presence of inspection staff.

- Policies to expand full and dignified employment, designed to create employment opportunities in regional zones and groups,

taking into account the added value of each region (for example, in Ica, provide creative opportunities for agroexports).

Information on labour supply and demand must be upgraded. Each region of the country must have information media and technologies providing accurate information on needs and opportunities in the zone, so that education supply can be geared to these aspects. If the education supplied reflects regional needs and opportunities, it will be possible to link these to labour demand by considering the level and quality of professionals and technicians needed by enterprises. With appropriate and clear labour-market information, it will be possible to link supply with labour demand.

The public sector, by means of employment agencies, should adopt a proactive approach and open communication channels between enterprises and unemployed or underemployed persons, as well as visiting enterprises and providing real vocational guidance from a regional perspective.

- Positive employment policies for vulnerable groups such as young people, disabled persons and women.

The goal is to promote measures that make it attractive to hire these social actors, for example:

- Regulatory reforms giving tax breaks to enterprises which can prove that they have hired such people on an indefinite basis.
- Higher labour quotas than those already existing in public corporations.

## **D. Conclusions**

The economic diagnosis of Peru's labour situation shows that the country is forging a growth economy in which labour segmentation still exists, since few people enjoy the benefits of the labour regulatory system. The macroeconomic figures are encouraging: in general terms, the indexes show very satisfactory results, boosted in particular by growth in consumption, domestic demand and private investment.

However, currently only one in four workers – five, in other studies – has access to labour rights and social security (health and pensions). Underemployment is the most striking characteristic of the population and labour productivity levels are still quite low compared with other countries. The consequence of this reluctance to implement reform is a paradox: Peru is one of the countries with the lowest levels of compliance

with labour regulations but, at the same time, it is among the 20 most protectionist countries in the world.

The Peruvian labour regime has been an example of the ideological swings of labour-market policies. It has moved from protective regulation in the 1980s to application of a range of regulatory actions aimed at introducing flexibility in the 1990s.

Since 2001, labour reforms have concentrated on bringing Peruvian legislation into line with the observations of ILO and of the United States within the framework of the Free Trade Agreement negotiations with that country, modifying specific aspects originating from trade union pressure—especially in the mining sector—and introducing a labour regulation system in micro- and small enterprises, which has had no major impact on labour relations or the formalization of such enterprises and has not improved access to labour and welfare benefits.

A recent reform in micro- and small enterprises has reduced levels of social protection. For micro-enterprises (up to 10 workers and sales not exceeding 150 Tax Levy Units), the State is subsidizing access to a new social welfare system (health and pensions) and workers have hardly any labour rights (all related to working time: halving of vacations, breaks and overtime payment). For small enterprises (up to 100 workers and sales up to 1,700 Tax Levy Units), a new labour regime has been created which is equivalent to half the social benefits of the general regime and the same system of social security. Lastly, for other enterprises the general regime applies.

It should be noted that the situation of government workers who had no labour rights has been formalized. However, the Government has given them only social rights and vacations, in a fourth labour system notable for the fact that it provides less labour protection.

This labour reform, focused on reducing labour costs and subsidizing enterprises to encourage them to become formalized, will not have a big effect on the labour market. The focus has been solely on cost reduction and flexibilization and not on market-based incentives, real advantages for enterprises opting for formality, special treatment for investment in training or a framework for improving productivity and competitiveness.

Flexibility and security are not contradictory terms. For the implementation of a comprehensive strategy such as flexicurity, both elements are interdependent.

Flexicurity is a balanced strategy with four components: (i) reforms of regulations relating to the labour regime; (ii) a reliable and adaptable system of vocational training; (iii) flexible systems of social protection

meeting the needs of people who change jobs or leave the labour market temporarily; and (iv) active labour-market policies.

In order to be effective and lasting, strategies such as flexicurity require sources of financing, elimination of obstacles and implementation of actions with all their components. Another prerequisite is consolidation of the social dialogue and participation of the four social actors: Government, employers' associations, trade unions and civil society.

So far, Peru has not implemented a flexicurity labour reform. Studies on this subject note that a phenomenon of "flight from labour law" has occurred. In other words, this is a labour market in which it is easy to find occult or disguised labour relations, with a proliferation of receipts for fees, hiring of independent services or work, weak outsourcing (to enterprises whose only expense is payroll), atypical labour hiring (part-time, intermittent) and a whole process of outsourcing of labour functions for the sake of commercial and civil relations.

In addition to informality, another problem is underemployment – a labour category that includes over half of Peruvians earning less than enough to pay for the basic family basket of goods. Other recurring issues are the figures on workforce training, for which Peru is among the continent's least successful countries and which aggravate the phenomenon of flight from labour formality that has been current in recent years. A stable and well-paid job with a good employer has been and still is a luxury, a scarce good according to Professor Alonso Olea of Spain.

In view of this phenomenon, what is needed is a comprehensive and urgent reform of the labour relations system, aimed primarily at labour inclusion: each Peruvian worker must have basic labour and social coverage and the number of persons excluded from the system must be drastically reduced. In order for this to happen, regulations will have to flexibilize conditions of access to employment (gradual access to labour and social rights is the best option for new workers) and the State should guarantee minimum social and labour protection for all (for example, nobody should be without formal earnings, health and pension insurance and annual vacations at the very least). At the same time, collective bargaining should become the instrument for improving basic standards and a solid system of labour oversight should ensure that the system is equitable both for workers and for employers.

In the current context, in which Peru is in a stable and growing economic situation and will be concluding a Free Trade Agreement with the largest market in the world, there is an excellent opportunity to reform and modernize labour relations, so as to improve levels of protection and security and enact provisions to make labour more formalized.

This is a huge task for the Government. Its activity to regulate the informal and uncompetitive labour market and its role as monitor of compliance with the rules in force and those to be enacted in a concerted market are vital. Regarding the latter, with the implementation of the Free Trade Agreement plus the trend existing since 2007 in labour inspection (larger budget, more inspectors with greater authority, electronic payrolling), there will probably be an increase in inspections and fines and, as a result, greater compliance with rules by enterprises. This oversight role —and, above all, its effectiveness— as well as the ability of inspectors to detect violations not only in quantitative but also in qualitative terms (outsourcing, anti-union actions, labour intermediation, professional fees, calculation of social benefits) may encourage complaints by workers, who may finally discover that the labour authorities can indeed protect their rights.

However, the Government must spearhead the labour reform, with rules and policies of social and labour inclusion. Here the challenge is to implement reforms which, on the one hand, flexibilize mechanisms for access to decent employment (gradual access to labour rights) and, on the other hand, guarantee effective compliance with legislation.

From a macroeconomic standpoint, the major challenge is to halt the trend towards informalization and low labour force productivity, showing an extremely low level of protection. Such informality means not only that a worker does not receive benefits but also that there is lower fiscal revenue, as well as low wages. In this connection, the big reform is pending: regulatory proposals and measures by the authorities geared to reducing the labour informality gap and raising the level of labour productivity and competitiveness.

The labour world is in constant flux and the responses of Government are still slow, timid or isolated. It is urgent to implement the comprehensive reform of Peru's public and private labour market. However, this must be done with greater social dialogue, with technical and comprehensive studies and with attention to the experience of other countries.

## Chapter VIII

**Flexicurity with informality: options and restrictions**<sup>1</sup>*Víctor E. Tokman***A. Reconciling flexibility with protection: flexicurity**

Improvement of the ability to compete in open and expanded markets assumes the existence of flexible labour relations. This flexibility results in greater insecurity and less protection and introduces social cohesion tension, as well as weakening the support of workers and their organizations for the process of globalization and integration. The experience of the developed countries seems to indicate that there are different combinations of protection arrangements in employment and social and labour security, with varying results as regards their economic effects and effects on employment, and as regards the public perception of security (ILO, 2004a and Boyer, 2006).

In the northern European countries (Belgium, Denmark, Ireland and the Netherlands), usually associated with a successful flexicurity strategy, employment law producing a low level of job security is combined with public spending on labour-market policies that provide considerable protection and promote the rapid reinsertion of workers in the labour market. The result of this combination is a perception of high security

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<sup>1</sup> For a fuller version of this chapter, see Tokman (2008a).

on the part of the public. This model is not unique. The Mediterranean countries (Spain, Greece, Italy and Portugal) have greater job security (the result of stricter employment law) and less generous spending on labour-market policies, which creates a perception of high insecurity.

There are also countries in the middle, with different degrees of success and also different perceptions of security. On the one hand, Germany, France and Sweden have high levels of both job security and labour and social protection. The perception of security among the public is high, but lower than in the northern European countries. On the other hand, in the United States and the United Kingdom, the perception of security is low, owing to more flexible employment law and lower spending on protection policies.

Perceptions are the result of subjective appreciations and objective factors, so that the combination of high employment stability and limited protection may lead to a perception of insecurity for many people: while they know that there is little likelihood that they will lose their job, they also know that if they do their replacement income will be less than they were receiving in the former job and that their unemployment will probably last longer because of the slower adjustment of the labour market. On the other hand, greater labour instability and the resulting greater probability of unemployment, associated with more support as regards income and reinsertion, will result in a shorter and more protected period of unemployment.

## **B. Flexicurity in Latin America**

Flexicurity can be useful for the Latin American countries, most of which are small and have very open economies. They are also more vulnerable and have less possibility of alleviating the intensity of economic cycles before their consequences spread internally and require an improvement in conditions of competitiveness on international markets. The diversity of developed countries' experiences in reconciling flexibility with protection can be useful, but it is important to recognize the limitations created by a different structural framework.

Based on the way in which the instruments of job security and labour and social protection are used, as well as public perceptions of the resulting security, the countries of Latin America can be divided into four groups according to the strictness of their employment law and the amount of government resources devoted to labour protection. At one extreme, and this is similar to what happens in developed countries, there are countries where employment law is less strict but is accompanied by high spending on protection and where the public perception of

security is the highest in the region. This group consists of Argentina, Chile, Costa Rica and Uruguay. At the other extreme, we have Mexico, Panama and the Andean countries, which have strict employment laws ensuring greater employment stability by making it expensive to dismiss workers but which spend little on protection. As a result, there is as high perception of insecurity in these countries.

Brazil and the Bolivarian Republic of Venezuela are in the middle. In these countries, strict employment laws are combined with a high level of protection. As a result, there is a high perception of security. However, this perception is less than that found in the Southern Cone countries and Costa Rica. Similarly, in small and open countries such as the Central American countries, Plurinational State of Bolivia and the Dominican Republic, employment law is less strict but stricter than in the Southern Cone and there is less spending on labour protection. As a result, the perception of insecurity is high, but less than in Mexico, Panama and the Andean countries.

Table VIII.1  
LATIN AMERICA (SELECTED COUNTRIES): LEVELS OF SOCIAL AND LABOUR PROTECTION  
AND EMPLOYMENT PROTECTION

Social and labour protection			
		High	Low
Employment protection	High	Brazil and Bolivarian Republic of Venezuela  Employment law: second strictest Social protection spending: second highest Perception of security: second highest	Colombia, Ecuador, Mexico, Panama, Paraguay and Peru  Employment law: strictest Social protection spending: second lowest Perception of security: lowest
	Low	Argentina, Chile, Costa Rica and Uruguay  Employment law: least strict Social protection spending: highest Perception of security: highest	Bolivia (Plur. State of), El Salvador, Guatemala, Honduras, Nicaragua and Dominican Republic  Employment law: second least strict Social protection spending: second lowest Perception of security: second lowest

Source: Employment law classified by strictness on the subject of layoffs, including flexibility of hiring and firing: World Bank, *Doing Business, 2004*, Washington, D.C.; social protection spending as a percentage of GDP includes pensions: Economic Commission for Latin America and the Caribbean (ECLAC), *Social Panorama of Latin America, 2005* (LC/G.2288-P), Santiago, 2005; perception of insecurity: *Latinobarómetro, 2005*, Santiago, 2005.

The summary classifications reveal the heterogeneity of the countries of Latin America and of the Organization for Economic Cooperation and Development (OECD), demonstrating the existence of different combinations of policies of social and labour protection and employment policies, as well as their results in terms of perception of security. The developed countries have policies for reconciling employment protection with unemployment social insurance, with increasing components of

“activation”.<sup>2</sup> The differences between the countries of the two regions concern the use of employment law as an instrument for providing job security and the allocation of resources for labour and social protection. While the cost of regulation to provide job security in the Latin American countries is on average more than triple the cost for the OECD countries, the situation is reversed as regards contributions to social security. In OECD, the resources allocated for this purpose are 1.5 times higher than those allocated in Latin America (Heckman and Pagés, 2005).<sup>3</sup>

Monetary payments are the preferred and established method used in Latin American countries to compensate workers who are laid off. It is simple and provides protection and strong incentives to seek work, but there are problems of capacity to pay when enterprises are in financial difficulty because of bankruptcy or closure. For this reason, supplementation with insurance or mechanisms that separate funds for compensation from corporate funds may provide greater security and could reduce layoff costs. However, as correctly noted by Blanchard (2003), these two methods are not ideal substitutes, firstly because of the legitimacy of workers’ compensation and, secondly, because of the limitations associated with insurance in general. Workers are faced with situations of unemployment early in the labour cycle, when they have not accumulated sufficient funds to face long periods without work. Consequently, these funds must be supplemented with public insurance, provided by an agency that is sufficiently generous but focused on people finding and accepting work.

### C. Flexicurity and limiting structural factors

The various flexicurity arrangements show that opportunities exist for promoting the creation of productive and protected employment. These policies are potentially less effective in Latin America, firstly because there is an extensive informal economy involving most of the people excluded from the formal labour market and secondly because fiscal resources are insufficient to finance a system of social and labour protection that is sufficiently generous to provide security to the entire population. The first aspect is related to the progress made in formalization of the labour market, as regards the importance and the nature of labour relations, as well as the size of productive units. The second concerns the level of the

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<sup>2</sup> Following the European Union policy adopted in Lisbon, countries are devoting additional resources to active labour policies (intermediation, employment programmes for vulnerable groups, and training) and at the same time making passive labour policies (unemployment insurance) stricter.

<sup>3</sup> A more recent estimate by Loayza, Oviedo and Servén (2005) states that labour regulation in Latin America is on average 27% higher than in OECD and higher than the estimate for all the developing regions.

tax burden and the amount of public spending on active and passive labour policies and on social security.

Labour heterogeneity in Latin America is very marked within and between countries. Around 2005, on average 30% of the region's labour force was working in agricultural zones and wage earners represented 64% of those employed in urban areas. In addition, 63% of the non-agricultural labour force was working in the informal economy.<sup>4</sup> This heterogeneity reduces the impact of labour policies and results in low coverage of social and labour protection. Social protection coverage extends on average to 38.7% of all employed persons and to 45.4% of urban employed persons.<sup>5</sup>

There are significant differences between countries with regard to each of these indicators. In some countries, less than 10% of workers are employed in rural areas, as is the case in Uruguay and Argentina, but in other countries, including Nicaragua, this percentage is as high as 54%. Three out of every four employed persons in Chile and Argentina are urban wage earners, but only 48% in Guatemala. The informal economy varies between 38% in Chile and 87% in Plurinational State of Bolivia, and urban protection coverage between 67% and 68% in Costa Rica and Chile, but only about 20% in Paraguay, Peru and Plurinational State of Bolivia (Tokman, 2006).

Despite this diversity of situations, countries tend to fall into categories similar to those mentioned in connection with the flexicurity models analyzed. The countries with greater security are also the most urbanized, with a high proportion of wage earners and less informality. These are usually the countries with more protection coverage for the nation and for urban areas. At the other extreme, the greatest insecurity is found in the less urbanized countries, with fewer wage earners, greater informality and low social protection coverage. This seems to indicate that, in the countries where there is a greater perception of this security, there is more likelihood that the effects will spread to the population as a whole (Chile, Argentina, Costa Rica and Uruguay). On the other hand, countries where there is a high perception of insecurity also have significant structural limitations, which alter the potential effect of the

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<sup>4</sup> Including own-account workers, unpaid family workers, domestic servants and employers and workers in micro-enterprises with less than five employees and all workers without a recognized labour relationship or whose relationship is not recognized and whose labour rights are not respected, wherever they are employed (Tokman, 2008b).

<sup>5</sup> Percentage of employed persons making pension contributions (ECLAC, 2006 and Tokman, 2006). If one uses the percentage of employed persons in urban areas making contributions for pensions or health or both, coverage increases to about 60% (ILO, 2007a).

policies analyzed.<sup>6</sup> In the middle, we have Brazil and the Bolivarian Republic of Venezuela, and perhaps also Mexico and Panama.

Less tax revenue is available in Latin America than in the OECD countries and this is an additional limitation. The average tax burden in the Latin American countries was 15.7% of GDP in 2000, whereas in the OECD countries it was 2.3 times greater and in the European Union (15 countries) it was over 40%. In the period 1990-1995, the figures varied between 30.9% in Brazil and less than 9% in the Bolivarian Republic of Venezuela, Guatemala and Haiti. The countries with a higher tax burden are those which also have fewer structural limitations on the introduction of labour and social security policies. In Brazil, Uruguay, Argentina and Chile, the tax burden during that period was around 25% (Gómez Sabaini, 2006).<sup>7</sup>

Allocation of public spending is another difference between Latin American countries and between those countries and the developed ones. Countries with higher tax revenues not only have greater spending capacity, but also allocate more of such expenditure to labour policies. These policies in turn have more impact when applied to more homogeneous and formalized labour markets. On average, OECD countries devote 2.14% of GDP to labour policies and European Union countries devote 3.25%. The countries with a greater perception of security are those which devote more resources to such policies—over 3% and a maximum of 4.5% of GDP in Denmark. Germany, France and Sweden, where there is also a high level of security, devote 3% of GDP on average to active and passive labour policies. The Mediterranean and Anglo-Saxon countries spend less: on average 1.6% and 0.8% of GDP respectively. This compares to the Latin American countries with higher tax revenue, which allocate 0.46% (Brazil) and 0.27% (Argentina), with Chile in the middle (0.32%).<sup>8</sup>

It is also noteworthy that all the OECD countries devote a greater share of GDP to passive labour policies (unemployment insurance) than to active ones, with the exception of the United Kingdom. However, as the figure for public spending on labour policies decreases, the gap between the two types of measures narrows. In Brazil, Argentina and Chile, on the other hand, more is spent on active than on passive policies.

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<sup>6</sup> These include the smaller and more open countries such as the Andean countries (Colombia, Ecuador and Peru).

<sup>7</sup> In the case of Chile, the tax burden includes contributions made to individual retirement accounts. Since they constitute compulsory savings, they are equivalent to taxes.

<sup>8</sup> Data on distribution of public spending in Latin America (including social security and labour policies) show that the more secure countries are those with higher rates of investment (9.4% and 8.1% of GDP on average). The less secure countries have rates below 2.8% and the most insecure have an average of 1% (ECLAC, 2005).

In fact, apart from those three countries, unemployment insurance exists only in Ecuador, the Bolivarian Republic of Venezuela and Uruguay and coverage as a percentage of unemployed persons varies between 9% in Uruguay and 2.8% in Ecuador (Velásquez, 2005).<sup>9</sup>

#### **D. Informality: a concept in a state of flux**

The existence of labour informality, particularly in developing countries, is widely recognized but its definition and origin are constantly evolving. The “informal sector” concept was first used in the report of the ILO Employment Mission to Kenya in 1972, which recognized that, unlike the situation in the more developed countries, the problem in developing countries is not unemployment but primarily employment that does not provide workers with enough earnings to survive.<sup>10</sup> This is the case of “poor workers” performing activities which characterized by their low productivity, as opposed to formal activities, and which result in exclusion from access to markets and productive resources.

In Latin America, the analysis has benefited from various inputs. The logic of survival in the context of the process of insufficient job creation was incorporated. This approach is based on the structuralist theories developed by Raúl Prebisch and ECLAC and leads to the conclusion that the informal sector emerges as a result of pressure exerted by surplus manpower and insufficient creation of jobs, especially good jobs. In order to survive, people are obliged to seek low-productivity and low-wage work (Souza and Tokman, 1976). These activities (production or sale of something) are easy to take up, require little capital and skill and have no marked division of tasks and hierarchies. The manpower employed in such activities consists of the employer, who is also a worker, unpaid family members and wage earners, usually without contracts. It is a highly flexible employment alternative allowing efficient use of available family time and sharing of resources between the enterprise and the home. This type of production is characterized by low productivity and lack of protection, but it does provide an option for using capital that is available but difficult to transfer outside the home.

In both of these approaches, the basic element of analysis is the production unit, but there is as link with the rest of the economy and with labour-market segmentation. The first link is observed directly in the sale of goods and, particularly, of services, as well as in

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<sup>9</sup> On average, existing insurance covers only 0.66% of the labour force in these countries.

<sup>10</sup> The ILO Mission was headed by R. Jolly and H. Singer. There is also an acknowledgement of the influence of little-known earlier work by Hart (1973), who was also a member of the Mission.

subcontracting. Labour-market segmentation is observed in the limited mobility and inter-sectoral wage differentials, even for workers with similar human capital.<sup>11</sup>

This conceptual theory was not universally accepted: even within ILO, various researchers questioned the autonomous character attributed to the informal sector and emphasized the disguised and subordinate labour relationship of wage earners and even of own-account workers (Lubell, 1991). These observations led to the conclusion that there was exploitation and extraction of surplus manpower by the more organized sectors.

In the late 1970s and the 1980s, these interpretations gained ground by being linked to the need to increase the large enterprises' profit margins by means of decentralization of the production process and, primarily, of labour. Nineteenth-century subcontracting arrangements (textile and garment industry) are being updated and replaced by a number of subordination relationships ranging from direct subcontracting to activities that appear to be performed independently but in fact help to lower manpower costs (garment industry, staff placement by intermediaries, informal distribution) or provide raw material at lower prices (including waste recycling). According to this theory, linking of informal enterprises with organized enterprises fills a need for decentralization in order to adapt to globalization and to changes in the international division of labour (Portes, Castells and Benton, 1989). A dual role is assigned to the informal sector: cost reduction and erosion of trade union power. It is also recognized to be universal, because it exists both in developing and in developed countries.

Three decades after the introduction of the informal sector concept in ILO, that Organization, mindful of the numerous dimensions that emerged in the analysis, recognizes that preoccupation with the informal sector as a structural erosion of protection capacity cannot be viewed in isolation from the increasing precarization of labour. This process was first observed in the 1980s and affects not only people working in the informal sector but also those working in formal enterprises. It culminated in the adoption of the "informal economy" concept at the 90th session of the International Labour Conference in 2002.<sup>12</sup> This expands the informal sector concept by adding to the production unit labour relations that are not legally regulated or protected. Thus, under the new definition,

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<sup>11</sup> Tokman (1978) analyzes the type of existing inter-sectoral relations and considers a balance of payments between the informal and the formal sectors.

<sup>12</sup> Mention must be made of the significant contribution of Women in the Informal Economy: Globalizing and Organizing (WIEGO), in support of this change to add to the original definition certain types of precarious jobs mainly performed by the poor (Chen, Vanek and Carr, 2004).

persons employed in the informal sector include all workers, regardless of their place of work, whose employment relationship is not subject to the standards of employment law.<sup>13</sup>

At the same time, more attention is being paid to an interpretation derived from a liberalizing theory that legislation and regulation are basically responsible for the existence of informality. The inadequacy of these regulatory frameworks gives rise to informal activities and also restricts their productive expansion (De Soto, 1986). This inadequacy is the result of a colonial legacy reflected in costly regulations and bureaucratic structures which stifle the development of small productive activities. More recently, this approach to informality led to a broader interpretation emphasizing the voluntary character of informality, particularly for self-employed workers, who prefer to be informal because they earn more outside the legal frameworks. This is also true in countries where the benefits of social protection derived from formality are limited and there are universal trade-offs or non-contributory programmes that offset the lack of protection. "Escape" as a deliberate decision makes sense in a context of inadequate and costly regulations and coexists with the "exclusion" resulting both from labour-market segmentation and from the difficulties of conducting business on a small scale (Perry and others, 2007). With a diagnosis similar to this one but a different strategic approach, it is proposed to modify legislation, streamline procedures and empower informal workers. This legally-based empowerment must be accompanied by the possibility for these workers to make their voice heard and to organize themselves.

## **E. Informality: dimensions, structure and diversity among countries**

In Latin America, the informal economy accounted for 63.3% of non-agricultural employment in 2005. The informal sector accounted for 50.7%, and 12.6% consisted of wage earners without protection employed in formal enterprises. The informal sector accounted for 80% of employment in the informal economy, but the remaining 20% were informal workers in formal enterprises.<sup>14</sup> The informal economy expanded between 1990 and 2005 from 57% to 63.3% of non-agricultural employment, as a result of the growth of the informal sector and of the number of precarious formal workers. Although both groups contribute in a similar manner to

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<sup>13</sup> This definition also means that the informal economy concept can be applied universally, given the existence of "non-standard" labour relations in OECD member countries.

<sup>14</sup> The number of workers in formal enterprises whose labour rights are not fully respected was considered to be the percentage of workers employed in such enterprises who do not contribute to any pension scheme.

the expansion of the informal economy, the rate of growth in the number of unprotected formal wage earners is almost five times the growth rate for the informal sector. In 2005, the informal sector consisted of unskilled own-account workers (55%), workers in micro-enterprises with less than five employees (33%) and workers in domestic service (12%) (see table VIII.2 and figure VIII.1).

Table VIII.2  
INFORMAL ECONOMY IN LATIN AMERICA, 1990-2005  
(Percentages of non-agricultural employment)

	1990	2005 <sup>a</sup>
Informal economy	57.0	63.3
Informal sector <sup>b</sup>	47.5	50.7
Precarious wage earners in the formal sector <sup>c</sup>	9.5	12.6

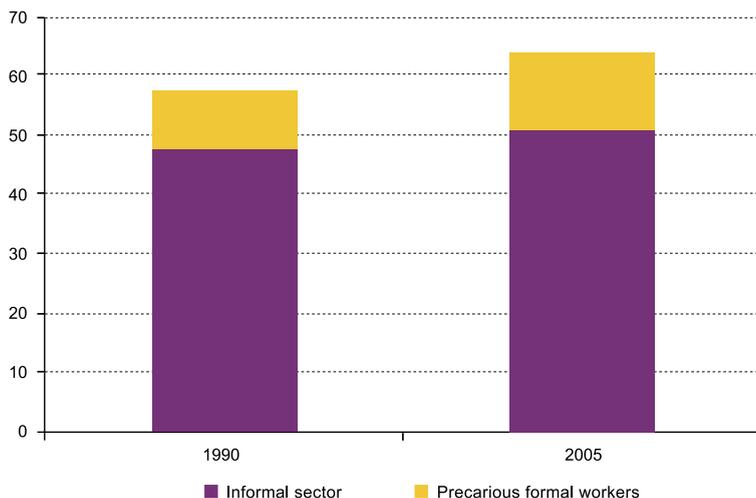
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries; and V.E. Tokman "From the consensus reforms to reforms for protected and inclusive employment", *IDS Bulletin*, vol. 39, No. 2, 2008.

<sup>a</sup> The percentage for 2005 does not significantly differ for 5 or 16 countries.

<sup>b</sup> Data for 16 countries are included in the informal sector.

<sup>c</sup> Data for five countries are included for precarious wage earners in the formal sector.

Figure VIII.1  
STRUCTURE OF THE INFORMAL ECONOMY, 1990-2005  
(Percentages of non-agricultural employment)

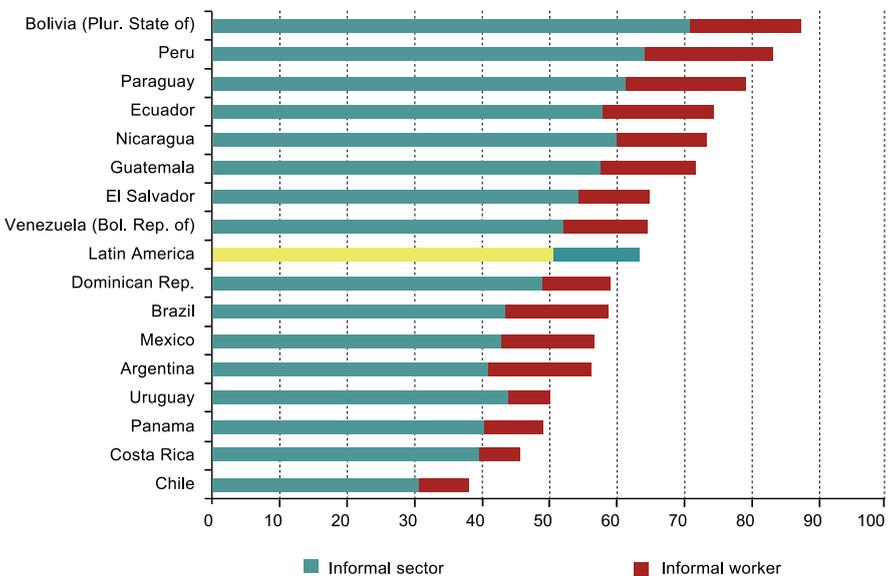


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries, and V.E. Tokman, "From the consensus reforms to reforms for protected and inclusive employment", *IDS Bulletin*, vol. 39, No. 2, 2008.

The situation differs from country to country. In Chile, 38% of non-agricultural employment was informal in 2005, whereas in Plurinational State of Bolivia and Peru the figures were as high as 87.4% and 83.4%, respectively.

Countries fall into at least three groups: (i) those where employment in the informal economy is over 65%, which are mainly the Andean and Central American countries (Plurinational State of Bolivia, Ecuador, El Salvador, Guatemala, Nicaragua, Paraguay, Peru and the Bolivarian Republic of Venezuela); (ii) those where employment in the informal economy was between 55% and 65%, which include Argentina, Brazil and Mexico; and (iii) those where there is less than 50% informality, such as Uruguay, Panama and Costa Rica and even less than 40%, such as Chile (see figure VIII.2).

Figure VIII.2  
INFORMAL ECONOMY, BY COUNTRY, 2005



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

Differences in intensity of the informal economy are also observed in relation to the informal sector, with the exception of the middle group, which includes the three largest Latin American countries. The first group consists of the countries with higher informal economy levels, in which there is also a larger informal sector and more labour precarity in the larger formal sector. Similarly, the group of more formalized countries also has lower informal sector levels and, in particular, more formality for wage earners in formal enterprises. On average, about 93% of wage earners in formal enterprises have a formal labour relationship and have access to labour and social protection. The countries in the middle group, which include Argentina, Brazil and Mexico, are more similar to

the former group as regards informal sector size, but the proportion of unprotected wage earners employed in formal enterprises is about 15% (see table VIII.3 and figure VIII.2).

Table VIII.3  
INFORMAL ECONOMY, BY COUNTRY, 2005 <sup>a</sup>

Country	Informal sector	Precarious workers	Informal economy
Chile	30.6	7.4	38.0
Costa Rica	39.9	5.7	45.6
Panama	40.5	8.5	49.0
Uruguay	44.3	6.0	50.3
Argentina	41.2	15.2	56.4
Mexico	42.9	13.7	56.6
Brazil	43.6	15.0	58.6
Dominican Republic	49.3	9.8	59.1
Latin America	50.7	12.8	63.5
Venezuela (Bol. Rep. of)	52.0	12.5	64.5
El Salvador	54.6	10.1	64.7
Guatemala	57.6	14.2	71.8
Nicaragua	59.9	13.6	73.5
Ecuador	57.9	16.7	74.6
Paraguay	61.3	18.0	79.3
Peru	64.6	18.8	83.4
Bolivia (Plur. State of)	70.9	16.5	87.4

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of household surveys conducted in the relevant countries.

<sup>a</sup> Percentages of urban employment; arithmetical mean for Latin America.

The importance of own-account workers not included in informality is an additional distinguishing feature to be taken into account in policy formulation. As noted above, on average about 55% of persons employed in the informal sector are own-account workers; this figure drops to 44% for the entire informal economy. The differences from one country to another are also significant.

In general, two groups of countries can be identified according to the number of self-employed compared with informal wage earners, either in micro-enterprises, domestic service or even in a precarious situation in formal enterprises. The first group includes countries with more informality, where participation of self-employed workers in the informal sector averages 60%, with higher figures of about 70% in the Bolivarian Republic of Venezuela and the Dominican Republic and 65% in Peru, Plurinational State of Bolivia and Ecuador. The Central American countries which can also be included in this group have a participation slightly lower than the average for the group, which in turn amounts to 50% of the informal economy. The remaining group consists of countries with less informality, in which the participation of own-account workers in the informal sector

averages 46% and in the informal economy drops to 38%. Costa Rica has less participation by such workers, with percentages of 40% and 35% respectively, but in Argentina the figure for the informal sector is 52%, dropping to 33% if the informal economy is considered. This illustrates the importance of precarious wage earners in formal enterprises.

## **F. Exclusion or exit: earnings differentials in the informal sector**

The various definitions of informal employment recognize that it is the result of the exclusion of workers from the better paid and more protected jobs in the formal sector. This is due both to the inadequate rate of job creation and to the segmentation existing in the labour market, to the unsuitability of legislation which discourages the start-up of new production units and to the strategy of decentralization of enterprises to reduce taxation and regulation. A consensus exists that this affects informal wage earners, but it also argued (Perry and others, 2007) that self-employed persons and micro-enterprise employers opt for informality because they see no potential benefit in switching to formality, in view of the poor quality of the services provided by the State and its limited enforcement capability. According to this study, in these groups a non-wage view predominates, so that informality is an option of flexibility, autonomy and skills development that produces greater benefits, in both monetary and non-monetary terms. This is "exit", occurring voluntarily.

The family micro-enterprise can match available family time with the scarce resources available and represents an efficient option in view of the shortage of resources and jobs suited to needs (Tokman, 1978). It also represents a family enterprise option which allows manpower to be mobilized by juggling duties, as in the case of housewives and working mothers and children between school and work. In addition, family property can be used since the home also functions as commercial premises, and family means of transport are used by the micro-enterprise. This arrangement introduces a degree of flexibility allowing roles and resources to be matched. However, the most recent interpretation, mentioned above, also notes that "exit" results in higher earnings than would be obtained by joining the formal sector. For this reason, self-employed workers and micro-enterprise employers have no incentives for inclusion.

A study of earnings differentials by sectors and occupational category provides more information on these issues. In Latin America, persons employed in the formal sector have average earnings that are

80% higher than those of workers in the informal sector. This is due to differences in productivity between productive units of different sizes and to human resource differences and collective bargaining capacity, which is non-existent in informal enterprises. The average earnings of self-employed workers and informal micro-enterprise employees are 28% higher than those for the sector as a whole and 57% higher than those of informal wage earners. However, these earnings are 13% less than what they would earn if they were employed as wage earners in enterprises with more than five workers, which is an incentive to become formalized even though the higher earnings are offset by a loss of independence.

The differences between self-employed workers and informal micro-enterprise employers are, however, very significant. An unskilled self-employed worker could on average triple his income if he were to become a micro-enterprise employer, even an informal one. His earnings are 16% higher than those of informal wage earners, meaning that he would have no incentive to change his status, but a change to paid work in the formal sector would mean an expected average earnings increase of 36%. "Exit" does not seem to be justified on the basis of the information available. Informal micro-enterprise employers, on the other hand, would have no incentive to switch to a wage-earning job, even a formal one, because the move would mean a reduction of earnings to one third of what they earn informally. Their options would be to grow in micro-enterprises by becoming formalized, since there is a direct link between formalization and establishment size. This is observed in micro-enterprises and, to a greater extent, in larger enterprises.

Since averages may not show the particular situation of each country, earnings differentials must be analyzed by country (see table VIII.4). Firstly, it is confirmed that in the countries analyzed self-employed workers could actually triple their earnings if they become micro-enterprise employers, even informal ones. In the Bolivarian Republic of Venezuela, this gain is apparently even larger. Secondly, self-employment is a valid or at least a neutral option compared with wage labour in the informal sector in most countries. Only in the Bolivarian Republic of Venezuela do informal wage earners have earnings that are one third higher than those of self-employed workers. Thirdly, in Chile, Argentina, Mexico, the Dominican Republic, Uruguay and Brazil, the earnings of self-employed workers far exceed those of informal wage earners. Lastly, only in Argentina, Chile and, to a lesser extent, Mexico does there seem to be no incentive to switch to formal wage-earning, so that being an informal self-employed worker is apparently a conscious choice rather than an exclusion.

Table VIII.4  
EARNINGS DIFFERENTIALS BETWEEN SELF-EMPLOYED WORKERS AND WAGE EARNERS, 2005

Country	SE/WE<5 <sup>a</sup>	SE/WE>5 <sup>b</sup>	SE/E<5 <sup>c</sup>	SE/E>5 <sup>d</sup>
Argentina	2.17	1.35	0.38	0.21
Bolivia (Plur. State of)	0.86	0.40	0.31	0.11
Brazil	1.27	0.70	0.32	0.16
Chile	2.36	1.30	0.32	0.15
Costa Rica	0.89	0.53	0.50	0.29
Ecuador	1.00	0.60	0.36	0.17
El Salvador	0.96	0.62	0.33	0.28
Guatemala	0.82	0.37	0.26	0.10
Honduras	0.59	0.30	0.24	0.13
Mexico	1.74	0.93	0.35	0.09
Nicaragua	1.05	0.59	0.33	0.05
Panama	0.84	0.45	0.30	0.14
Paraguay	0.83	0.47	0.27	0.07
Peru	0.89	0.40	0.30	0.09
Dominican Rep.	1.53	0.79	0.38	0.25
Uruguay	1.29	0.64	0.34	0.21
Venezuela (Bol. Rep. of)	0.67	0.42	0.14	0.08
Arithmetical average	1.16	0.64	0.32	0.15

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of special tabulations of data from household surveys conducted in the relevant countries.

- <sup>a</sup> SE / WE < 5: Self-employed workers compared with wage earners in micro-enterprises with less than five workers.  
<sup>b</sup> SE / WE > 5: Self-employed workers compared with wage earners in enterprises with more than five workers.  
<sup>c</sup> SE / E < 5: Self-employed workers compared with employers in micro-enterprises with less than five workers.  
<sup>d</sup> SE / E > 5: Self-employed workers compared with employers in enterprises with more than five workers.

## G. Informality, labour relationship and social protection

Employment and legal recognition of the existence of a labour relationship are essential prerequisites for access to social security coverage. The unemployed in countries such as the Latin American countries generally face a double exclusion: lack of employment and lack of social protection, resulting both from the virtual non-existence of unemployment insurance and from the inadequacy and poor coverage of non-contributory pensions (when they exist). The form of incorporation in the labour market also plays a role, resulting in important differences in levels of social protection.<sup>15</sup>

Persons employed in the informal economy have less access to social protection coverage, because the self-employed have no labour relationship, and wage earners employed in micro-enterprises have only partial access. Even in the case of wage earners working in formal

<sup>15</sup> In view of the information available for this analysis, contribution to a pension scheme is used as the indicator of access to social protection.

enterprises, the partial compliance with labour and social protection obligations is one factor of employment precarity. In the case of wage earners, although a labour relationship exists, it is not usually recognized or confirmed by an employment contract, or this contract does not provide for full coverage, or the responsibility for contributions is spread because of subcontracting.

Self-employed workers and micro-enterprise employers have the lowest levels of social protection coverage: on average in Latin America only 13.5% of them were making contributions around 2002 (ECLAC, 2006 and Tokman, 2006). None of them are in a labour relationship and in most countries they are not required to contribute to the pension scheme. Among micro-enterprise wage earners, 21.7% have access to protection, while among informal wage earners in formal enterprises this figure is only 29%. On average, for persons working in the informal economy coverage is about 20%.<sup>16</sup> Insertion through employment in informality results in a lack of protection, although the degree varies from one country to another. Countries which have lower levels of informality and greater protection coverage have fewer differences between coverage depending on the type of labour insertion. In Costa Rica, Chile and Uruguay, between 35% and 38% of persons working in the informal sector have coverage, whereas in Guatemala, Nicaragua, Peru and Paraguay coverage is found to vary between 2% and 3.5%. If one also considers that informal workers in formal enterprises account for only 6% of urban workers in the former case, whereas in the latter case they account for three times this percentage, the differences between countries with regard to coverage of persons employed in the informal economy are even greater.

Another factor affecting access to social protection is the existence or non-existence of an employment contract and the type of contract concluded. Of all wage earners, 63% have an employment contract. Of those who have a contract, 78% have indefinite contracts and the remainder have other types of contract. If wage earners who have no written contract are added to those who have fixed-term contracts, over half the wage earners in Latin America are in a situation of informality (Tokman, 2007c).<sup>17</sup> This proportion varies from a low of 21% in Argentina to a high of 74% in Plurinational State of Bolivia. The employment contract provides legal recognition of the labour relationship and is a requirement for access to social protection.

Social protection covers 85% of wage earners with formal contracts and 15% of those not in a recognized labour relationship. Coverage of

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<sup>16</sup> Estimate based on information for 16 countries (ECLAC, 2006 and Tokman, 2006).

<sup>17</sup> Arithmetical mean for 16 countries in 2002 (ECLAC data).

persons with indefinite contracts is as much as 89% but for persons with other contracts it drops to 65%. Coverage among wage earners in micro-enterprises is only 50% for those with contracts and 10% for those without contracts. Coverage depends on the duration of the contract and drops from 63% for indefinite contracts to 35% for other types of contract.

It is also noteworthy that 68% of wage earners in micro-enterprises have no labour contract and that those who do mainly have indefinite contracts. On the other hand, 74% of wage earners in formal enterprises have a recognized labour relationship, but just over half have permanent contracts.

## **H. A strategic option for social inclusion and competitiveness**

Flexicurity, as defined at the beginning of this analysis, consists of a combination of flexibility and security (needed in a more open and globalized world), as a tool for improving the ability to compete. Even in the more developed countries, there is no one strategic recipe for achieving consistency between the two components. Indeed, employment and labour and social protection policies reflect the specific features of each country, so that the mix is variable, although the goal is to meet the common challenge of increasing competitiveness in more volatile and uncertain markets.

The developing countries, particularly in Latin America, still have structural restrictions that limit the potential effects of these policies. The existence of a significant informal economy requires a strategy of economic and social inclusion. Lack of such a strategy is an obstacle to the pursuit of generally recommended policies and makes it impossible to tackle the problems of employment, instability and lack of labour protection. Moreover, a strategy that does not adequately address informality may result in greater informality. The informal economy is partly a structural imbalance and partly also the result of labour policies designed to increase competitiveness which create growing insecurity and lack of protection.

A sense of belonging is central to social cohesion. It is acquired through entitlement to civil, economic and social rights, so that all citizens are included in the dynamics of development and the well-being it implies. The countries of Latin America have made considerable progress on civil and political rights with the establishment of democracy, after a long period of authoritarian government and restricted freedoms. Today the focus has shifted to economic citizenship and particularly social citizenship, which are the prerequisites for addressing existing

inequalities and for ensuring that everyone is treated as a full member of society (ECLAC, 2007b). Poverty, informality and exclusion reflect poor access to resources, low incomes and high vulnerability and represent a failure of citizenship in that many people are denied entitlement to rights. This situation runs counter to a sense of belonging, which is acquired through inclusion associated with recognition and participation.

This could be the context for a strategic reorientation designed to incorporate informality into modernity (Tokman, 2004). What is needed is a global strategy complemented by specific strategies and policies in various spheres, exercise of the right to engage in productive activities and labour rights, including the right to protection.

The Commission on Legal Empowerment of the Poor, an international body created within the framework of the United Nations, proposes a strategy to enable the poor in a situation of informality to progress in the full exercise of their rights and interests vis-à-vis the State, markets and other citizens.<sup>18</sup> The goals are access to opportunities and protection, which it is hoped to achieve through exercise of the legally recognized rights of access to justice and ownership, as well as labour rights and the right to engage in productive activities. Legal recognition of identity and of the right to organize and express oneself would enable the poor to participate directly in the promotion of the reforms and legal actions needed to correct the shortcomings of the market, public policies and regulatory institutions (Chen, 2006).

A more limited proposal to incorporate the informal sector in modernity reflects the approach described above (see Tokman, 2004, 2006 and 2007b). This strategic reorientation is based on three fundamental principles. Firstly, social inclusion must be sought initially by means of enforcement of the economic and social rights of the excluded instead of through the usual approach of promoting compliance with obligations. Secondly, greater “formalization” is justified not from the point of view of those included but principally because of the benefits that formality can provide to persons working in the informal sector and to the work they do. Thirdly, the desired effects will not come about automatically but require changed behaviours and attitudes from those involved, so as to create a more favourable atmosphere for their activities. This requires a cultural transformation of those working in the informal economy. Ultimately formalization paves the way for economic and social citizenship and these, in turn, are a requirement for belonging and being fully incorporated into a more inclusive society.

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<sup>18</sup> See Commission on Legal Empowerment of the Poor (2008).

The informal economy embodies two main types of exclusion. The first is the existence of a significant informal sector that is not declining. This is where most of the jobs are and where most of the poor and medium-low income groups earn their living. These are employers and workers (and many of them are both simultaneously), belonging to the world of the excluded, since they have low earnings and suffer from a lack of protection and stability. The second type of exclusion affects workers in formal enterprises or production lines with various subcontracting arrangements who do not enjoy labour security or full protection. They all need a comprehensive strategy to promote social inclusion based on recognition of entitlement to civil, economic and social rights. They also need both production and labour reforms including at least five pillars: productive development and the regulation of informal activities, labour rights in informal enterprises with limited ability to pay, measures to combat insecurity and lack of protection among informal workers in formal enterprises, regulation of diffuse labour relations and, lastly, social protection for informal workers.

## **I. Five strategic pillars for the informal economy**

### **1. Productive development and the regulation of informal activities**

This involves recognizing the right of micro-enterprise employers and self-employed workers to engage in productive activities that enable them to earn a living and at the same time decreasing the vulnerability created by their informal status. To this end, existing regulations must be adapted to informal workers' possibilities of compliance by modifying a regulatory system designed for larger enterprises and more organized sectors with no heed for the capacities of those who are not in a position to comply with the requirements laid down. As part of this reorientation giving priority to recognition of formality, mechanisms are proposed which include the right to initiate and conduct business, to legitimize ownership, to distinguish between the assets of the enterprise and those of the informal employer and to trade in private and public spaces equipped for that purpose.

It is also necessary to adjust and streamline the process of recognition to facilitate compliance with obligations. The red tape involved in opening or closing activities takes up considerable resources and time because of the numerous laws and regulations to be followed and State bureaucratic inefficiency. A number of measures have been adopted to streamline registration systems by standardizing them and reducing administrative formalities and it has been proposed to streamline procedures by

introducing a “single registry and single window” regime, reducing formalization costs. As noted in an ILO study (2006), these regulations apply generally to all enterprises, but smaller ones are most affected because they do not have the means and information to comply.

According to another study (Loayza, Oviedo and Servén, 2005), in Latin America there are 2.6 times more regulations than in the OECD countries and more than there are in the Asian countries. Only Africa and the Middle East have more regulations. There has been marked progress in commercial openness and financial sector modernization, but the largest backlogs have occurred in the regulations governing trading licences. In this connection, it is suggested that authorizations for individual or family businesses should exist automatically with the identity cards.

Recognition of property title must be simplified. De Soto proposed that certification of ownership should be simplified and reflect situations of *de facto* ownership. There would be no contractual prerequisites or submission of proof of ownership and alternative methods of recognition would be used such as long-term usufruct, calling on witnesses and having boundaries recognized by third parties that might have conflicting interests. In addition, certification of title to assets owned by informal workers would create opportunities for access to credit.

The separation of assets of the individual from those of the employer is also an important factor legally empowering micro-enterprise employers to do business and avoiding a situation in which asset losses associated with the result of the productive activity are transferred to the family. In order for this to be achieved, there must be types of companies suited to the needs of micro-enterprises, such as the individual limited liability companies already existing in several countries.

The situation of street traders deserves special attention, because of the need to reconcile the right to use public spaces and the right of traders to have an income-generating occupation. These activities must be regulated within a unified framework that covers legal, fiscal and labour issues. For this, the persons concerned should have access to urban spaces that they can lease or own for the purpose of engaging in commercial activities complying with existing municipal regulations. In addition, available spaces must be chosen in the light of the availability of public transport to ensure access by potential buyers. Lastly, if traders were organized, both at the level of specific markets and on a larger scale, they would be better able to negotiate with local authorities and with suppliers.

Adaptation of these regulations will create more opportunities for the productive development of informal activities. The likelihood

of progressing towards formal sector status is determined mainly by a productive unit's capacity for growth. There have been experiments with productive support for these activities, improving access to productive resources (capital and credit, skills and training, and technology) and to markets (organization and location). However, the greatest potential for a major impact throughout the system lies with the regulatory framework. Expanded access to credit requires legal recognition of capital, while the ability to take commercial risks without involving the family assets can be improved by better legal arrangements for the creation and development of enterprises. New accounting and administrative techniques can improve management and thus improve enterprises' earnings. Similarly, the extent to which employment labour relations in micro-enterprises could be recognized and regulated depends on enterprises' ability to comply with regulations, which is linked to their economic success. These are prerequisites for improving productivity, investing in training and promoting labour and social protection for workers.

## **2. Labour rights in informal enterprises with limited ability to pay**

More than one third of wage earners in the private sector in Latin America are working in informal enterprises, and 68% of them have no written labour contract.<sup>19</sup> This means that for most of them labour and social protection is not a right, because they have no recognized labour relationship. And informal productive units have little ability to pay in order to meet the obligations inherent in the labour relationship.

There would be some movement towards regulated and protected employment relations if the employment relationship were recognized, notably with proof of the existence of unwritten contracts, such as time sheets and payment of regular wages registered in the accounts or confirmed by witnesses. This would provide workers with the necessary credentials to be entitled to coverage under protection schemes and would encourage micro-enterprises to do business on a proper basis.

However, taking this first step already involves difficulties with compliance, because of the low capacity to absorb the costs associated with formalization of the enterprise's workers (Tokman, 2001). In Colombia, 76% of micro-enterprises could not pay labour costs in their entirety; it was estimated that, in order for them to do so, sales would have to double. In Peru, 85% of micro-enterprises were also not in a position to absorb the costs, since to do so would halve or eliminate their profits. However, 15% in Colombia and 49.5% in Peru were partially complying with certain obligations.

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<sup>19</sup> About 30% of wage earners in the informal sector are domestic workers.

This is happening partly because social protection is designed for larger enterprises, but adjustment should not be confused with deregulation: being more responsive to the needs of micro-enterprises does not mean that existing labour conditions should be allowed to deteriorate. It may be possible to make improvements in response to demands to increase efficiency and expand coverage of the organized labour market.

One possibility is to design special regulatory systems for micro- and small enterprises, creating dual or preferential systems. This practice is followed in several countries, including Argentina, Brazil and Peru. However, this option has drawbacks for reasons of regulatory efficiency and as a matter of principle. It may result in fiscal and labour law evasion and create barriers to micro-enterprise growth by setting limits on capital investment. In the labour sphere, issues of principle are involved, because there would be differential treatment of workers before the law, depending on the size of the enterprise employing them. It is therefore preferable to have a single regulatory system (ILO, 1991), which does not preclude simplified taxation systems or preferential rates for credit.<sup>20</sup> On labour issues too, arrangements are accepted that are better suited to the needs of small enterprises, especially in relation to collective bargaining.

Another type of differentiation would be to recognize that a dual situation exists *de facto*, without seeking to convert it into a *de jure* situation. This implies not applying sanctions and acknowledging that non-compliance results from inability to pay. Nor should it mean lack of oversight, but simply that inspection should be overhauled to reflect reality. ILO (2006) proposed an innovative strategy for monitoring compliance with employment law in micro- and small enterprises, based on the assumption that regulation will be more effective when there are more options for encouraging compliance, options allowing gradual oversight and correction of problems.

Earlier analyses (Tokman, 2008b) proposed the introduction of a state of preformalization which, in addition to regularizing micro-enterprises as productive units, would establish a compulsory minimum threshold on labour issues incorporating the fundamental labour rights set out in the 1998 ILO Declaration of Fundamental Principles and Rights at Work: freedom of association and collective bargaining, prohibition of forced labour and child labour and non-discrimination. Human rights are thus transferred into the labour sphere. In addition, other rights relating to

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<sup>20</sup> In Argentina, Brazil, Paraguay and Uruguay, special tax regimes are applied to micro-enterprises replacing all taxes by a single consolidated tax. This simplifies tax returns and, except in Paraguay, social security contributions are also included.

working conditions would be incorporated: minimum wage, working hours and occupational illnesses.<sup>21</sup>

Unlike the series of labour obligations for which compliance is limited by enterprises' lack of ability, this threshold should be non-negotiable, since absolute values are involved. A threshold does not mean that workers in the informal sector will have access only to limited labour rights. On the contrary, the proposal is to recognize the need to make progress by improving the informal enterprises' ability to comply and committing them to taking this path. Implementation should be subject to follow-up, promotion and oversight, taking into account the specificity of the subject being regulated.<sup>22</sup> Advance commitment to compliance with targets would be similar to the system used for ILO supervision of certain international labour standards. The preformalization stage would cover a specific period in order to avoid being perpetuated, which would in fact create a dual labour system.<sup>23</sup>

### **3. Measures to combat insecurity and lack of protection of informal workers in formal enterprises**

Insecurity and lack of protection are linked to the absence of legally and explicitly recognized employment relations, but also to situations governed by contracts other than the indefinite employment contract. Both situations arise both in micro-enterprises and in formal enterprises. However, the former occur mainly in informal enterprises and the latter occur mainly in formal enterprises, so that their workers consider themselves to be members of the informal economy.

The indefinite contract has had to compete with new forms of contract resulting from labour reforms establishing greater flexibility and reduction of non-wage labour costs as ways of increasing competitiveness in more open economies. They generally do not reduce the protection of

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<sup>21</sup> The expanded threshold was incorporated in the free trade agreements concluded by the United States with several Latin American countries, including Mexico, Chile, the Central American countries and the Dominican Republic, Peru, Panama and Colombia (for the last two final approval is still pending). More recently, the proposal was incorporated in the recommendations of the Commission on Legal Empowerment of the Poor (2008) and in the recommendations of the Presidential Advisory Council on Labour and Equity (2008) created by the President of Chile, Michelle Bachelet.

<sup>22</sup> In Chile, the Directorate of Labour has since 2001 been applying a system of educational inspection to micro-enterprises, in which fines can be replaced by attendance at a training course on employment law, in recognition of the limitations existing in these enterprises as regards access to information and their inability to enlist the help of professional consultants.

<sup>23</sup> The special labour regime adopted in Colombia for micro-, small and medium-size enterprises gradually reduces labour and tax contributions but aims at convergence with the general regime by the end of a four-year period.

workers while they are employed and are not illegal because they were introduced and promoted by legislative reforms.

In Argentina in 1991 and 1995 and in Peru in 1993, broad labour reforms were adopted which introduced a series of atypical contractual arrangements with the above-mentioned goals. Non-wage labour costs were not significantly different in the various contractual arrangements (Chacaltana, 2005), which seems to indicate that labour obligations and protection would be maintained at levels similar to those of indefinite contracts. The exception is unregistered workers and those with special contracts designed to encourage employment of certain groups.

Although the new forms of contract may have entailed some loss of protection, their chief effect has been uncertainty about the continuity of the current contract. This insecurity affects workers and their families, as well as productivity, since it reduces the incentive for learning and innovation. For this reason, use of these contracts should be restricted and the search for flexibility should focus on long-term contracts.

That is what occurred in Spain, which with its 1981 reform pioneered the introduction of flexibility into the labour market, without affecting the levels of protection of workers with permanent contracts. Twelve types of special contracts were introduced, which lowered dismissal costs and reduced social security contributions during the first two years and which targeted specific groups of persons under 30 and over 45 years of age, the long-term unemployed and persons with disabilities.

In Spain and Argentina, labour reforms changed direction in the mid-1990s. Spain redefined the strategy by means of a tripartite agreement, limited the use of fixed-term contracts to collective bargaining and focused the search for flexibility on permanent contracts, facilitating dismissal with due cause and reducing the costs of dismissals. In 2006, a new tripartite agreement confirmed the earlier trend by promoting conversion of fixed-term contracts to indefinite contracts if over a 30-month period the same worker accumulated more than 24 months in the same enterprise or with successive contracts in the same job. Benefits were also introduced for women, young people and long-term unemployed persons who were given indefinite contracts, social security contributions were reduced and illegal placement of workers between enterprises was more clearly defined and measures taken to combat this practice.

In Argentina, a similar redirection of labour reforms took place between 1998 and 2000, limiting the use of atypical contracts, reducing severance pay under contracts of long duration and extending the probationary period. In Brazil, the 1998 reform introduced atypical

contracts but made them conditional on the creation of new jobs and allowed limits on such hiring to be set by collective bargaining.

Experience has shown the limitations of using atypical contracts to ensure flexibility and the effects on employment with stability and protection. The redirection signifies a re-assessment of the importance of contracts that are indefinite but adapted to reduce severance costs. Renewal of atypical contracts is limited to specified periods to avoid their de facto conversion into long-term contracts and the determination of limits on their use is subject to the tripartite agreement.

#### **4. Regulation of diffuse labour relations**

A fourth area of regulation covers labour relations which for the purpose of this analysis will be called “diffuse”, because they are difficult to recognize, are disguised or remain unprotected owing to gaps in employment law or in compliance monitoring. In many cases, the obligations and rights of the parties are not clear, which may result in loss of protection for workers. They are becoming increasingly important in the context of globalization and decentralization of production, and there is a need to establish workers’ rights and to allocate responsibility for compliance with obligations among the various enterprises concerned.

In 2006, after a process of analysis that started in 1998, ILO approved Recommendation No. 198 on the Employment Relationship, which urges countries to clarify the law in order to guarantee protection for workers who perform their activity in the framework of an employment relationship. It also advocates determination of the existence of an employment relationship and drawing of a distinction between wage earners and self-employed persons. For this purpose, it emphasizes the importance of promoting methods for determining the existence of an employment relationship (including regular remuneration, work carried out according to instructions and under control, working hours, provision of materials and tools). It advocates the adoption of measures to combat disguised employment relationships and urges enactment of standards which are applicable to all forms of contractual arrangements, including those involving multiple parties, and which establish who is responsible for protection. It basically represents progress in the creation of a framework for making disguised employment relationships more transparent and for identifying the responsible employer in all cases, including subcontracting.

In this connection, it is noteworthy that in 2006 Chile adopted a law on subcontracting that restricts the provision of staff solely to short-term jobs and exceptional tasks (including replacements and occasional or

urgent activities). In order to ensure compliance with labour obligations, registration is compulsory and a financial guarantee must be provided to cover workers' salaries and insurance in case of non-compliance. Subcontracted workers are the responsibility of the subcontractor, but the contracting enterprise also has labour responsibilities. The law transforms the existing subsidiary liability into a joint liability, meaning that the contracting enterprise is responsible jointly with the subcontractor for compliance with obligations. The contracting enterprise is entitled to require the subcontractor to produce certificates of compliance with labour obligations and to withhold the relevant amounts from pending payments in case of non-compliance. In this way it can transform its liability into a subsidiary liability.

ILO Convention No. 177 adopted in 1996 provides guidance for the formulation of a regulatory framework for home work. In appearance this type of work is an activity performed on own account or with a family structure. However, it often amounts to paid subordinate wage work that is performed not in an enterprise but for a subcontracting enterprise or an intermediary. Such work is performed largely by women, with help from family members, including children, and is not covered by employment law, so that there is no recognized employment relationship and therefore a lack of protection and bargaining power.

The Convention recommends that national policy should promote equality of treatment between home workers and other types of worker, taking into account the special characteristics of home work. Equality of treatment includes the right to establish or join organizations of one's own choosing and to participate in the activities of such organizations (freedom of association), protection against discrimination, compliance with the minimum age for work, remuneration and protection in the field of occupational safety and health, social and maternity protection.<sup>24</sup> As noted, the minimum established rights echo the minimum proposed for micro-enterprises with the addition of social security and maternity coverage. On these latter aspects, Recommendation No. 184 concerning Home Work, which accompanies the Convention, specifies that these two requirements can be met by: extending existing social security provisions to home workers; adapting social security schemes to cover home workers; or developing special schemes or funds for home workers.

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<sup>24</sup> Two of the most notable examples of promotion of freedom of organization are found at the national level in India (Self Employed Women's Association, SEWA) and at the global level (Women in Informal Employment: Globalizing and Organizing–WIEGO), which includes national and international organizations, academics and members concerned with development.

## 5. Social protection for informal workers

Provision of social protection coverage to workers employed in the informal sector requires a strategy ranging from expansion of coverage provided by existing schemes to development of new protection instruments such as insurance and consolidation of the resources contributed by the informal workers themselves. This coverage should include health, pensions and, since most informal workers are female, maternity coverage. It would be extended to workers in micro-enterprises, and to self-employed persons. In the case of informal workers in formal enterprises, responsibility for protection should be linked to enhancement of the labour contract and to the shared contribution with the employer.

From a systemic perspective, the right to social protection should be granted to all persons as citizens rather than as workers, and awarded on the basis of the principle of universality. This has been the major change in the redesigning of the traditional model in Latin America, as well as in supplementing the private contributory pension schemes by adding a solidarity pillar funded from public resources.

In its recent report on informality (Perry and others, 2007), the World Bank fully supported this change for both health and pension coverage. As regards health, it is recognized that uncovered events involve significant costs to society, so that there is a case for providing essential direct coverage, de-linked from the labour contract and financed through general taxation. Similarly, when the elderly have insufficient income, there are social costs involved that justify support to guarantee a minimum income not associated with the labour contract.

Various steps in this direction are being taken in different parts of the world. In India, a law was recently enacted to regulate the protection of unorganized workers by providing them with social security, health coverage and welfare by means of a welfare fund financed by the Government and registered employers. In the Philippines, the social security systems and health insurance plans have increased their coverage through voluntary schemes open to self-employed workers.

Plurinational State of Bolivia is the only country in Latin America that has introduced a universal pension scheme (BONOSOL, now known as *Renta Dignidad*) and Brazil has a similar system for rural workers (FUNRURAL). In Chile, which pioneered the privatization of pension and health schemes, the system was reformed by the introduction of a non-contributory pillar that guarantees a solidarity pension to all citizens over 65 years of age.

Health has better coverage than pensions and is approaching universality through a combination of different schemes: social security

in Costa Rica, which covers contributors and non-contributors; a public system in Cuba and a mixed system of public institutions, social security and private insurance in Uruguay, Brazil and Chile, among other countries. Chile has expanded access to public health for all citizens by introducing guaranteed care for 56 groups of illnesses (Universal Access Plan with Explicit Guarantees - AUGE), in addition to the existing National Health Fund (FONASA).

As well as guaranteeing greater security, de-linking protection from labour participation should create opportunities for increasing employment and improving business. It should help to reduce existing deficits but will require sound fiscal policies and, in particular, adequate funding of health and pension coverage. Lastly, maternity and child care coverage should be expanded, because of the potential effect on early development of children's cognitive skills and on the participation of women in the labour market, particularly those from poor households.<sup>25</sup>

## J. Conclusions

In this analysis, the term "flexicurity" is defined as a strategy for combining flexibility to improve productivity and competitiveness in open economies and security to ensure that workers do not suffer a deterioration of protection or of working conditions.

The analysis of developed countries' experience with flexicurity shows that it does not follow a uniform pattern but takes different forms depending on the country concerned. It is, however, acknowledged that the experiments in Denmark, Ireland, Finland and the Netherlands have been the most extensive and successful.

Application of this strategy in the Latin American countries provides a useful approach for tackling the global challenges involved in increased competitiveness, which requires flexibility in production and labour, and at the same time for providing workers with security and opportunities for moving to better jobs.

As is the case in the developed countries, the diversity of situations found in Latin America requires not a "one size fits all" approach but

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<sup>25</sup> However, progress can also be made in the social protection coverage of self-employed workers through initiatives such as those adopted in Argentina, Brazil and Uruguay introducing simplified schemes for small contributors and, in the case of Brazil, reducing the compulsory contributions of self-employed workers. The single consolidated tax existing in Argentina and Uruguay has made it possible, for example, to achieve better coverage of self-employed workers than in Chile, which has the best coverage of wage earners (Bertranou, 2007).

one that can be adapted to the specific requirements of each country. In addition, structural restrictions peculiar to the region determine the potential effects and feasibility of financing a strategy of this kind. The most important limitations are those resulting from the existence of a significant informal economy and from the limited fiscal capacity to increase earnings of this kind.

This analysis emphasizes that informality limits the spread of potential benefits of a strategic option such as the one described and examines its relevance in the Latin American countries in the light of the evolving concept of informality.

In general, a formalization strategy is proposed as a prerequisite for advancement in more integrated and cohesive economies and societies. This is a requirement for the development of the region in general and, in particular, for absorption of lessons learned from the policies pursued by the more developed countries. Formalization is understood to be the legal recognition and exercise of workers' labour rights and entrepreneurs' rights. Both activities must be legally recognized, since informality restricts access to labour benefits. The goal is also to enhance the empowerment and access to justice of potential beneficiaries, so that they can become active agents of their own economic and social inclusion.

The heterogeneity of the informal economy is recognized by including employers and workers, as well as the various types of relationship between them and with the regulations and institutions. For this reason, the strategy is organized around five pillars: productive development and regulation of informal activities, labour rights in informal enterprises with limited ability to pay, measures to combat the insecurity and lack of protection of informal workers in formal enterprises, regulation of diffuse labour relationships and, lastly, social protection for informal workers.

The first pillar concerns capacity to do business, proposing both simplification of the regulatory process and adaptation of the regulations so as to recognize, *inter alia*, the right to ownership and to do business. The second pillar refers to workers in informal micro-enterprises whose labour relationship is not legally recognized because they have no labour contract and are therefore not entitled to any type of labour right, including rights to labour and social protection. It is proposed that a minimum level of labour rights should be established which includes fundamental rights in employment and working conditions (working hours, protection against occupational accidents and illnesses, and minimum wage). In view of the inability to pay of most micro-enterprises, it is difficult to impose a minimum level for access to a preformalization stage. What is proposed is a gradual progression towards equality of labour rights regardless of enterprise size and avoidance of their segmentation; the

minimum level is considered to be transitional and subject to verification by the relevant administrative authority.

The third pillar concerns workers with atypical contractual arrangements in formal enterprises. On the basis of experience with labour reforms geared to greater flexibility, it is suggested that there should be a refocusing on the indefinite labour contract ensuring stability but that it should be adapted to reduce dismissal costs and processing difficulties. At the same time, it is proposed to increase the liquidity of compensation and to expand unemployment insurance.

The fourth pillar relates to the situation of workers with diffuse employment relationships, including home workers who work or produce for third parties, as well as subcontracting. The diffuse character resulting from disguise of the labour relationship or from its legal non-existence leads to erosion of the labour rights of those concerned and generates a spurious transfer of benefits in the production chain to the more organized sectors. The introduction of new laws designed to recognize the existence of these relationships and to assign shared responsibilities among the enterprises involved as regards compliance with obligations represents progress.

The fifth pillar refers to access by informal workers to social security and mentions the advisability of enhancing access to health and pension coverage on a universal basis, in view of the existing segmentation, which undermines contributory benefits for a broad segment of workers in the informal economy.

However, isolated measures cannot be expected to have a systemic effect and the main challenge considered here is how to include them in a strategic framework designed to promote formalization as a necessary instrument for economic, labour and social inclusion.

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