CEPAL

REVIEW

NUMBER 57
DECEMBER 1995
SANTIAGO, CHILE

ANIBAL PINTO
Director of the Review

EUGENIO LAHERA
Technical Secretary

UNITED NATIONS

CONTENTS

New trends
in wage policies

Andrés Marinakis

International Labour Organisation, Wages Section, Department of Labour Law and Labour Relations, Geneva.

Up to a few years ago, wages policy was a central instrument of macroeconomic policy in Latin America, and there was a great deal of State intervention in it. Now, in the early part of the 1990s, however, the countries of the region are mostly in a more balanced macroeconomic situation and have gone a long way in their process of trade openness. Both these factors heighten the importance of costs, in view of the need to maintain the competitiveness of national production, so that the search for instruments to facilitate control over costs, including labour costs, is now a constant concern. These changes of circumstances and of approach have reduced the role of the State in the area of wages and have transferred the matter to the enterprise level. With regard to wages, there are constant references to the need for wage flexibility and the need to link wages to productivity, although emphasis is usually placed on the supposed macroeconomic benefits to be derived from this approach. This article holds that not enough importance has been attached in the consideration of this issue to the motivational aspects at the enterprise level and the changes needed in the organization of the latter, and it is suggested that flexible wage systems must be adapted to the characteristics of the enterprise concerned if the latter is to attain its strategic objectives.

I

Introduction

As in various other areas of economic policy, wages policy is subject to changes designed to adapt it to the prevailing economic circumstances and further the achievement of certain objectives. In recent years, there have been a number of important changes in the wage policies of various Latin American countries, which may be summed up as the abandonment of policies of intervention in wage fixing in favour of a more flexible position.

In some countries, this change has been related mainly to the process of adjustment and recovery of some degree of macroeconomic balance and to the process of trade liberalization, which demands greater international competitiveness. These two processes have given rise to a change in the approach to wages policy, which was heavily dominated by State intervention up to a decade ago, but which now tends towards the determination of wages at the enterprise level. The recurrent issues in this new approach are labour costs (among which wages are an important factor), productivity, the attainment of more flexible control over company costs (in which a variable wage component is one of the options) and factors of motivation (among which some forms of remuneration may play an important role).

II

General objectives in fixing wages

The main objectives pursued in wage fixing, along with other macroeconomic policies, may be grouped around four concepts: equity, macroeconomic stability, efficient allocation of labour, and operational efficiency.[1]

With regard to equity, it is necessary to distinguish between several different notions. First of all, equity is linked with income distribution and improvement of the situation of the most underprivileged groups. From this point of view, it is closely linked with the development process. Equity also depends on the application of the principle of equal pay for equal work. This same principle means that there will be different levels of pay for jobs that make different contributions to the production process, thus giving rise to differences of pay or remuneration based on performance. Finally, equity is also connected with the way wages are fixed, so that many countries assign a positive role to collective negotiation, which gives employers and workers broad opportunities to participate in decisions affecting their conditions of employment.

The natural desire for equity is subject to a number of economic objectives, among which macroeconomic stability occupies a leading place. When appraising systems of fixing wages, it is therefore important to verify whether they facilitate or hinder price stability, job creation, growth of production and equilibrium of the balance of payments. As we shall see later, these considerations have occupied and still occupy a leading place in the Latin American countries.

Systems of fixing wages should contribute to the efficient allocation of labour by providing incentives for workers to move from activities where there is a surplus of labour to those where there is a shortage. These changes should promote the movement of human resources to the sectors of highest productivity, thus helping to increase the overall efficiency of the economy.

Finally, the fixing of wages has an essential role to play in the operational efficiency of the enterprise, by maximizing production for a given level of capital

[1] For a more detailed discussion of these objectives, see ILO, 1985a.

and human resources. The efficiency of the company can be stimulated through the introduction of remuneration conditional upon improvements in labour productivity. At the same time, however, the remuneration must seem fair to the workers, because otherwise it may give rise to open conflicts (strikes) or concealed problems such as high levels of absenteeism or worker rotation or low levels of motivation.

Obviously, among these four objectives macroeconomic balance is that which is furthest removed from the company level, while operational efficiency is closest to it. In spite of this difference, however, the two are interrelated. Issues having to do with the achievement of macroeconomic balance, such as inflation or the balance of payments, will always form the framework for the determination of wage adjustments, for example. At the same time, these objectives often involve opposing demands, so that it is necessary to formulate wage policies which take them into account and sometimes lead to intermediate solutions. If, however, an objective is considered so primordial that other objectives are left aside, then it is almost inevitable that there will be imbalances.

III

Wages policy as an instrument of economic policy

In recent decades, wages policy has been one of the instruments most frequently used to attain macroeconomic balance in a number of Latin American countries. This has been particularly so in countries which have suffered high rates of inflation and hence had to make periodic reviews of nominal wages. Within this context, State intervention in the labour market became increasingly important and complex and took various forms.

One form of State intervention was through policies for fixing wages in the public sector, which employs a substantial proportion of the urban labour force in developing countries. [2] Another was the expansion of the public sector towards production activities through the establishment of public enterprises, thus extending its influence to a sector in which working conditions were similar to those obtaining in the private sector. Minimum wages were also an important means of intervention: from the earliest stages in the industrial development of Latin America, minimum wages played the dual role of establishing an important yardstick for industrial investment while at the same time guaranteeing a minimum level of income for the wage-earning population.

As regards the influence of wage policy on the private sector, the experiences registered have been of a varied nature, as State intervention has taken various forms (ILO, 1991). Bipartite negotiations without direct State intervention represent the least interventionist version. It should be noted that this option requires well-developed trade union and employers' organizations and can best be adopted in situations where collective negotiation covers a substantial proportion of the labour force.

State participation in wage fixing increased in line with the State's power to act as an arbitrator in collective negotiations. Later on, in certain periods when such negotiations were suppressed or restricted, this arbitral function was converted into the direct establishment of general and sectoral rules on wage adjustments. In some cases, these adjustments directly followed the various economic policies. In other cases, the introduction of some indexing system led to a more autonomous adjustment process. Almost all the Latin American countries used some form of intervention through different types of indexing systems, either legally established (as in Brazil) or applied on an informal but very widespread basis.

[2] It is calculated that in the period between 1975 and 1985 total public sector employment absorbed an average of some 20% of the non-agricultural labour force in Latin America and some 30% in Africa (Marinakis, 1994).

IV
Wage policies during the adjustment

In Latin America, State intervention at the different levels of wage fixing probably reached its height in the 1980s. The effectiveness of this intervention went down as wages policy became more complex, however. The overlapping of policies and their multiple objectives often led to incompatibility in different areas, because of the difficulty of establishing general criteria which satisfied the special features and needs of different sectors.

With the external debt crisis, restoring macroeconomic balance became the prime objective, conditioning the other objectives and often running counter to them. Thus, containing wage levels became the basic aim of the public sector and of the wage guidelines fixed by the authorities for the private sector (such as minimum wages, rules on indexing, or ceilings for collective bargaining). The consequent fall in real wages has led in many cases to a number of maladjustments which, although they originated in public sector policies, have an impact on the labour market as a whole. While not wishing to indulge in generalizations which may not always be appropriate, it may be said that this policy led to severe maladjustments of a similar nature in many countries. These maladjustments may be classified as those connected with the wage structure and performance, and those connected with remunerations proper.

1. Maladjustments connected with the wage structure and performance

The fall in public sector real wages led to the departure of part of the most productive and highly-trained staff, especially at the higher levels. Moonlighting spread and became an accepted practice, absenteeism increased, and illicit practices grew. As a way of making up for wage freezes or the drop in real wages, the promotion process was speeded up, thereby distorting salary scales.

Government intervention through income policies was generally directed only at the lowest wage levels, and it often imposed freezes or severe restrictions on adjustments. Despite the legal restrictions –or because of them– companies sometimes increased other forms of remuneration, depending on their capacity to pay. This had two important effects. On the one hand, it made wage structures more complex, so that in many cases the instruments used have not served the interests of the workers or of the company. On the other hand, since they do not form part of the basic wage, such forms of remuneration have not been taken into account when determining pensions, for example.

Because of the fall in investment in capital goods, the necessary balance between capital and current expenditure was upset (more noticeably in the case of companies and public services than in the civil service), causing serious declines in the efficiency of the services provided.

2. Maladjustments connected with remunerations

Real wages fell in all areas of the public sector, but the budgetary item corresponding to wages and salaries continued to be very substantial, since at the beginning the level of employment was maintained unchanged.

In many cases salary scales were compressed, either because the increases granted to the lowest levels exceeded those of the upper levels, or because the increases were a fixed sum which naturally had a greater impact on the lowest wages.

V

Wage differences

Wage differences between the public and private sectors increased to the benefit of the latter; the differences between regions of the same country increased when those countries had decentralized structures, and the differences between the civil service and public enterprises increased in favour of the latter.

Towards the end of the 1980s, State intervention in wage policy went down appreciably with the application of certain policies linked with the adjustment programmes. In many countries, for example, the size of the State was reduced as a result of policies of cutting public employment and, in particular, of the big privatization programmes undertaken. This undoubtedly reduced the percentage of the population which depended directly on public wages policy.

A second example of the reduced weight of the State in wages matters was the evolution of minimum wages. In most Latin American countries, real minimum wages went down considerably during the 1980s. What had originally been an indicator of the stabilizing intentions of the authorities ended up as a signal of flexibilization of the labour market. In many cases the minimum wage lost its significance, because it ceased to have any relation with some type of basic shopping basket or given level of purchasing power, thus raising the question of the need for periodic reviews of the way it was determined.

Finally, the stabilization achieved by some countries lightened the burden of frequent wage adjustments and indexing problems and led the authorities to encourage the linking of wage increases to productivity improvements, although without specifying how this should be done. This change of approach reduced the State's role in the area of wages and naturally transferred wage discussions to the enterprise level.

VI

The renewed importance of labour costs

As already noted, there was a change in the situation displayed by the Latin American countries in the 1980s. Now, in the first years of the 1990s, most of them are in a more balanced macroeconomic situation, with levels of inflation which are very low for the region. This different profile gives a new dimension to the cost evaluations made by companies. In the past, the high levels of inflation on the one hand made the estimates less accurate, but on the other hand they gave companies more leeway to pass on the higher costs to prices and to ensure that adjustments (i.e., reductions) in real wages could be achieved by omission rather than by action. Now, however, in countries with low levels of inflation greater control over production costs is needed.

At the same time, the process of greater trade openness which was begun in most of the Latin American countries during the 1980s has been stepped up, partly because of an international trend towards liberalization. Greater openness and appropriate exchange rate policy are also pillars of the stabilization plans applied in a number of countries. This also heightens the importance of costs, because of the need to keep up the competitiveness of national production.

The renewed importance attached to costs has led to greater attention to labour costs, and this has been reflected in two areas. The first of these is the area of the regulations governing employers' contributions, seasonal bonuses, extra pay for holidays, allowances for various events such as compensatory payments or labour accidents, public holidays, etc. These factors have a big influence on the competitiveness of a country's firms in the international market.

Based on the costs involved in these regulations, a recent study compared the cost per hour actually worked with the net remuneration of workers in five Latin American countries.[3] In Argentina, for example, for every 100 pesos received by a worker his employer has to contribute 103.5% more for every day effectively worked, while the corresponding contributions are 99.6% in Uruguay, 86.5% in Brazil, 61% in Paraguay and 53.8% in Chile (Bour, Susmel, Bagolini and Etchart, 1992).

The second area where labour costs have a major impact is at the enterprise level. In this case, the possibilities for changing the cost structure are connected with, among other things, the company's organization, financial structure and choice of technology.

Consequently, the search for instruments which provide greater flexibility of labour costs is now a constant concern of both governments and enterprises, especially in the most developed countries of the region. On the government side, the interest in making the labour market more flexible is due fundamentally to the desire to keep inflation down and create jobs. On the enterprise side, the objective is to control costs, because as the variations in their prices are now much smaller than in the past (when inflation rates were very high), it is hard for them to offset even the smallest increases in their labour costs. The common aim of both governments (through laws and regulations) and enterprises (through changes in organization) is to keep up or attain levels of international competitiveness.

Among other instruments aimed at greater flexibility on the labour side, various forms of more or less temporary hiring have been used, or certain services or parts of the production process have been contracted out. This type of flexibility is known as external or contractual. However, there is a limit to this tendency towards more temporary arrangements, since it partly runs counter to the need for more highly trained or versatile labour that can meet the high quality standards demanded. Consequently, use is also made of other means of achieving greater flexibility, such as the elimination of restrictions on the introduction of organizational innovations: work groups, just-in-time production, etc. (Monza, 1994). This internal or technological flexibility is another aspect that strengthens the trend towards greater flexibility of systems of remuneration.

The importance of the question of labour costs has also varied as a result of the series of changes that are taking place in production and in systems of remuneration. To begin with, successive changes in technology and in the organization of production seem to have reduced the relative weight of labour costs, since in various sectors they now account for a smaller share of total production costs. Secondly, the structure of labour costs has been changing because companies have tended to increase their use of indirect forms of remuneration. Thirdly, the combination of a basic wage with a variable remuneration component is considered to be a promising means of bringing flexibility into the system of payment. And finally, this last combination also opens up the possibility of incorporating motivational elements into the system of payment and increasing its attractiveness in terms of recruiting and retaining skilled workers.

As regards the weight of labour costs in total costs, changes in forms of production have reduced the relatively high percentage that previously corresponded to labour (especially unskilled labour). This effect is most clearly seen in the industrialized countries: in the Japanese electronics industry, for example, the labour component is now only 5 or 10% of total costs. The changes in this respect do not seem to be limited to high-technology sectors, however. Changes in the cost structure due to the application of new technologies have also affected traditionally labour-intensive industries such as textiles, even swinging the balance back in favour of the industrialized countries in some cases. An example is that of Benetton, in the garment industry: unlike its rivals, who have transferred their production activities to Asia, this firm manufactures 80% of its products in Europe (*The Economist*, 1994). This is because changes in technology have permitted Benetton to

[3] While the costs connected with certain regulations can be measured exactly (in Brazil, for example, employers' contributions are equivalent to 35% of net remuneration), provisions for outlays such as labour accidents or seniority are not so exact, as they depend on whether events actually occur or on the staff structure of each firm. The estimates of these provisions are based on certain hypotheses which introduce a margin of error. With regard to staff seniority, for example, the study in question adopts the hypothesis of average seniority of 10 years. This means that in countries where the average seniority is less than this figure, the labour costs are over-estimated. For more details of the methodology used, see Bour, Susmel, Bagolini and Etchart, 1992, pp. 6-8 and tables 1-5.

change its structure of production to a capital-intensive one, which has allowed it to maintain its operations in a region of higher labour costs.

The burden of additional costs that have to be paid on top of the basic wage, such as various types of allowances, overtime, etc., differs between sectors and between firms. Generally speaking, it may be said that the weight of these costs in total labour costs has increased for various reasons. In recent decades, the component of labour costs which has grown most in the industrialized countries has been the employers' contribution to social security systems, because of such changes as improvements in the benefits of those systems and the higher cost of pensions and medical attention (although recently this cost has stabilized).

VII

Wages systems and flexibility

The recent concern with making the system of remuneration more flexible has contributed to the adoption of indirect forms of payment and the incorporation of a variable component in wages. From the point of view of the enterprises, whatever their performance, the aim is usually to avoid systems of remuneration involving fixed payments to their workers. When wages represent a fixed cost, this means that in periods of poor business the employers have to resort to dismissals in order to reduce their costs, which is always a traumatic process. The introduction of a variable component makes possible endogenous adjustments which automatically reduce labour costs in times of crisis and thus make outright dismissals a last resort.

Although cost-related aspects are important, due attention has not been given, in the current debate on the need for greater wage flexibility in Latin America, to motivational aspects and the organizational changes which are necessary and desirable. The fundamental aim of introducing a variable component is to link remuneration immediately and directly to the actual performance of the worker or company, so that it becomes an incentive. In addition, however, material incentives linked to performance must also be designed to improve the company's performance in areas which are its responsibility. The various aspects that must be taken into account in designing such systems must be adapted to the characteristics of the company, so that it can achieve its strategic goals. The identification of such aspects is therefore a fundamental factor in the success of a given system.

Systems of remuneration which include a variable component may display very different characteristics in their various aspects (Belcher, 1991):

i) The unit whose performance is to be measured and remunerated may range from the individual worker to a group, section, factory or the enterprise as a whole; the choice will depend not only on practical aspects (difficulty of determining the productivity of some workers, for example) but also on the attitude that it is desired to promote (team work or individual activity).

ii) The nature of what is to be remunerated (such as output, quality, use of machinery, productivity, or a combination of these factors) may vary; care must be taken to ensure that the incentive created does not adversely affect other aspects (for example, there are incentives designed to raise productivity which may have unwanted side-effects such as deterioration in the quality of the final product or an increase in labour accidents).

iii) The starting level from which it is desired to improve performance can be fixed on the basis of technical measurements or of the levels attained in the past.

iv) The expected variable component of total wages must be set at a level which is high enough to form an incentive but not so high that the actual wages can fall considerably below the going rate. [4]

v) Finally, it will be necessary to select the periods over which the results are to be measured and remunerated, taking care that they are not so short that the corresponding administrative costs become

[4] When there are suitable conditions for the successful application of such systems, the expected variable portion will represent between 25% and 30% of total wages. If such conditions are not present, then the variable portion will have to be smaller (ILO, 1985b).

too high, nor so long that they cause the workers to lose sight of the link between more diligent work and higher pay.

Those in favour of incorporating a variable component in wages claim that this option holds out benefits at the macroeconomic level in terms of employment and lower inflation. This makes these systems particularly attractive to governments. As far as employment is concerned, linking a substantial part of wages to company performance may stimulate new hirings, as it reduces the employers' risks by bringing in a variable element. With regard to inflation, linking wage increases to company profits or increased productivity reduces the wage-related causes of inflation. For the workers, the main benefit of these systems is that they may reduce dismissals when the company is passing through a bad spell, since the reduction in labour costs is endogenous. In periods of growth, in contrast, the workers will automatically share in the better results.

In spite of the advantages that these systems seem to offer, however, in practice they suffer from some limitations. At the macroeconomic level, the basic limitation is that these systems have only been adopted by a small number of firms, so that they have not yet had a significant impact. Indeed, as they have to be centered on the specific characteristics and objectives of the firms involved, variable wage systems are basically a microeconomic instrument.

The problems encountered at this level are very varied. An example is that of Great Britain, where the government promoted the adoption of wage systems including a portion linked to company profits by offering tax rebates. The results observed are as follows:

i) the variable component generally takes the form of a bonus on top of the basic wage, and has ended up being used instead of annual wage increases;

ii) when the variable portion is not a significant part of total wages, it is not enough to compensate for high labour costs in times of recession, and therefore does not avoid dismissals;

iii) companies may find it difficult to retain their best workers in periods of depression when the non-payment of the variable portion may cause wages to drop below market levels; and

iv) the factor selected for fixing the variable component may be exposed to various influences which are beyond the control of the workers, thus breaking the link between their pay and the effort made by them (IDS, 1990 and 1992).

VIII
Qualitative and motivational aspects

All the above considerations are connected with the qualitative aspects of work, to which the system of remuneration should make a positive contribution. Thus, the wages policy of a firm should attract workers in the necessary numbers and quality, retain that labour force, and motivate it to improve the firm's performance. With regard to motivation, it should be emphasized above all that wages policy is only one of the instruments available for motivating workers, and in no sense can it take the place of other personnel policies.

Wages systems which include a variable component can help to raise the workers' degree of motivation, and are generally aimed at doing this. Among the arguments in their favour, it is claimed that these systems help the workers to identify more closely with the firm and take an interest in its success, and they also make it possible to stimulate various forms of participation aimed at changing old forms of production, such as work in relatively small teams, improvements in quality, or the submission of specific proposals to save materials or reduce costs. These systems require smooth and effective communication between staff and management, both in their design and in their implementation. Lack of transparency in such communication may lead to the failure of the programme, while the existence of big fluctuations due to external factors outside the control of the staff may lead to disputes.

Finally, it should be emphasized that in the context of the present trend towards greater trade openness, the quality of labour occupies a leading place which is not always recognized. At the international level, relative labour costs are an important factor, not only in themselves but also within the context of local productivity, the existing infrastructure, government policy, and the levels of education and training of the workers. Low labour costs alone can only be a factor of comparative advantage in the short term. In order to attain long-term competitiveness, low costs must be accompanied by high quality. Countries where labour is cheap but its quality is low will be more vulnerable in the new international economic context.

IX

Conclusions: the need for a new balance

In the first part of this article it was noted that excessive intervention which gives priority to one objective but neglects the rest may impair the success of a system of remuneration. In the case of Latin America, we illustrated this by the example of a period of containment of wages, especially in terms of its effects on the structure and performance of public sector employment and on wage differentials. In practice, we have seen the limitations of some of the instruments used, while the passage of time has reduced the effectiveness of some means which could be useful over shorter periods. As an example of the former, we may mention the attempts made to apply partial indexing mechanisms or place limits on negotiated wage increases, while in the case of the latter we may note the incomes policies used during the application of non-traditional stabilization programmes.

At the present time, there is a trend to seek greater flexibility both at the level of the labour market in general and at the level of the company itself, frequently thanks to technological or operational changes. The adoption of some measures to promote greater flexibility may be valuable in certain circumstances, but this must not be seen as the only solution, nor must too much faith be placed in its capacity to solve very complex problems.

The formal introduction of measures to promote flexibility is not the only option, since even systems normally described as rigid can show some flexibility when necessary. An example of this is the case of Germany, whose wage system is often criticised for its rigidity. Nevertheless, the German trade unions agreed to wage adjustments below the level of inflation in the early 1980s, in 1989 and in 1993-1994. In addition, the industry-wide agreements are supplemented with arrangements at the company level, thus providing possibilities of limiting total wage payments. In some industries, companies pay up to 30% over the agreed minimum. When these companies need to reduce their wage costs, they cut this extra payment while keeping total pay unchanged (as in the case of Bosch), or they keep the extra payment unchanged but reduce its weight as a percentage of the total (as in the case of Mercedes-Benz). Another example of flexibility is the recent Volkswagen agreement whereby working hours are cut and so are wages (UIMM, 1994).

Flexible wage systems have their limitations as means of attaining the multiple objectives assigned to them, however. It is important to note that these limitations affect both the objectives of governments and those of employers and workers.

With regard to the objectives of governments, variable wage systems cannot be expected to solve all employment problems and control inflation. It would be more realistic to see them as one contribution, among various other necessary measures, for providing relative relief in crisis situations at the enterprise level. Flexible wage systems should be viewed fundamentally as instruments which are useful at the microeconomic level but which have only marginal effects at the macroeconomic level.

On the enterprise side, this instrument must be used with caution, after clearly defining the strategic aspects that it is desired to promote and identifying the negative effects that its application could have. Moreover, as already mentioned with respect to Great Britain, companies which establish a variable portion of total wages often set it at quite a limited percentage of the latter, which means that it may not give the margin of flexibility that companies need when there is a drop in demand.

From the point of view of the workers, the most obvious attraction is that they can share to some extent in the company's profits at times of growth (profit sharing) or increase their income by making a greater effort (payment by results), as well as achieving more stable contractual relations. This is particularly so in the case of companies which are obliged to increase productivity and improve quality in order to compete at the international level; such firms have to invest in their human capital and will naturally be interested in reducing staff rotation. At times of crisis, however, these conditions may change.

Generally speaking, changes aimed at securing greater flexibility demand changes in behaviour and management. Forms of remuneration linked, among other things, to output, productivity and the business results of the company should be complemented with more open and participative management structures which make them more acceptable and involve the workers themselves in the quest for improvements. It has been seen that the success of these systems depends largely on the way they are introduced (with or without the participation of the workers) and their subsequent implementation (forms of communication and follow-up of the business results of the firm). Obviously, this calls for more transparent and responsible forms of negotiation than in the past, when high and fluctuating rates of inflation led to frequent adjustments which had dubious real effect.

(Original: Spanish)

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