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LABOUR AND LIBERALIZATION IN LESS DEVELOPED COUNTRIES

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Foreword

The 1990s opened up new perspectives for the welfare of the developing countries. For many of them external events are likely to prove more favourable than in the 1980s, although for a considerable number the foreign exchange constraint will continue to be severe. Some countries are experiencing a radical transformation in economic and social development towards the liberalization of all markets, greater openness to the external sector, a different emphasis in market regulation, and towards greater political pluralism. An apparent novelty of this situation is that political pluralism and economic liberalism were rarely joined in the past. Whether there has been a major cultural shift based on a belief that markets are indeed less likely to fail in delivering the goods than are governments, or whether the identification of political and economic liberalism will be short lived, remains to be seen.

However, the widespread changes in the design of economic and social policy appear drastic and it must be expected that they will call many objectives and instrumentalities of government intervention in the economy into question. The nature of the desirable form of regulation of financial markets, goods markets and, most importantly for the ILO, labour markets will also change, although the process of change is likely to be spasmodic, uncertain and perhaps contradictory.

The present study by Professor J. Mohan Rao (University of Massachusetts at Amherst) looks at the impact which market liberalization policies are having, and are likely to have, on the labour markets of developing countries. He considers the extent and origins of the labour market segmentation involved in the informal-formal sector divide and reviews a wide range of factors associated with the emergence and expansion of the informal sector. He finds that the forces which are behind this segmentation are too powerful to be erased by current liberalization policies. Furthermore, he stresses that labour markets can never be free of institutions and practices linked to distortions and rigidities. Segmentation by gender or educational credentials cannot be ignored and rules determining the modalities of labour contracts are always needed.

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October 1994

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Labour and Liberalization in Less Developed Countries

I. Introduction

The recent spate of structural adjustment programmes and the growing influence of neo-liberal theory on economic policy may lead the casual observer to conclude that developing countries have moved towards a liberal market system. Focusing on the structure of labour markets and of industrial relations (that is, the 'labour regime'), this paper assesses the extent to which this conclusion is justified. It also evaluates the changes occurring in labour regimes from the perspective of stimulating income growth, increasing labour utilization, and alleviating poverty and income inequalities in less developed countries.

This requires an assessment of the differences in labour regimes in developing countries before the onset of the global economic depression in the early 1980s. This diversity rested on a firm foundation of structural similarities stemming from underdevelopment itself and from the manner in which these countries were integrated into the global economy. The section that follows places these similarities and differences in a theoretical and empirical perspective. This is not an easy task. Well-documented information is scarce, labour regimes are irreducibly complex, and existing theories are frequently at odds with one another. In developing this perspective, we have tried to synthesize available information and provide the most relevant theoretical interpretations.

Stabilization and structural adjustment programmes have typically been undertaken in response to economic crises in the external balance and the public sector accounts. Predictably, trade, financial, and public sector reform measures have taken precedence in these programmes. Reforms aimed directly at the labour regime have been neither fully articulated nor always carried out. Nevertheless, labour regimes have affected, and have been affected by, the functional success of other reforms. Section III considers the transition that has been taking place in labour regimes. Our focus is not on transitions engineered by structural reforms per se; but rather on changes in labour regimes whatever their source. In addition to policy and structural reforms, we shall examine the direct effects of the shocks generating the crises and changes within the labour regimes themselves.

The final section of this paper evaluates the transition in the light of emerging trends in labour regimes. Is the transition, as often claimed, converging on a liberal market regime? Do ongoing changes place developing countries in a position to make the best use of available economic opportunities? What new challenges do these changes present for developing country policy makers?

II. Pre-crisis labour regimes

Developing countries share two features of labour market structures in common: 1) the virtual absence of unemployment insurance and other elements of a social wage and 2) the ubiquitous reserves of under-utilized labour outside the formal sectors[1] of private and public industry and services. These two factors distinguish the labour regimes of developing countries -- before and after the crisis -- from those of the developed ones. The widely prevalent employment lag -- a persistent deficit in the rate of growth of formal employment relative to the rate of growth of formal output -- is paradoxical in light of these two

[1] Conceptual issues in the definition of formal and informal sectors are considered later in this section.

observations.[2] Understanding this paradox requires a grasp of the largely imported nature of technology and organization of production which is characteristic of late industrialization.

Do the aforementioned structural features together with the imperatives of late industrialization completely define labour regimes in the less developed countries? While these factors provide critical common foundations, they do not encapsulate all relevant features of pre-crisis labour regimes.

1) Reserve armies versus "luxury unemployment"

In a less developed country, an unemployed worker who receives unemployment benefit from either his or her former employer or from state support programmes is rare. The unemployed are essentially left to their own devices to support themselves. While support may come from communal and especially familial networks, its extent varies widely from individual to individual and across socio-economic groups. One argument suggests that the only general and sustainable remedy for unemployment is employment. This is the weak version of the 'luxury unemployment' hypothesis. The strong version holds that unemployment in these economies is essentially voluntary, a luxury that only the upper segments of the income hierarchy can afford.

Unemployment data have been interpreted to support the latter version of the hypothesis. Even during cyclical economic downturns, measured open unemployment rates in developing countries rarely approached those in most developed country recessions.[3] Exceptions aside, the normal rate of unemployment before the crisis varied within the 3-6 per cent range, much of which, especially in developing countries, could be dismissed as transitional or informational. Open unemployment rates tended to be significantly higher among the educated and well-off, those people who were able to wait for the right sort of employment. Moreover, unemployment tended to be concentrated among secondary workers whose earnings were a supplemental source of income.

The grain of truth in the 'luxury unemployment' hypothesis is obvious enough: poor people with no access to a social wage must work out of economic necessity. However, there is no warrant for the strong version of the hypothesis. Measured unemployment and its composition cannot be taken at face value in assessing the success attained in finding work. The difficulty in determining who is and who is not 'employed' and who is and who is not in 'the work force' is compounded by the fact that self-employment and part-time employment are the core rather than the periphery of the employment situation in these economies.

While full-time jobs comprise a considerable proportion of formal sector employment, the bulk of the labour force working outside the formal sector must engage in voluntary and involuntary forms of job-sharing. Self employment masks underemployment and the true participation rate (including 'discouraged workers') of women and children especially. Indeed, measured rates of participation may depend strongly on the economy's rate of job creation, labour 'supply' tending to follow labour demand. The incidence of seasonal unemployment and part-time employment, in both rural and urban areas, is similarly widespread. Employers have little difficulty in filling full-time positions when they open up, within or outside the formal sectors.

[2] "Jobless growth", experienced by developing and developed countries is a phenomenon of the 1980s, whereas the employment lag referred to here is a secular phenomenon in the developed world.

[3] The experience of the 1980s is different. We are concerned here with the three or four decades prior to this period.

A rough estimate for India, for example, puts the sum of recorded and unrecorded unemployment at about 25 per cent of the labour force (Robinson, 1983).[4] Similar estimates of labour under-utilization are fairly common elsewhere in the developing world. This situation reflects the continuing inability of late industrialization to absorb surplus labour even as it undermines the viability of traditional sources of employment. Suggesting that employers, whether urban or rural, face 'unlimited' supplies of labour would therefore not be too far off the mark.

Given endemic labour under-utilization, two questions immediately arise. First, how can the 'luxury unemployment' hypothesis (in its weak version) be reconciled with the existence of large reserves of underemployed labour? Second, how are wage levels and relativities determined and labour allocated across sectors?

An answer to the first question hinges on characteristics of informal enterprises which permit wide and effective sharing of available work. The second question involves the heterogeneity of sectors, the segmentation of factor markets and the array of labour market institutions through which market forces function. We will first consider the foundations of dualistic economic organization.

2) Foundations of dualism

Segmented labour markets, usually classified into modern and traditional and more recently into formal and informal, regulate the matching of labour demands with 'unlimited' labour supplies. This classification and its associated *dualism* is well supported in the literature by numerous empirical accounts (Mazumdar, 1989). The advantage of a conceptual framework with differentiated organizational forms and segmented factor markets[5] in *close association* is apparent. Conceptualization remains clouded, however, by multiple and incompletely theorized criteria. The following is a descriptive summary of the criteria commonly used:

(1) Technology and organization: There are measurable technological differences between the two sectors. In Latin America, for example, the capital-labour ratio in the formal sector is 35-50 times that of the informal sector (Tokman, 1988), a finding that may be typical of developing regions measured in terms of labour and capital employed. Formal firms are also generally characterized by deep internal hierarchies, attempts at Taylorization of work, and unionization.

(2) Motives of enterprises: As a rule, formal firms are driven by the profit motive. While significant segments of the informal sector may also be so driven, the more limited goal of securing a livelihood may be the sole motive in many cases.

(3) Products: Both sectors tend to be heterogeneous in the products or services produced. Some products and services may be produced exclusively in one or the other sector: for example, handicrafts, hay making, and household services (informal); ball-bearings, beef, and banking services (formal). Yet, there are many others, whether homogeneous or differentiated, that are produced competitively in both sectors, such as, cloth, coffee, and construction services.

(4) State intervention: Informal firms are frequently exempt from and often evade the fiscal claims and state regulatory strictures which formal firms cannot avoid. By the same token, the informal sector has less access to state-provided services.

[4] This is also supported from more recent survey data for 1987-1988 (Visaria and Minhas, 1991) when the rate of 'usual status' unemployment is added to the percentage of workers available for work.

[5] Whether this differentiation of markets and firms should be dichotomous or more complex is a secondary issue.

(5) Access to factors: Formal sector firms have access to formal financial institutions which informal sector producers generally lack. Informal firms and farms must often rely on internal finance or informal loans at interest rates which are a multiple of institutional rates. On the other hand, formal firms typically have to pay premium wages to their workers. While formal firms are invariably based on hired labour, informal firms combine hired labour and self-employment, including 'unpaid' family labour. Among labour-hiring firms, spot hiring of casual labour is characteristic of informal firms while formal firms rely more heavily on 'internal labour markets' with administered wage and promotion hierarchies.

(6) Location: Formal sector activities are predominantly urban-based. Most agricultural activity in developing countries displays of all of the above-noted features of the informal sector. Hence, informal activities, though mostly studied in the urban context, have a major rural component.

It is evident that dualism is described both severally and jointly by these criteria. What is less clear is their standing in the analytical basis of dualism. A closer examination separates causes from effects.

Neither *location* nor *access to factors of production* constitute independent determinants. As already noted, the informal sector, properly characterized, extends beyond the urban economy to include agricultural activity. Hence, the dualism at issue here is largely independent of location.[6] Differential factor market access or segmentation cannot be an independent source of dualism either so long as all firms are profit-oriented.[7] At least under conditions of competition among such firms, differential factor rewards or factor access together with differentiated technology and organizational choices will be arbitraged away.[8] In short, differential market access is a consequence, not a cause, of dualism.

Government interventions, whether fiscal or regulatory, in both factor and product markets distort the level playing field that unhindered competition can sustain. Informal firms are merely those that secure a competitive advantage by adapting to these interventions. Such adaptation involves the creative choice of technique, product, scale, and organization, weighing the costs of productive disadvantages that may ensue against the benefits of evading regulations. For example, small firms can avoid government-protected unions but large firms cannot. Dualism is then a consequence of the differential configuration of the technology of production and the 'technology of evasion' across diverse sectors of economic activity. In this view, the differentiation of sectors and of their associated markets is the product of government regulations.

This explanation of the sources of dualism may appear irrefutable at first. Yet, its validity as a theoretical or historical foundation is easily challenged. (a) Insofar as state interventions are *evaded*, what makes such evasion possible? State interventions do not produce dualism. Dualism is the consequence of the *particular forms of intervention and implementation* chosen interacting with feasible technologies. (b) We must ask why intervention policy is designed to target the formal sector so that the informal sector can avoid it. On both counts, allowing state policy to be endogenous makes the explanation incomplete or even wrong. State policy is undoubtedly endogenous with respect to economic organization and outcomes. To that extent, the explanation puts the cart before the horse. If diverse sectors coexist to begin with, then, state policy could be adapting to the pulls and

[6] Of course, the rural sector may well be classed as a third sector. However, the strong similarities - in terms of both organization and access to factors - between the urban informal and rural sectors makes this additional distinction superfluous if not misleading.

[7] Dualism that is associated with differing firm objectives is considered separately below.

[8] Assuming competition exists among firms in markets for such aggregated factors as labour and capital.

pressures emanating from these sectors as they seek to survive and prosper in competition with each other. (c) Historically, the informal sector is not just a product of modern forms of state regulation. What passes as the informal sector today had been in existence long before modern states acquired a developmental ideology or designed economic policy. Together with imported technology and forms of organization which practically define the formal sector, this provides the historical inheritance governing state policy.

Following the proposition to its logical conclusion, one might ask whether ending government interventions would eliminate the informal sector. Paul Streeten (1993, p. 8) has argued in response that "The evidence does not show ... that modern technology, in the present state of know-how, even with the most "realistic" equilibrium prices for labour, capital, and foreign exchange, can absorb the numbers of workers who will be seeking jobs at wages that can support them". A complementary response would be to deny the meaningfulness of the question itself. [9] This is not to say that state interventions are unimportant in widening or narrowing the extent of dualism but that the assumed autonomy of state policy as a determinant of economic structure is dubious.

Dualism is most commonly attributed to *differentiation in the products produced*. Direct competition between the sectors occupying separate market niches is therefore reduced. Typical examples of this include the urban-rural dichotomy in early development models and, within the urban economy, the manufacturing-service dichotomy. Non-competing sectors may therefore have wide differences in production technology and organization. [10]

This argument is incomplete in two important ways. (1) It does not explain why factor markets must be differentiated in structure and relations as well. This structural and relational differentiation [11] is the core of the dualism under discussion. (2) Empirically, dualism in developing countries is hardly confined to non-competing or complementary commodity-producing sectors. Such competitive coexistence in fact requires differentiated access to factors of production. On the first count, the argument fails to demonstrate why sectors that are complementary in product markets should also not compete in factor markets. On the second, it fails to explain why sectors competing in product markets survive with widely differentiated technologies.

Dropping the assumption of *profit-maximizing behaviour* permits one important and independent source of dualism to emerge. [12] Traditional producers -- craftsmen, peasants or those engaged in petty services -- will often resist the onslaught of the market in order to preserve their skills, status, or way of life. They may continue to employ their resources -- crafts, lands, or finances -- in the old ways even when this means reduced incomes from labour or sacrificing opportunities to make a profit. [13] There are theoretical limits, of course, as to how much traditional producers will endure. But these limits may be elastic in that such

[9] Note also that the prices of labour and capital may be "realistic" in Streeten's sense but not equilibrium prices in the sense of clearing markets.

[10] The argument is not vitiated merely because a highly aggregated dichotomy of sectors based on it is empirically unsupported. The remedy is a suitably refined disaggregation.

[11] This consists of the analogous composition of enterprise structures on the one hand and market structures on the other. In other words, dualist enterprises and markets appear to be made for, if not by, each other.

[12] Arthur Lewis (1954) drew his famous distinction between the modern and traditional sectors not, as often mistakenly supposed, on the basis of the commodities produced (industry and agriculture) but on the absence of reproducible capital in the traditional sector. <u>Dualism</u> in his model, is not just technologically based; it derives from the absence of the profit or accumulation motive in the traditional sector.

[13] This source of persistence of traditional organization may appear to contradict our earlier rejection of "differential access to factors of production" as an independent cause of dualism. Recall however that the earlier argument had profit-seeking producers as a premise. While tradition is also a form of differential access to resources, its basis lies in the motives of producers, not in the structure of markets.

producers can be flexible in the face of growing competition by improving their techniques, products or ways of working and organizing. [14]

Perhaps the most important source of dualism and the most neglected is *technology*. Technology *per se* has not been neglected; it features prominently in many discussions of dualism beginning with Arthur Lewis. What has been overlooked is its role in differentiating firms and markets in terms of structures and relations. Suppose that a homogeneous good can be produced with sharply differentiated technologies and associated production organization, and that government interventions are non-existent or neutral. Then, the competitive survival of all the producers depends on *endogenous* differentiation of factor market access. [15]

Examples of this differentiation should make this point clear. (a) Formal firms enjoy easy access to cheap formal finance from organized money, bond, and equity markets whereas informal firms can expect little financing from these sources and rely instead on high-cost financing from informal intermediaries. This bifurcation of the financial system doubtless mirrors 'real-side' dualism: financial markets specialized to each sector rise for reasons related to the technology of processing, monitoring, and enforcing financial transactions. [16] (b) We have already noted that formal firms set up internal wage and promotion hierarchies; these and other aspects of formal sector labour 'markets' are partly designed to secure the requisite quality and quantity of effort from employees. On the other hand despite the exaggerated neo-liberal [17] claim of the importance of state support to unions, the tendency to unionize is markedly more pronounced in the formal than in the informal sector. (c) Even product market structures are subject to such a 'revised sequence' wherein the nature of the firm has a determining influence on the structure of the market. As Galbraith argued, the modern corporation, committed to large and irreversible investments with payoffs into a distant and uncertain future, acts in ways to reduce this uncertainty by defending its market power and shaping consumer demand. (d) Our earlier argument about the endogeneity of state policy illustrates the same general point. These examples indicate how the segmentation of factor markets is the institutionalized expression of organizational and technological constraints. Even if the forces of competition were perfectly effective within each sector of a dualistic economy, as far as competition across sectors is concerned, they are regulated by the mediating influence of these constraints.

We conclude with four propositions. (1) the dualistic economic structure of developing countries comes from the constraints placed on market competition (especially in access to labour, finance, and land) by technology and enterprise organization even where firms are profit-oriented. Modern technology, large-scale wage employment, and attempts to separate conception from execution define and distinguish the formal sector. (2) Dualism is also partly sustained by nonprofit goals that some producers pursue. (3) Over time, technology, organization, market access, and even producers' goals evolve interactively to produce a history that is difficult to unscramble. This largely accounts for both the confused state of theorizing about formal and informal dualism and for the actual diversity of economic structures in developing countries. (4) State interventions are not irrelevant to dualism

[14] The hypothesis of profit maximization may be an ambiguous basis for predicting formal enterprise behaviour for a different set of reasons. This will be considered below.

[15] Competitive coexistence is a contingent outcome depending on whether differential factor costs, given the two technologies, balance out net competitive advantage. If the products produced are different, then, endogenous differentiation is not necessary but may still prevail.

[16] This is not the place to elaborate and support this argument.

[17] By 'neo-liberal', we refer to the now dominant tendency in development thinking that identifies development failures with one or another form of state intervention and sees market coordination as a solution to each of them.

though they are neither independent nor decisive. Such interventions do not provide the foundation for the informal sector as some suggest, but state action can weaken the informal sector as well as strengthen it.

3) Late industrialization

Industrialization in the post-War period has contributed to, but not created, the pronounced difference between formal and informal organization and markets. In earlier times, the influx of industrial imports from the industrializing West and the growth of export specialization that produced primary agricultural products and minerals, was promoted through direct interventions in the traditional colonial economies. The economic basis of agrarian and artisanal producers was disrupted by new competition from industrial products and discriminatory policies of taxation, resource control, and infrastructural investment. These policies were designed to create labour supplies for plantations, cash crop production and mining. Both dualism and underemployment are a legacy of this era.

Late industrialization has built on this inheritance by importing technical and organizational forms typical of industrialized countries. But the rapidly advancing technological lag has been difficult to bridge in most developing countries. In many cases, this transplantation has happened suddenly, without a prior transformation of the traditional agrarian and non-agricultural sectors. The segmentation of capital and labour markets has reinforced this discontinuity. The knowledge acquisition process has not adapted to local conditions. Production relations in the formal sector, characterized by strict hierarchy, minimal worker participation, and the separation of knowledge from execution faithfully conform to the Taylorist model. There has also been a strong tendency towards vertically integrated firms, reliance on full-time, permanent workers and in-house supervisors. But in other respects, the acquisition and learning process has been dissimilar. The abrupt transition from agricultural to factory production without any intervening merchant-craftsman stage has eliminated the de-skilling process of early Taylorism. Yet, the labour force has had to be trained and adapted to industrial conditions and, successful adaptation and learning ultimately hinge on both enterprise strategies and the environment in which they have to function.

The continuing gap in productivity and wages between developed and developing countries has required a greater reliance on cheap labour rather than technological development as the basis of competitive advantage. Modern industry in the developing world is based on routine assembly tasks employing mostly unskilled and semi-skilled labour. Competitive advantage derived from static labour cost advantages is short-lived. Late industrialization has therefore been vulnerable to external strangulation, which is displayed in bouts of foreign exchange, fiscal and debt crises. State policy has often had to hide and underwrite the resultant losses through protection and subsidies. The ongoing employment crises outside the formal enclaves, are the true costs of such industrialization.

A significant part of the growth of the public sector in many developing countries is also the result of late industrialization in the above sense. Public investment was expected to hasten the transition to a modern economy. This growth, far from counteracting the above-noted tendencies, only contributes to them. As the major employer of educated and (to a lesser extent) skilled workers, the public sector's pay and employment policies have a major influence on the formal sector labour market in the relevant occupational and educational segments. In a sample of 23 developing countries, it was found that the public sector accounted for an average of 44 per cent of total nonagricultural employment (Heller and Taite, 1983). When the substantial portion of nonagricultural employment in the informal sector is considered, the public sector's dominance within the formal sector is evident. Moreover, between 1960-1980 the public sector expanded much more rapidly than the private. Apart from the fact that the technology and production strategies of public sector employers differ little from their private sector counterparts, their employment and work practices also reflect political imperatives to provide jobs for a growing middle class that cannot otherwise be productively employed. The problems of the public sector are both cause and consequence of the employment lag. The spread of transnational investments and technology in developing countries is equally unable to create an alternative dynamic impetus. Although transnational corporations are important in the dislocation of established relative wage within developing countries, they too exploit the 'advantages' of cheap labour.[18]

4) Common contours of labour regimes

The convergent contours of labour regimes in developing countries rest on economic dualism and widespread underemployment. Labour allocation is based on a two-tier system of employment rationing; on the first level, available full-time *jobs* in the formal sector are rationed by employers; on the second level, available *work* in the informal sector is shared among the remaining workers by both voluntary and involuntary processes. This hierarchical process of labour allocation is structured by complex institutional rules of wage determination. Theory must account for this process and its attendant rules.

The allocation process derives from significant differentials in the average wage, work conditions, and job security *favouring formal employment*.[19] Recruitment to the formal sector therefore tends to be highly restrictive with educational credentials, gender, and personal connections playing a major role. Although kinship, village and other non-economic ties are also important in both sectors, it is undoubtedly much easier to get jobs in the informal sector than in the formal.

A study of the Bombay labour market in the late 1970s clearly shows such segmentation and entry barriers. About 50 per cent of the labour force was occupied in the 'organized' (read formal) sector. Only 11.2 per cent of these workers started in the 'unorganized' or urban informal sector. For every additional formal job created, there were three additional migrants into the city. Few of these could expect to move into the formal sector at anytime and the rate of return-migration was also large.[20] Moreover, workers in the organized sector came predominantly from the landed classes, far more so than did casual workers (Deshpande, 1983, p. 90). This segmentation is perpetuated down through the generations because children of formal sector workers have greater access to education. Segmentation also reproduces the modern/traditional polarities; there is little transfer of traditionally skilled workers into the modern sector; instead newly-skilled workers are created as needs arise in the formal sector (Papola, 1981). Thus, social and economic factors, some specific to the traditional economy, serve as gate-keepers to the formal sector.

Other studies of the informal sector support the claim that it is not just the temporary receptacle of the reserve army of workers -- a 'disappearing' anachronism. While its survival may appear to be the consequence of the formal sector's inability to absorb labour, their joint survival is not the result of the particular constraints on the dynamics of the formal sector alone but of their interactive dynamics.

[18] Successful instances of late industrialization are exceptions among the developing countries. Their experience illustrates the importance, among other things, of a critical minimum investment in technological learning.

[19] While many in the informal sector consider formal sector workers to be privileged, there are others who resist its lure preferring their craft independence or way of life. For the present argument to apply, it is enough that there is a large enough margin of workers in the former group.

[20] However, patterns of mobility between segments vary over time and place. It appears that mobility from the rural and urban informal segments has declined over time in the long-established, metropolitan industrial centres (Papola, 1977, p.143). Similarly, recruitment from the rural hinterland is of greater significance to the smaller or newly-established towns (Robinson, 1983, p.96).

It cannot be assumed that outside the sheltered formal sector, the raw forces of supply and demand rule: that the informal wage in the urban sector is market-determined. 'Ease of entry' into the informal sector does not imply unrestricted entry. Were this so, then, there would be no lack of jobs and all workers would be fully employed.

This point needs to be treated somewhat differently as between the self-employed and hired-labour segments in the informal sector. In the case of hired labour, we may assume a floor wage at which labour is paid, and labour demand is accordingly limited. In the case of the self-employed, the actual level of employment (allowing for disguised employment) within the enterprise will depend both on the availability of outside employment opportunities and on the enterprise's non-economic goals (if any). In either case, employment is ultimately restricted by the availability of complementary factors of production, capital, and land. [21]

If employment rationing -- governed by limited means for employment and (hierarchical) wage floors -- is prevalent in both sectors, there is a crucial difference. Premium wages, internal labour markets, relative job security, and the relative longevity of formal sector firms help ensure a low rate of labour turnover. Therefore, the formal sector contributes very little to spreading its income and employment opportunities around. In contrast, the informal sector has a naturally greater capacity for work and income sharing. In the case of family or self-employment, this sharing is involuntary, uncoordinated, and competitive. Individual informal firms suffer high rates of variability of demand, whether seasonal or secular, as well as high rates of mortality. The labour demanded is also often largely casual. Hence, there is a much greater play of voluntary and involuntary factors causing labour turnover. While the resultant sharing of work and labour incomes may not exactly be random, it is perhaps nearly so. These features of informal activity allow the 'luxury unemployment' argument to be reconciled with the long-term persistence of underemployment: the high turnover and 'flexibility' of the informal sector, though largely unplanned, is functional to the economic system as a whole.

How inflexible indeed are informal sector wages? In the absence of detailed wage data, this is a difficult question to answer. Such data are inherently more difficult to generate and interpret. The labour income component in major parts of the informal sector is not easily identified because of the importance of own-account employment, the small size of establishments and, not least, wage differentiation based on skill, experience, and other factors. The great heterogeneity of the sector -- in terms of location, gender, and age divisions, products produced, etc. -- further complicates the matter. Hence, the existence of wage inflexibility, at least in the form of a *wage floor*, can only be hypothesized on the basis of available wage data coupled with indirect evidence on employment and underemployment. For example, examining four decades of research on rural labour markets in India, Dipak Mazumadar concluded that "the market clearing model does not explain the facts in rural India" (1989, p. 12). This conclusion applies *a fortiori* to the urban labour market.

However, the wage floor and therefore the availability of informal sector employment is not immune to economic forces. The wage floor need be neither uniform across space nor rigid over time. A comparison of the pattern of urban industrialization in the United States (before the First World War) and Latin America showed that the productivity differential between the formal and informal sectors has been substantially greater in the latter than in the former. The differential is correlated with the lower ratio of agricultural to manufacturing productivity (Tokman, 1988). This suggests that since agricultural employment accounts for

[21] All this is premised on competitive product markets. Where this is not the case, restriction on competition must take the form of restrictions on the entry of firms. Even where no complementary factors are needed, such as in purely labour-based services, there will be informal restrictions limited the extent of crowding tolerated. However, product market competition rather than restriction appears to be the rule in the informal sector.

a large share of non-formal employment, the level of agricultural productivity is the main influence on the wage and productivity levels in the informal sector as a whole.

Apart from the capital-intensive trajectory of imported technology, the low level of informal sector productivity also reflects the large inequalities in access to capital. It is not just that labour absorption into the modern sector requires large amounts of capital; the terms on which capital can be used differ steeply as between the two sectors. In fact, the variance *within* informal sector earnings appears also to be related to the unequal access to capital. These inequalities are both cause and consequence of dualism.

The following example illustrates the importance of the capital constraint vis-à-vis government regulations of the formal sector labour regime. Suppose that the two sectors produce a homogeneous good and compete directly in the product market. The example assumes a large difference in the capital-labour ratio (of the same order of magnitude as is observed). In Case I, the formal sector wage is taken to be as much as three times the informal sector wage; in Case II, it is only half again as large as the (constant) informal wage. The example is constructed with a differential in implied rates of return on capital (or costs of capital) in Case I -- 40 per cent in the informal versus 11.25 per cent in the formal -- that may be taken to be typical.

Capital & Labour Costs in Sectoral Competitiveness

	Informal sector	Formal sector
Output (value-added)	100	100
Capital stock	100	400
Labour needed	10	1
Capital-labour ratio	10	400
Capital productivity	10	0.25
Labour productivity	10	100
Case I		
Depreciation	10	40
Labour costs	50	15
Interest/profit	40	45
Return on capital	40%	11.25%
Case II		
Depreciation	10	40
Labour costs	50	7.5
Interest/profit	40	52.5
Return on capital	40%	13.125%

Despite halving the formal wage in moving to Case II, the implied return on formal capital rises only marginally from 11.25 per cent to 13.125 per cent. The point is that the large differential in interest rates facing the two sectors, in conjunction with the wide difference in the capital-labour ratios, greatly diminishes the significance of the wage rate differential as a factor in competitive advantage between the two sectors. By implication, government regulations and restriction on labour markets (assuming that all of the reduction in formal wages in Case II can be attributed to a relaxation of these) are far less significant in determining the relative size of the two sectors than is the segmentation of the capital market. As Mazumdar (1989 p. 66) has argued, "It is true that if the microenterprises were asked to bear the costs of regulation many of them would go out of business, but it is unlikely that reducing the burden of regulatory costs in the formal sector will help many of the informal businesses to grow".

The discussion so far clearly discredits the simple neoclassical model of competitive wage determination at full employment and discounts the supposed central role of exogenous government-instituted labour market barriers. What then are the positive factors determining wage structures? One general line of argument -- the *efficiency wage* model[22] -- views non-market clearing wage levels (including formal sector wage premia over the informal sector wage level) as optimal responses of profit-seeking firms to reduce costly turnover, preserve the value of firm-specific training and ensure effort quantity and quality. Consider first the formal sector. Higher wages and stable employment in large, formal enterprises may be rationalized, in one version or another, of the efficiency wage hypothesis. These provide larger enterprises with heavy investments in newer technologies the means to internalize training and learning benefits (Taira, 1977). Smaller enterprises, by contrast, can afford to be more open to the labour market.[23]

In the Bombay labour market study cited above, wage and salaried employees in the organized sector earned substantially more than workers elsewhere. In 1974-75, taking wages in factories employing more than 50 workers to be 100, the wage index for smaller factories was 45, for urban unorganized sector workers 36, and rural workers 19. These differentials need, of course, to be discounted for the effects of skill, experience, and education. But even controlling for these, earnings tended to be strongly correlated with firm size; thus, workers in firms with employment exceeding one thousand earned about 2.5 times as much as casual labourers *after* adjusting for these other factors (Mazumdar, 1988, p. 226). These differentials are much above the 30-50 per cent premium that unskilled factory workers may be expected to command on efficiency-wage grounds. Another version of the argument, the internal promotion ladder, also cannot explain large entry-level wage premiums above the informal sector wage.

Can the efficiency wage argument account for the wage floor in the informal sector? Note first that several forms of the argument are belied by the high rate of labour turnover in this sector. Neither promotion nor seniority counts for much nor are learning and training investments noteworthy. With employment precarious and job loss imminent, the additional effort forthcoming may be negligible. Second, the vast scale of underemployment in many developing countries appears to be *prima facie* incompatible with this argument; it is hardly tenable that such a scale of involuntary underwork is necessary to discipline even casual workers. Nor can the widespread labour underemployment in family-labour enterprises be dismissed as the secondary consequence of the unemployment induced by the efficiency wage. Third, kinship, caste, village, and other bases of 'discriminatory' hiring that are important in the informal sector make both the wage and the effort extracted exempt from a spot market efficiency-wage type explanation: loyalty may be purchased by such non-economic affiliation without recourse to extra economic rewards. Fourth, the tiny size of many informal enterprises calls into question the importance of the effort-extraction problem that is basic to

[22] The term 'efficiency wage model' is intended here to include several variants all of which share the assumption that labour market institutions derive from narrowly-defined optimizing behaviour by firms.

[23] Similarly, mills in Bombay's early textile industry employed permanent workers with relatively high wages while also maintaining a significant proportion of workers on a casual, daily-wage basis to insure a committee core and a flexible periphery (Mazumdar, 1973).

the hypothesis. A need for coordinated team-work deriving from lumpy capital or sophisticated divisions of labour is usually absent.

Clearly, important though the efficiency-wage considerations may be, they are not the binding constraint explaining actual wages and wage relativities. In the formal sector, factors related to bargaining, such as labour unions, and the acceptance of rent-sharing as a social norm and a constraint on relative wages may be more important. In the informal sector, amorphous but real floors on wages determined by fairness, family wage, 'subsistence', and other such social considerations may be influential. When these constraints on wage-setting are binding, firms may still use the threat of layoffs to discipline their workers.

It should be evident that the attempt to *endogenize* the wage structure via the efficiency wage model is consonant with our own analysis of the exact correspondence between enterprise structure and factor market structure. However, while optimizing models of individual (enterprise and worker) behaviour give some insights, such models are too narrow to cover the range of influences that help produce this correspondence. Social norms including those governing collective action do not just come from selfish goals. Social interdependence, in the form of empathy or envy, e.g. militant forms of union action, cannot be so reduced. The same applies to the political action which influences state policy. Wages and workplace conditions may be susceptible to social influences which are outside the scope of efficiency wage models. This wider complex of influences is also one of the sources of differentiation among labour regimes.

III. Differentiation

Though anchored by economic dualism and widespread underemployment, labour regimes in the developing world are hardly homogeneous. We have argued that economic dualism produces its own environment of structured labour and capital markets; we have also argued that it influences the nature of state interventions. These effects need be neither uniform nor static across nations. The fundamental reason for this diversity is that economic dualism conceals a variety of concrete differences in economic structure stemming from the diverse histories of developing nations. These histories define the interactive evolution of technology, organization, market access, producers' strategies, political structures and state policies. Here, we confine ourselves to a broad-brush outline of the more important dimensions of diversity and suggest their main causes.

1) Inequality, agricultural productivity, and cheap labour

The level and rate of growth of agricultural productivity have an important bearing on labour regimes and enterprise strategies. Rural poverty and underemployment, associated with low productivity, depress the supply price of urban labour; slow growth sustains low wages by reducing labour absorption within agriculture and accelerating rural-urban migration. This cheap labour scenario, in turn, increases the size and competitive strength of the informal sector vis-a-vis the formal sector.[24] As a result, the speed of industrialization may be adversely affected: a) because technical innovation in informal firms is likely to be less than in the formal sector because enforceable patents are virtually non-existent; b) learning and skill development are subject to scale economies which cannot be realized; c) adverse fiscal consequences will also flow from the shift (due to lower tax rates or higher evasion), reducing infrastructure creation and, hence, growth. On the other hand, the absence of labour market pressure also weakens the formal sector employer's

[24] This is based on the premise that the possibilities of labour-absorbing expansion for the informal sector are more elastic than for the formal sector and that low income levels sustain a composition of demand favouring the informal sector.

impetus to invest in continuous technological improvement or training; instead, it encourages them to sub-contract to low-wage informal enterprises.

Agrarian inequalities are at least partly responsible for the slow transformation of agriculture and the associated low-wage, high-underemployment, low-industrial growth scenario just described.[25] In east Asian countries, early reforms in land relations and investments in infrastructure and education contributed to the productive absorption of labour within the rural sector while simultaneously raising agricultural productivity. These factors contributed to a pattern of industrial growth in which rising productivity as well as both high and rising wages were imperatives. In particular, by the mid-to-late 1970s, east Asia had begun to experience a rapid tightening in labour market conditions. Elsewhere in the developing world, the lack of agricultural dynamism resulted in the cheap labour scenario. In south Asian and Latin America, agrarian inequalities remained entrenched contributing to the relative stagnation of agricultural productivity.[26] Even when technological breakthroughs came in the form of biochemical improvements, they were quickly followed by labour-displacing mechanization. In sub-Saharan Africa, technological stagnation (or worse) in agriculture coupled with accelerating rural-urban migration similarly contributed to the employment lag.

The case of Pakistan illustrates our argument. Large rural inequalities and high rates of underemployment have underpinned an economy of cheap labour. There is a clear negative relationship between the rates of growth of large-scale manufacturing and the small-scale sector. In manufacturing, the growth of employment has been only a third as large as the growth of output with a negative time trend in the employment elasticity of output. Formal enterprises are driven to control costs through the use of cheap labour rather than through process or product improvements (Cameron and Irfan, 1991). They still view machines as the best way to discipline low-paid workers to produce minimum quality and adequate quantity of output. This low-wage, low-quality, low-effort trap "could spring disastrously as exposure increases to international competition based on very different principles of organization" (Cameron and Irfan, p. 66). Although the inequalities referred to increase the size of the informal sector, they also exacerbate the constraint -- the high price of and inadequate access to investment finance -- on its productive and dynamic expansion.

2) Macroeconomic structure

Though growth is driven by several sources of demand, growth regimes may be distinguished by their leading source. Accordingly, growth regimes may be classified as export-driven, home market-driven or public-investment-driven. Different growth regimes have some broadly identifiable correlates in the labour regimes.

Under import-substitution, export sectors tend to have lower wages compared to the sheltered sectors (Irfan, 1979). Wages in large-scale manufacturing firms oriented to the home market are positively related to the degree of protection afforded through trade policy. Scale economies generate monopoly rents for these firms in protected markets. While a part of the wage premium may be attributable to capital intensity and dualism *per se*, another part is due to the sharing of these rents. Such rent-sharing is more likely among the unionized labour force but it also strengthens unionization itself. Besides, as long as the regime is in place, a high degree of job security also exists.

[25] For the underlying connections between agrarian inequalities and slow growth, see Rao (1986) and Rao and Caballero (1990).

[26] An agricultural subsistence floor to urban earnings probably loses its force as growth proceeds and the center of gravity of the labour force shifts to the urban sector. This may be relevant to Latin American and the more industrialized countries of Asia.

Polarized wage structures (even within the formal sector) are not unique, however, to import-substitution regimes. Under export-oriented regimes such polarization is due more to the non-economic segmentation of labour than to the countervailing power of labour vis-a-vis monopolistic firms. Especially important has been the use of largely non-unionized young female workers. Their labour is cheap because they are transferred directly from unpaid household and agricultural work without benefit of the protective institutions that many male manufacturing workers have created for themselves. They tend to be amenable to tighter forms of labour control and easily dispensable in periods of demand shortages. There is also extensive use of child labour particularly in informal industries oriented to exports. These features of export production labour show that the technological handicaps in the periphery are to some extent made good by super-exploitation.

The Republic of Korea's industrialization has depended not just on labour repression (see below) but also on gender-based wage polarization. Low wages for females (at only 44 per cent of the male average) mostly employed in labour-intensive export industries provided the surpluses which financed (with credit subsidies) investment in capital-intensive industries with dynamic technology (You, forthcoming). The Republic of Korea seems to be a prime example of the influence of sharp technological differences in the labour regime, as reflected in skill-adjusted wage differentials, that are strongly correlated with capital intensity (even more than with firm size). But this technological segmentation very nearly coincides with gender segmentation.

As in the case of the Republic of Korea, in Singapore, Hong Kong, and Taiwan (China), labour quiescence is due in part to the growth of a large class of employees within the export industries with low wages, low skills, and minimal employment security. In all these cases, females now make up a larger proportion of the manufacturing labour force than in Japan or the United States (Deyo, 1986).

Public investment has spearheaded industrialization in a number of countries, among them, Egypt, India and China. Public enterprises functioned in naturally sheltered non-tradables or in import-protected sectors, mainly capital-and skill-intensive. Even when pricing or entry restrictions did not allow them market monopoly, they were sheltered against losses through subsidies and the infusion of state resources. The dominance of the public sector in infrastructure, capital goods and modern services such as banking and transport had a determining influence on wages and industrial relations in the formal sector. A high proportion of public sector workers tends to be unionized. Wage determination has also tended to be centralized, permitting demands for parity in wage levels to be pressed successfully and reducing enterprise autonomy in this sphere. Public sector employees (workers or managers) and their civil service counterparts also enjoyed *de facto* job security.

3) Repressed, sheltered, and open regimes

The rules of coordination that mediate between individual behaviour and collective outcomes are important determinants of labour regimes. The set of rules pertaining to wage formation, union action or other labour market institutions is by definition part of the labour regime. Another set, related to price setting, investment decisions and enterprise regulations, influences the labour regime indirectly. In either case, labour regimes are shaped by a combination of uncoordinated market forces and extra-market, state and other collective, action. We leave to one side the relative autonomy or dependence of state policy in this determination. Focusing on the nature of state interventions, whatever their origins, does however, provide a useful point of entry for describing the diversity of rules of coordination.

Throughout the developing world, poverty and underemployment indicate a potentially quiescent and easily-disciplined working class. This limits the value, for example, of the view that institutionalized collective bargaining (whether corporatist or decentralized) determines wage and work conditions. Yet, the realization of this potential is far from being uniform not only across the formal/informal divide but also among different countries. From a state-centred perspective, labour regimes may be classified as open, sheltered or repressed. In fact, the latter two are versions of what may be termed "managed" regimes.

In east Asian countries, political authoritarianism has supported the authoritarian paternalism of employers towards their employees. This has enabled the transformation of unions into instruments of government control, and, as noted above, facilitated the exploitation of gender-based differences. State repression of labour took various forms. In the Republic of Korea, 'one enterprise one union' and affiliation with the ruling-party controlled FKTU were both mandatory. The right to strike was banned in 1971 and unions could only bargain with state permission. Social wage provisions were virtually non-existent. These policies had predictable effects: a weak union movement with corrupt leadership, minimal wage indexation, fragmented bargaining that produced meagre wage effects, and a strong hand for employers in dealing with labour.

Employers used this leverage through a mixture of authoritarian paternalism and economic incentives for loyalty (You, forthcoming). Very long working hours, a widespread seniority pay system as well as productivity-linked bonuses are reflective of this regime. Though Western-style industrial engineering has been adopted, Taylorization has not been rigidly followed. Quality Control circles and other forms of "self-management" have therefore been fostered both by enterprises and the state.[27] At the same time, however, wage guidelines issued by the state and by the employer federation ensured that wages kept up with the trend in productivity (Mazumdar, 1990). Hence, enterprise flexibility and rapid learning went hand-in-hand with macroeconomic stability and political containment.

Repression was not confined to labour. The authoritarian structure of capital-labour relations was joined with the Republic of Korean state's ability to discipline the business class. This capacity was deployed through the selective allocation of credit, export subsidies, and access to foreign loans. The visible hand of the 'developmental state' firmly guided the Republic of Korean success in achieving international market competitiveness.

Singapore, Taiwan (China), and Hong Kong also share with the Republic of Korea the complete stagnation (compared to many other countries) in both union organization and militancy during the period of successful export-oriented industrialization (Deyo, 1986). But as in the Korean case, it would be simplistic to assign success simply to the repression of labour and an export-led strategy. High rates of growth were achieved through 'managed repression' which was built on low relative inequality.

India strongly contrasts to the Republic of Korea in the governance of capital-labour regimes. Whereas Korean labour has been repressed and capital disciplined, formal sector workers in India have been sheltered from the threat of unemployment and large enterprises protected from competition. The contrast is all the stronger by virtue of the slow growth of the Indian economy and the continuing presence of a large and impoverished rural and urban labour force outside the formal sectors.

In addition to being the leading agent of growth, the state has also played a strong role in economic coordination. Among the more important of these coordinating functions were trade restrictions, the licensing of private investment decisions, interventions in the food market, administered pricing in industry and various regulations affecting wages and workplace relations in the organized sector. State laws all but eradicated (larger) enterprises'

[27] Authoritarian paternalism did not assure job security. Despite other similarities, You notes that the Japanese norm of life-time employment does not hold for the Republic of Korea.

right to lay off the individual worker or to close altogether. When industries did poorly they were frequently taken over by the state. Given employment security, statutory regulation of both bargaining and the union movement have effectively separated wages and job tenure from productivity. The sheltering of labour, however, has been more than matched by import restrictions, industrial licensing, and other forms of protection of capital from competition.

A peculiarity of the Indian model is the state's simultaneous attempts to enhance and limit the market power of enterprises while similarly institutionalizing job security and manipulating unions and bargaining. This is explained (as is state-led growth itself) by the conflicting demands of stability and growth in a mixed economy. These demands are amplified by the pulls and pushes of powerful classes on state policy, the vulnerability of large segments of the population to inflation, and the restraints of electoral democracy.[28] To these must be added the state's direct interest, by virtue of its leading role in growth and ownership of over half the organized sector capital stock, in containing wage differentials and other elements of the wage contract. Instruments of policy which are considered necessary for planned development may not assure 'stability' in the sense of maintaining relative incomes among classes which can resist the erosion of their incomes (Rao, forthcoming).

Taylorism, however, has been mostly thwarted because of weak managerial authority, the continuing influence of paternalism, and resistance by workers. Unresolved workplace conflicts spill over into wage bargaining which assumes prominence. Sheltered markets and industrial regulation focus wage bargaining on issues of parity. Another implication of this structure is that firms have been less flexible in responding to changing markets and technologies.

Elsewhere, in Brazil, for example, the industrial relations regime was regulated until 1978 by the 1943 Labour Code. This allowed the state to intervene in all aspects of capital-labour relations (Amadeo and Camargo, 1989). Unions, limited to occupational groupings and restricted to individual cities, were approved by the Ministry of Labour and negotiations were mandated and scheduled annually. Labour courts were resorted to whenever bilateral bargaining failed to achieve agreement. Strikes could only be called under very stringent conditions.[29]

Though the union movement became highly fragmented, the stronger unions often pressed their claims successfully through (nominally illegal) strikes and, in the course of time, their gains were transmitted to the less successful unions through the Labour Courts. The growing strength of the unions in the populist years of the early 1960s partly contributed to the military takeover in 1964, and outright repression followed in the period through 1975. In 1965, the previous job security law which protected workers with more than 10 years' experience from being fired and required compensation for other dismissed workers was repealed while a formula for wage indexation was introduced. Democratization arrived in 1974 in an era when large firms were growing and there was a large body of industrial workers. The unions became less dependent on the state and acquired the strength to carry out successful strikes. An important gain was the change in the indexation law tying it less to 'expected' and more to the actual inflation. By the late 1970s, a large part of the Labour Code and strike laws had become de facto defunct.

In contrast, Uruguay had a relatively 'open' regime with no legal code to regulate union formation and bargaining. Industry-level unions predominated and were affiliated to a single

[28] The common underlying element is the complexity of the class structure. The rural kulak class has ties to the state apparatus that are no less significant than those of bourgeois classes. Most of the small-holding peasantry are as vulnerable to food price increases and inflation as the urban working classes.

[29] These regulatory provisions are surprisingly similar to the regulation of industrial relations in India.

federation. Secret balloting in union representation votes was instituted from the very beginning. The result was strong centralization. Paradoxically, state codification of labour regulations decentralized and fragmented union structures in Brazil; whereas the reverse was true in Uruguay (Amadeo and Camargo, 1989).

The openness or repressiveness of a labour regime may be masked when protective legislation is not backed by strong implementation. Though laws against unjustified dismissal have been on the books for many decades in most Latin American countries, they have not guaranteed even relative, much less permanent, employment security (Bronstein, 1990). Just as much as workers and their unions see this as a primary issue concerning employment conditions, employers have argued vehemently that the existence of such laws causes inflexibility and lack of discipline in the work force. In fact, these laws seem to restrict labour mobility very little. There are no legal provisions as in India restraining enterprises which trim their labour force for economic reasons, certainly none that are enforced for collective dismissals.

IV. The transition

1. Crisis and restructuring

The world-wide crisis has had similar effects on most of the developing world although the magnitude of the shocks and of required adjustments has varied materially. On the one hand, inflexibilities (perhaps different in form and degree) inherent in all of these economies account for their common deflationary experience. On the other, differences arise from the diversity of the pre-existing macroeconomic structures and growth regimes underpinning wide differences in external competitiveness and vulnerability, and varied capacities to adjust (ILO, 1987).

Structural adjustment programmes under Fund-Bank ministration draw their inspiration from the standard trade-theoretic critique of state-directed development policy. As articulated by neo-liberal theory and championed by the Bretton Woods institutions, structural adjustment is concerned with market-oriented liberalization designed to improve supply-side flexibility and performance. It presumes that import-substitution industrialization and state interventions distort resource allocation and reduce resource utilization. Reforms seek to reallocate resources from home goods to traded goods; within the latter from import-competing to export goods; and from the public to the private sectors. Improved resource efficiency is to be secured from the exposure of enterprises to internal and external competition and through a drastic reduction in the scale and discretionary component of government interventions in enterprises and markets. The main instruments include trade policy reform (dismantling quantitative restrictions, reducing tariff rates, and introducing currency convertibility), openness to capital and technology flows, unhindered flow of domestic investment across sectors, financial reform to permit market-determination of investment and saving, and public sector disinvestment.

Neo-liberal theory is anchored in four basic assumptions: 1) that a politically unconstrained market regime is feasible (distributional problems can be resolved without 'distorting' the market); 2) that the market can fully coordinate individual decisions (the state can only get in the way); 3) that private investment and public investment are substitutes in the growth process (complementarities are negligible); 4) that the unhindered import of technology can provide an adequate basis for building up competitive strength (a level playing field imposes no handicaps in building up dynamic competitive advantage).

The success of market liberalization requires as a cornerstone a labour regime that is free from distortions and rigidities. At the level of state policy, this is usually defined in terms of the absence of 1) direct intervention in wage-setting and indexation, including legislated non-wage elements of compensation; 2) exit barriers on firms in the form of job tenure legislation or restrictions on employers' freedom to lay off or retrench workers; 3) free mobility of capital without soft budget constraints or other ways of rescuing firms that fail.

As for the role of the labour market in adjustment, two rather extreme models are distinguishable. In the first model, labour markets are characterized by full employment and unhindered reallocation of labour. The key price is the real exchange rate. Shifts in this price produce a smooth reallocation of labour in the short run following real wage flexibility. Full adjustment follows in the medium run when investment responds to relative profitability. The second model recognizes wage and employment rigidities, segmentation, and non-competing groups. With real wage rigidity in the formal sector, adjustment entails a sharper fall in real wages in the uncovered or informal sector. On the other hand, if real wages are flexible but labour markets are segmented by mobility barriers, then, a given rate of real depreciation can only be attained with correspondingly larger real wage declines in both sectors. Therefore, not only will output responses be restrained, but the reallocation of capital (and therefore the medium term response) will also be limited. In the section that follows we reconsider actual responses to structural adjustment and the role of the labour regime in that process.

2. Labour regimes in the transition

Labour regimes have mediated adjustment to the crisis in diverse ways. The severity of the crisis has shown itself in the unexpectedly large reductions in the recorded wage share of national income in Latin America and sub-Saharan Africa. Such reductions have made investment recovery in the medium term highly problematic. Informal sector employment has grown at the expense of the formal sector. But such growth is attributable, in many cases, more to the crowding effect of formal sector decline rather than to productive labour absorption. Trade reforms and relative price changes have also reversed the normal pattern of development by raising the recorded share of agriculture and services employment at the expense of manufacturing.

(i) Unemployment, wages, and effective demand

Stabilization and structural reforms have had important effects on labour utilization relative wages and the structure of employment throughout the developing world. The economic crisis sharply raised open unemployment rates to unprecedented levels in many countries. In some, participation rates have fallen reflecting the withdrawal of discouraged workers. The openly unemployed during the 1980s were more likely to include primary workers and not, as in years past, just secondary workers (van Ginneken, 1988a).

In Latin America, stabilization was followed by sharp reductions in activity levels while devaluations and price reforms caused a surge in inflation. In the labour market, increased unemployment and reduced workers' bargaining power were the result. Major cuts in budget deficits necessitated wage reductions in the public sector with parallel effects on private sector wages. Real wage trends, which had been divergent across countries during the 1970s, have turned negative after 1980 falling by more than 30 to 40 per cent nearly everywhere (van Ginneken, 1988a). In sub-Saharan Africa, massive cutbacks in the public sector and severe reductions in import capacity have produced a substantial shrinkage in modern sector employment. Real wages in regular (formal) employment have been falling for nearly two decades, often in excess of 40 per cent in total.

There is a perception that labour market conditions, including pliant unions, have made for easier structural adjustment in Asia compared to Latin America. Some of this difference may be illusory: macro adjustments in Latin (and SSA) economies had to be deeper and quicker than in the Asian economies. It is nonetheless true that Latin firms faced greater difficulties in regard to wage escalation clauses, severance pay and collective agreements concerning the division of work between different categories of labour (Edgren, 1989).

In most Asian countries with large agricultural and unorganized sectors, recorded rates of open unemployment have fluctuated cyclically but do not show a trend towards deterioration. Weak trade unions, relative price and wage flexibility, little wage indexation, and strong government controls over the wage-setting process have contributed in significant measure to the control of inflation even in the face of large devaluations. However, there has been a sharp deceleration in the rate of growth of manufacturing employment in several countries as well as employment reductions in export sectors that suffered declines in their terms of trade. In some of the poorer Asian economies, real wages have tended to fall appreciably in response to price shocks. Moreover, wage growth has generally tended to fall behind productivity growth by a substantial margin. This lag is closely related to a lagging minimum wage in the Philippines and Thailand where the statutory minimum is close to the market norm in the formal sector.[30] In India and the Philippines, the prolonged use of incomplete indexation and flat rate adjustments to the cost of living have been a further cause of wage erosion and wage compression (Edgren. 1990). Real wages in Asia appear on the whole to have been more flexible than in either Europe or Latin America due primarily to differences in indexation rules (Edgren, 1990).

While real wage reductions in excess of real GDP declines have been commonplace in developing countries, lending credence to the view that wage rigidities are not an absolute constraint to adjustment, such reductions appear to have been excessive from a macroeconomic standpoint. That is, while excessive rigidity has not been a microeconomic constraint, excessive flexibility may have added to the macroeconomic costs of adjustment. Large wage reductions translated into effective demand problems causing substantial falls in national output. Hence, the prime reason for the surge in unemployment has to do with structural constraints on aggregate demand and on product markets rather than with real wage inflexibility (Horton, Kanbur and Mazumdar, 1991).

Successful adjustment depends not only on the share of wages but also on the importance of capital and import costs. With quick downward adjustments in wages, interest rates and exchange rates, the transition can be swift and less painful. Gains in competitiveness as a consequence of such factor market adjustments were important in some Asian cases, particularly in the Republic of Korea and Malaysia. In Latin American countries, Bolivia for example, real wage reductions were significantly higher than GDP losses; moreover, informalization further added to the loss of the labour share in national income (Horton, Kanbur and Mazumdar, 1991). These effects tended to depress domestic demand while, product market structures proved harmful to the growth of exports despite large devaluations.

Wage flexibility does not imply the absence of distributive conflict: the conflict, in particular, between maintaining the wage share and achieving external balance. How this conflict plays out also depends on the production structure and on government price policy. Thus, where basic foods are tradable and food prices largely unregulated, the exchange rate and the real wage in non-tradable sectors are closely related. Real wage reduction occasioned by devaluation exacerbates an ongoing struggle over real shares. In many Asian countries, government policy insulates the domestic food market (producers and consumers) from world prices, providing a form of basic incomes policy (Paukert, 1988).

[30] In India by contrast, the minimum wage rate is below the formal sector wages.

(ii) Changes in employment structure

The contraction of aggregate demand and the growth of unemployment imply, in the first instance, a redistribution of the labour force in favour of the informal sector. This follows from the informal sector's relative ease of entry and work-sharing characteristics in both self-employment and wage-employment. An inverse relation between formal and informal employment levels is a reflection of displaced workers without social security moving into the informal sector. Such a movement is segmented by age, gender, and skill. Females in the formal sector, including those with education, tend to be disproportionately affected by unemployment. A sample of displaced manufacturing workers in the Sao Paulo region of Brazil identified older females, younger males, and the relatively unskilled as much more likely to move into informal employment than their counterparts (Hirata and Humphrey, 1991).

The redistribution of labour is not inconsistent, however, with an absolute contraction in informal activity levels. Labour force and employment statistics will fail to pick up weak labour demand and contracting informal activity since the 'crowding effect' will disguise increased underemployment.

On theoretical grounds, even a relative expansion of the informal sector in response to stabilization and structural adjustment is not certain. First, the informal sector is generally more dependent on expenditures out of labour incomes whereas a larger share of formal sector demand derives from non-labour incomes (including investment expenditures). The observed fall in the share of wages due to stabilization and reforms will therefore reduce the relative size of the informal sector. Second, relatively easy entry into the informal sector may produce asymmetric price and quantity responses to demand contraction in the two labour markets -- employment reductions being more pronounced in the formal market and wage reductions in the informal. This suggests that formal activity levels will shrink in relative terms. Third, price changes in favour of tradables (especially exportables) will have ambiguous effects on employment structure. The informal sector includes tradable agriculture, non-traded subsistence agriculture, non-tradable services and manufactures. Hence, the impact of price reforms on relative size depends on the precise composition of the informal sector. Fourth, the undoubtedly lower import-intensity of informal outputs and services indicates that relative profitability in the informal sector will rise after devaluation. Finally, financial liberalization may well produce an adverse effect on the informal sector through the reduced availability and higher price of credit in the informal financial system.

What can be said about the impact on the wage gap between formal and informal employment? With rigid wage rates or proportionate wage reductions in both sectors, the crowding effect implies that the gap in *effective earnings* between them will widen. In addition, if informal wages are indeed more flexible downward than formal wages, then, the gap in *wage rates* will also widen. In practice, whether formal-informal labour income inequality grows or shrinks depends on the extent of real wage reductions in the formal sector and on opportunities for productive expansion of the informal sector.

Statistics on employment and wage conditions outside regular paid employment are not available for most countries. Nevertheless, the broad outlines of the impact of reforms can be pieced together. Trade reforms, reduced investment rates, fiscal cuts, and privatization have all contributed to the growing informalization of the labour force in most countries. Available data present a mixed picture, however, about the productive absorption of this labour within the informal sectors (van Ginneken, 1988a).

In sub-Saharan Africa, cash agricultural incomes have fallen drastically because of declining export revenues and the urban population's changing consumption patterns. Thus, although subsistence production appears to have been maintained total agricultural income has fallen. On the other hand, there have been dramatic reductions in both employment and real wages of urban unskilled workers, especially those in the government sector (Jamal and Weeks, 1988). The security and stability of urban formal sector employment has also dwindled and the small-scale microenterprise sector has served to soak up the surplus labour created in addition to rural migrants. Hence, the distinction between the formal and informal sectors has become blurred and the urban-rural income gap has narrowed considerably. Contrary to expectations however, the last of these effects has been accompanied by an increase in overall income inequality and continuing rural out-migration. The greater part of income inequality in the countries surveyed by Jamal and Weeks derives from intra-urban inequality rather than inequality between urban wage-earners and rural workers.

In Tanzania, the wage share of total urban incomes fell from three quarters to a half between 1976 and 1984 contributing to a sharp narrowing of rural-urban labour income differentials (Bevan, Bigsten, Collier and Gunning, 1988). At the same time, small entrepreneurs appear to have gained as witnessed by the resilience of self-employment incomes. In Nigeria too, in the years during and following the oil booms, the income share of urban professional and entrepreneurial classes rose significantly. Thus, a rapid income differentiation within the urban sector rather than a widening of the income gap between the mass of urban workers and rural inhabitants was the result (Jamal and Weeks, 1988). In Côte d'Ivoire, on the other hand, the narrowing of formal/informal income gaps has been due partly to a robust expansion of the informal sector. The informal sector benefited from the difficulties of the formal sector especially because of the latter's dependence on imports. Hence, a large part of the effective demand has been transferred from the modern sector to the informal sector.

Colombia's experience illustrates the element of complementarity between the two sectors deriving from wage-led demand. With the onset of recession, formal employment fell sharply while informal employment continued to rise significantly. This is because the latter sector provides basic consumer goods and services which are tied to the wage bill in the formal sector. This continued to grow with real wage increases compensating for employment decreases. But once the wage bill started to decline, the recession caught up with the informal sector as well (de Gomez, Ramirez and Reyes, 1988).

In much of rural Asia, the share of wage employment and landlessness has been growing in recent decades. But there are many countries and regions (China, Malaysia and parts of India and Pakistan among them) where rural incomes have been rising due to the growth of agricultural productivity and rural industrialization (van Ginneken, 1988a). The slower growth of formal sector employment, together with continued economic growth, has therefore allowed the productive expansion of informal sector employment.

Another key sectoral distinction in the stabilization and adjustment context is the one between tradables and non-tradables. A recent study concluded that labour reallocation has on the whole been in the desired direction, that is, towards tradables (Horton, Kanbur and Mazumdar, 1991). But a disturbing feature of labour market adjustments is that there have been reversals from the normal pattern of development as formal sectors have atrophied. We have already noted one aspect of such an abnormal trend, viz. the shift of labour from the formal to the informal sectors. Growth of the recorded labour force in services and commerce perhaps indicates weak labour demand overall, crowding into the informal sector and underemployment. Another aspect has to do with the manufacturing sector's share of employment. Since the end of the 1970s, the proportion of employment in manufacturing has decreased in many developing countries -- reaching a temporary plateau of 10 to 15 per cent which is much lower than the peak share achieved in the advanced countries (van Ginneken, 1988a).[31] While the manufacturing share rose in Asia during structural adjustment, in Latin America and SSA, the shift into tradables is on account of a reversion to agriculture and cutbacks in government (largely non-tradable) employment. An explanation for this reversion is that whereas exchange rate depreciation produces a net benefit for agricultural exports, the benefits to manufacturing are countered by simultaneous trade liberalization reducing import tariffs and quotas. Evidence from Côte d'Ivoire, Ghana, Kenya and Egypt show that along with sharp reductions in manufacturing employment have come migration reversals and increased agricultural employment. It has even been suggested that these changes in employment structure are a reversion to the colonial pattern of labour allocation (Commander and Ugaz, 1992).

Structural adjustment in most African economies has included an attempt, quite apart from devaluation, to reform agricultural price policies so as to favour that sector. This policy may have bridged some of the rural-urban earnings gap but has done little to foster growth. In many SSA countries, agriculture produces tradables and non-tradables as joint products so that the incentive content (in terms of export promotion) of price reform is accordingly diluted. On the other hand, since infrastructure creation and technological change contribute strongly to agricultural output growth, public investment cutbacks do little to restore growth momentum.

3. The transition in labour regimes

Changes in the levels and structure of labour utilization noted above have also been accompanied by shifts in industrial relations and labour market institutions. Some of these shifts, notably in the public sector, are due to reforms aimed directly at the labour regime. But even where such reforms have not been articulated or implemented, there are discernible shifts in developing countries. Besides trade liberalization, the transition in labour regimes has been caused by enterprise restructuring, technical change, and political democratization.

(i) Casualization, sub-contracting, and flexibility

Liberalization and changes in technology and markets have put a premium on flexibility in the employment relationship. Trade reforms have jeopardized sheltered markets for employers and workers in the formal sector and threatened the basis for the rent-sharing embodied in the terms and conditions of the employment contract. Changing product markets (especially for exports) and production processes have required firms to respond quickly and flexibly. The result is increased competition in product and capital markets, a growing risk of technological obsolescence, and the need to restructure enterprise organization. These pressures have produced two tendencies: formal enterprises have attempted to reduce and restructure their existing work forces and they have tried to change the pre-existing norms that shape the employment relationship.

Employers have engaged a broad range of devices to accomplish these goals. These include: (1) layoffs, retrenchments, and early retirement schemes; (2) reduction in the ratio of core/permanent employees to secondary/casual workers or the creation of a two-tier labour force structure; (3) increase in the proportion of apprentices, migrants, and women; (4) subcontracting the production of components and parts either permanently or seasonally; (5) subcontracting peripheral services such as transport, packaging, maintenance and security; (6) increased reliance on overtime and multiple shift operation; (7) greater reliance on piece rates and variable bonuses; (8) eliminating or subduing unions (Edgren, 1990).

[31] The manufacturing share of employment rose in the Republic of Korea during the 1980s and is around 28 per cent in Taiwan (China).

The success of employer strategies has varied depending on both existing economic structures and labour resistance. In countries or industries with a large backlog of obsolete plants and low productivity, liberalization accompanied by modernization poses the threat of large-scale layoffs. Elsewhere, the growth of capital intensity and modernization is likely to take the form of incremental changes in the rate of growth of employment and of the composition of skill demands.

Though job tenure laws and collective agreements may exist, their effectiveness has been severely tested by the particular conditions of the labour market, the strength of unions and political pressures underlying the degree of enforcement. In most Asian countries severance pay is legislated at a minimum level of one month's wage for each year of service. With weak labour demand, employers manage to get away with paying workers less than they are entitled to through "voluntary" settlements. This was the case of Malaysian electronics firm during the 1982-84 recession. Workers have been especially willing to settle for lump-sum payments when they see that they cannot fight "a unified establishment of management, government and the judiciary" (Edgren, 1990, p.634).

In Nigeria's private sector, reliance on collective agreements concerning job security has grown considerably since 1982. In addition to a freer hand to management in labour redeployment and the suspension of lengthy procedures for terminating employment on disciplinary grounds, there were substantial job-sharing arrangements. For the most part however, such concessional bargaining has failed to stem the tide of layoffs (Fashoyin, 1990).

When workers resist 'voluntary retirement' or when severance liabilities pose formidable barriers, enterprises rely on the process of attrition. The consequence may be, as in India, growing industrial sickness and employers resorting increasingly to lockouts. The creation of a "new exit policy" whereby firms which are doing poorly are either rehabilitated or closed and existing job tenure legislation for covered workers is annulled has encountered fiscal and political obstacles. Fiscal austerity under the current structural adjustment programme makes the design of a viable "safety net" nearly impossible for formal sector workers who have been laid off: unions and the political parties from which they draw their support have strongly resisted exit policy proposals. [32] Even in Ghana, where legislative barriers to retrenchment scarcely exist, end-of-service benefits, severance pay, and other elements of the collective bargain are obstacles to adjustment not only in the public sector but also in the private (Commander and Ugaz, 1992).

The creation of two-tiered labour forces with different wage and employment conditions (which have grown considerably in the past decade or more) may be seen as a gradual approach to creating a flexible and pliant work force while also permanently cutting the wage bill. The latter especially is a clear instance of evading provisions of law or collective bargaining. Even in China, there is a growing tendency to hire new workers on fixed-term contracts or to locate in rural areas. These practices are not just confined to countries such as India which have strict job security legislation. Citing as an example the Philippines garment industry, which has a much higher proportion of non-regular employment than does Pakistan, Edgren has argued against the view that "labour legislation is the most important reason for the trend towards casualization" (Edgren, 1990, p.636).

The drive towards flexibility has also spawned the growth of subcontracting relationships creating complementary links between the formal and informal sectors or

[32] During the 1980s state authorities have sometimes chosen to ignore the spirit if not the letter of the labour laws. In 1982, responding to the threat of job losses following modernization, Bombay's textile workers launched the biggest strike in Indian history aimed partly against the unrepresentative but legally recognized union. The strike lasted over a year and involved 250,000 workers. When it was over, nearly 100,000 had lost their jobs and those that remained won only a meagre pay raise. This defeat was engineered partly by the government which refused to dislodge the union.

between developed and developing country firms. Much of this sub-contracting has involved female home workers but it is hardly limited to home work. Sub-contracting has fuelled the rapid growth of small and informal firms in Pakistan's industrial sector. Between 1972 and 1986, this segment of industry grew faster in output terms and much faster in employment terms than the large-scale segment. The small and informal sector accounts for three fourths of all urban employment in Pakistan (Cameron and Irfan, 1991).

The practice has an obvious negative effect on the unionized proportion of the work force. However, it does not necessarily threaten, indeed it may even benefit, the economic status and employment conditions of the workers that are retained in the primary (formal or unionized) labour market. The Japanese example seems relevant here: whereas the labour forces of large companies enjoy life-time employment and high wages, the greater part of manufacturing employment growth has occurred in the expanding networks of subcontracting small firms (Edgren, 1989).

The growth of casualization and sub-contracting is not simply the result of enterprises trading on wage differentials between the protected and unprotected segments of the labour market. Were this the case, such subcontracting should have been accomplished long since in many developing countries. Rather, such practices evolve as an enterprise or industry learns from its own and others' experience. A significant part of this learning is not just technological but organizational as well. The learning process leads to the breakdown of tasks and their further simplification which in turn renders possible new divisions of labour between the enterprise and the market. An example is the putting out of work to subcontractors in the fields of electronics and textiles (Lawson, 1990). What this suggests is that the division of labour within the (formal) enterprise and between the formal and informal sectors are not determined by technology and the profit motive with exogenous changes in wage or other market conditions governing changes in those divisions. The divisions of labour at any point in time conceal potential organizational slack that are only revealed by learning over time.[33]

Do high wages, by inducing the formal sector to contract out some processes or activities to the informal sector, serve to raise total employment and wage incomes? The answer turns on the number of informal jobs that are created for each formal sector job lost. If this ratio is large, then, the labour share of income will go up even though the concentration of labour incomes also rises. Thus, there may exist a tradeoff between higher formal sector wages on the one hand and total employment and to all labour incomes on the other.

(ii) Public sector reforms

The primary force behind changes in employment conditions in the public sector is fiscal austerity under stabilization. However, fiscal belt-tightening has often been joined by efforts to dismantle the state's active involvement in the economy. Deep reductions in public sector employment have occurred in nearly all cases where structural adjustment programmes have been instituted. Public sector labour shedding has been greater than the drop in employment in the private formal sector. Reductions in the real wages of remaining employees have been nearly ubiquitous. The push from such retrenchment has not been matched by pull from private sector expansion.

Since the early 1970s, public sector pay levels have fallen dramatically in a number of African countries, including Ghana, Malawi, Sudan and Tanzania, particularly at the higher skill levels (Lindauer, Meesok and Suebaung, 1988). Such pay reductions have often

[33] This proposition fits uneasily into the static calculus of profit maximization with 'given' technology.

exceeded the fall in real GDP per capita. The severe budget crises along with the desire to maintain employment and to prevent lower level wages from falling too much has led to massive compression in the pay structure. Also the pay differential has narrowed in favour of the private sector. However, retirement incentives and benefits in the public sector impose special barriers to retrenchment via reduced employment.

The major hurdle to reducing the 'employment overhang' in Ghana's public sector has been the severance pay issue, along with the operation of wage bargaining institutions. The inability of financially strapped public enterprises' to meet separation or end-of-service benefits has both reduced separations and made privatization difficult. Hence, net job losses have been smaller than planned. On the other hand, with 50 per cent of all wage employment and an even higher proportion of unionized workers still remaining in the public sector, that sector continues to be the wage leader within Ghana's formal economy. To counter the tendency for wage increases underwritten by a 'soft budget constraint', Ghana has instituted an incomes policy whose main plank is to put a lid on collective bargaining agreements at the firm level (Commander and Ugaz, 1992).

By contrast, employment cutbacks in Nigeria have been particularly deep in the public sector, including parastatal enterprises. The unemployment rate has reached new heights, a conservative estimate of 15 per cent in the 1980s and, for the first time, the unemployed include the skilled classes. While union membership has declined, job security strategies have assumed unusual prominence. Prior to 1982, legislative decrees concerning layoffs, redundancy and separation benefits were weak or not enforced. Nor did collective agreements have the backing of law. However, a wage freeze was imposed from 1982 to 1987 avowedly intended to protect employment in the formal sector. In practice, job security has all but vanished. Summary terminations and "purges" have routinely occurred. A 1984 decree repealed any protection that previous laws had provided to employees who tried to redress wrongful terminations or forced retirements. Although state governments reduced the scale of terminations after 1985 because of the attendant financial burden, governments have often defaulted on salaries and benefits (Fashoyin, 1990).

Conventional wisdom assumes that the promotion of public sector efficiency requires outright divestiture or at least work force restructuring, including the creation of market-based mechanisms disciplining workers and managers. The replacement of soft budgets with hard budgets is considered the basis of the latter strategy. However, several implementation difficulties arise.

First, a significant part of public employment is concentrated in areas of production and/or delivery characterized by natural monopoly. Exposure of such enterprises or departments, whether under public or private ownership, to 'market forces' is neither feasible nor desirable. While operational autonomy in certain areas can certainly be secured, crucial areas such as pricing or even labour relations are likely to remain subject to (autonomous or state-guided) regulation. Budgetary discipline is therefore liable to be defined elastically depending on bargaining between managers and regulators and workers and managers.

Second, reform of the state sector, whether through enterprise divestiture or work force restructuring, tends to get stalled by existing institutional arrangements that define labour requirements, work force distinctions, redundancy and retirement benefits and collective bargaining agreements. A survey in Ghana found that enterprise managers often failed to find any work force redundancy or tended to target production workers rather than office or support staff. There is also a conflict of interest in that the managers negotiating on behalf of the firm with the unions of other employees, were themselves organized into union-like associations. Redundancy and retirement liabilities were so large as to rule out the divestiture of virtually all the firms in the public sector being considered for it as going concerns (Davis, 1991).

Finally, even in the face of the above obstacles, some governments have felt obliged to demonstrate the success of privatization. On the one hand, political resistance from the national unions (who stand to lose by way of influence in the relevant sectors) has been circumvented by handsome payoffs to affected workers. On the other, private buyers have been enticed by auctioning off public assets at bargain prices (Edgren, 1990).

(iii) Labour market institutions

A recent survey based on country studies has concluded that labour market institutions have not proved an insuperable obstacle to inter-sectoral resource shifts. Earnings function studies showed that in a number of countries the rewards associated with the characteristics of a formal sector worker fell and rewards and resources shifted in the direction required for adjustment (Horton, Kanbur and Mazumdar, 1991).

In some countries, however, liberalization of the labour regime has extended beyond dismantling job security laws, allowing private and public firms to exit freely or providing a safety net to displaced workers. More thorough-going 'reforms' -- aimed at eliminating unions, wage indexation guidelines or laws, minimum wages etc. -- as in Chile in the post-Allende years and in Bolivia, certainly led to job shedding in the deregulated sector, especially the public sector. Forcing such labour market 'flexibility' cannot eliminate conflict, it can only change the forms in which underlying social conflicts are played out; nor can it redress managerial failures that often underlie both general productivity failures and counterproductive industrial relations. Even the Republic of Korean state, which heavily managed the unions in order to stem open conflict, allowed the sharing of the gains of growth and created a basis for worker learning and improvement. Unions, especially where collective bargaining is accepted by the employer, can be a positive factor in restructuring, retraining, and redeployment of the labour force. Premium wages won by such unions are more than compensated by reduced turnover, flexible adjustment, and industrial peace. The alternative is a fundamental lack of trust that occasionally leads to explosive conflicts and freezes technological progress.

Unfortunately, the stagnation of recent years and the wrenching effects of structural adjustment do not bode well for the orderly reconstruction of industrial relations machinery based on trust, cooperation, and bilateral gains. While enterprises yield easily to the temptations of a strategy based on cheap labour and the fear of unemployment, workers and their unions resist equally hard relinquishing whatever levers they may have over preserving job security. Employers' gains under such circumstances, with or without state aid, can only be temporary because they are obtained by institutionalizing a zero-sum game.

Restructuring the labour regimes has proved considerably easier in China with high rates of employment growth than in India in an era of 'jobless growth'. As previously mentioned, protective legislation on the one hand and abundant reserves of both skilled and unskilled workers on the other have created a productivity and industrial relations stalemate in India. Though its resolution remains presently stalled at both state and enterprise levels, structural conditions and the current adjustment policy will probably lead to a one-sided solution. There is a danger, of creating a vicious circle with high 'flexibility' chasing low productivity.

Compared with most developing countries, labour reforms in China have taken place in an era of expansion. Because of high rates of growth, rural underemployment as well as urban unemployment have shrunk substantially. Starting in 1986, the labour contract system in China's state-run enterprises came under new regulations based on a fixed term rather than for life (van Ginneken, 1988b). The change has been supported with a generous system of unemployment compensation.[34] Although productivity-linked compensation has risen in importance, overall wage differences have been confined to a narrow band of about 3:1 between the best paid senior technician and the best paid blue-collar workers.[35]

Another important contrast is provided by newly democratizing political regimes. Political democratization in repressed regimes has been strongly associated with the renewed growth of workers' unions and collective action. In the Republic of Korea, the movement for democratization itself was propelled by successful industrialization that helped raise the power of both business groups and popular classes vis-a-vis a repressive though 'developmentalist' state. As early as the 1970s, an independent union movement had arisen centred around the labour-intensive sectors predominantly employing female workers. Following the slowed growth of the 1980s and the crisis of 1987, a powerful new movement grew rapidly in the male-dominated, heavy industries sector. The rapid exhaustion of labour reserves and the resultant squeeze on profits was an important factor in the rise of labour militancy. Without relinquishing the benefits of managerial paternalism, the movement demanded the abolition of authoritarian paternalism and questioned managerial prerogatives (You, forthcoming). Independent wage bargaining has taken strong root resulting in rapid increases in wage rates (Mazumdar, 1990), a major gain relative to the preceding decades when the union movement had been co-opted and repressed. While the wage differential between production workers and office workers has been reduced, inter-enterprise wage differentials have widened. This is the result of enterprise-level surplus sharing which had previously been checked by state-and employer-led common wage guidelines.

Similarly, the other east Asian cases of industrial success, attended by gradual labour-market tightening, have also seen changes in economic and labour regimes (Deyo, 1986). All of these countries shifted to higher technology fields especially basic engineering and electronics which called for upgrading worker skills. However, the authoritarian state has remained relatively unchallenged as the pivot in helping firms fashion new corporatist union structures to facilitate the economic mobilization and stabilization of the labour force, for example, in initiating campaigns for productivity increases and learning.[36]

Redemocratization in Latin America has also forced union movements into action. During the 1980s, Brazilian unions grew rapidly, creating a strong national federation and shaping an affiliated parliamentary party. As the power and autonomy of the movement grew, the threat of strikes was wielded successfully to increase the costs to employers of labour dismissal. Nevertheless, with bargaining itself following established regional and occupational lines rather than firmly coordinated, the scope of capital-labour conflict rose and with it the potential for inflation and instability.

Though there were convergent political trajectories in Brazil and Uruguay, the growth of conflict was much greater in Brazil. This has been attributed to uncoordinated, 'beggar-thy-neighbour bargaining' in Brazil coupled with quasi-centralization in the form of the union federation which causes the demands of the most powerful unions to lead the rest (Amadeo and Camargo, 1989). In contrast, coordinated bargaining has served to contain conflict in Uruguay. This shows that while democratization per se can contribute to both

[34] Dismissed employees with five years' experience are entitled to two-thirds of their wages for two years and one-half of wages for an additional year. Those with less than five years' standing are paid two-thirds of pay for a year.

[35] Wages and benefits are less rigidly regulated in enterprises located in the smaller urban collectives and in rural areas. Not only are average wages lower but performance-related bonuses can be a much higher proportion of total wages.

[36] New mobilizations of workers are also evident elsewhere. There have been vociferous protests in recent years over retrenchment in the export-processing zones of Malaysia, the Philippines, and Sri Lanka indicating that attachment to longer term employment in industry may be increasing in these industries (Edgren, 1990).

high-wage settlements and wage drift, its effect on macroeconomic stability depends on the containment of wage parity issues and, hence on union structures.

Of course, different union structures also have different micro economic impacts. From the perspective of workers, company unions (not company-controlled unions!) may seem to provide better results in terms of wages, job security, and working conditions. A study for India found that, company unions produced a pay level that was 15 per cent higher than the level achieved by national unions for comparable work (Bhattacharjee, 1987). In contrast, a Malaysian case study showed that national unions achieved a premium of some 10 per cent compared to company unions (Standing, 1990). These studies suggest that simple comparisons of union structures may be insufficient. The strength and unity of the membership itself may be more important than leadership and affiliation (Edgren, 1990). Nevertheless, in the context of labour surplus economies, national coordination may be of considerable importance in strengthening the union movement as a whole in relation to both employers and the state. This conclusion is reinforced for countries moving towards democratic government.

V. Convergence and alternatives

1. Limits to convergence

Significant areas of convergence in economic regimes are emerging from cutbacks in the public sector and state investment induced by fiscal crises, and from trade liberalization induced by debt crises. The changes are evident in the fall in overall labour utilization, the employment overhang in both private and, especially, public sectors, and the reversion of the employment structure from the normal pattern of development. Consequently, competitive pressures on formal enterprises and workers have risen. The drive towards flexibility has also altered formal sector employment relations through greater casualization and subcontracting. Along with the decline in the level, stability and wages of urban regular employment, there has therefore been a tendency for both working conditions and income levels between the formal and informal sectors to converge.

Perhaps, these convergent elements herald a new era of weak union movements, cheap labour, and untrammelled management prerogatives especially in the poorer countries. It is possible that the new labour regimes will induce a shift toward the employment end of the wage/employment tradeoff in the medium term. The growth of casualization and subcontracting, the shift to export production, and the reduction by attrition of the employment overhang all seem to point in that direction. Important factors working against this outcome include the backlog of obsolescent plants that will require modernization, the prospect of increased investment by transnational corporations in both manufacturing and services and, the likelihood that new skill demands from the formal sector will establish wage differentials and hierarchies anew.

Too much should not be read into these areas of regime convergence and the new tendencies and counter-tendencies that they may engender. There are two fundamental reasons for discounting the forces of convergence. First, policy convergence is not, as yet anyway, a *fait accompli*. Second, the diversity of income levels, economic resilience, and flexibility of less-developed economies preclude strong convergence in regimes or development outcomes.

The reform process itself remains stalled, incomplete or unstable in a number of countries. Liberalization has been crippled by both deep-seated economic rigidities and political constraints. Many countries are not yet out of the woods in terms of achieving external or internal macroeconomic stability. Whereas demand deflation has been universal, supply responses are subject to rigidities that may have been exacerbated by that deflation. Reductions in tariffs, tax rates, and administered prices unaccompanied by a recovery in growth have squeezed public investment that may be complementary to private investment. Not surprisingly, liberalization programs have been plagued by stagflation and destabilization in many cases.

Liberalization, whatever its long-term effect, imposes large burdens in the short-run. The uneven availability of external financing, domestic economic capacity, and political will have limited the extent and depth of reform efforts. The contrast in these respects between China and many other countries explains the speed and relative success of Chinese structural reforms. Progress in the de-regulation of industry, investment, and trade is usually threatened by political resistance arising from the fear of plant closures and retrenchment. The under-funding of existing end-of-service benefit provisions and of social safety nets has halted many a programme of divestment or privatization in its tracks. The ability to resist imposed conditionalities away from, for example, food subsidies, has varied from country to country and therefore limits convergent tendencies.

No doubt the force lent to neo-liberal policies by Fund-Bank financial support has been potent. This is particularly notable in the sphere of trade policy. But even in areas where policies have converged, this does not assure regime convergence. Economic structures will assert their influence if not through the policy regime, then, through the autonomous functioning of the economy itself. In low-wage countries, the impetus to exports based on cheap labour will be higher; in countries which have already achieved an intermediate level of wages, the same stimulus may just possibly permit the dynamic technological gap of late industrialization to be bridged.

It must be emphasized that the liberal ideal of markets free from "distortions" and "rigidities" is not even remotely realizable for a labour regime. For one thing, non-market institutions such as unions, collective bargaining, and segmentation by gender or educational credentials are persistent features of labour markets that cannot be ignored. Conflict, power, and compromise in the labour contract and industrial relations, of which these institutions are examples, may be repressed in particular forms but not entirely in substance. By the same token, moreover, diversity in labour regimes is to be expected. For another, it is virtually self-evident that a state policy of non-interventionism in the labour regime is a myth. Interventions may be discernibly restrictive as with minimum wage enactments or mandatory bargaining rules or they may be 'merely' facilitative, for example, as with union recognition laws. But in practice, the state's substantive impact on employer-employee relations can hardly be judged by the proximity of its moves to the labour market itself.

2. A critique of liberalization

However varied the actual outcome of liberalization may prove to be, it is necessary to examine its underlying assumptions. Free trade, public sector reforms, financial liberalization, and market coordination define the neo-liberal agenda for the establishment of a new and higher growth trajectory for less-developed countries. An 'unrestricted' labour market seems to fit naturally within this regime. What follows is a brief critical examination of the underlying assumptions. (1) *Comparative versus competitive advantage*: An open trade regime lies at the heart of the neo-liberal advocacy of a market-coordinated regime. The traditional theory of *comparative advantage* is supposed to rationalize this position. But this theory predicts neither radical improvements in productivity nor a shift to a higher growth path. With the neoclassical premises of a given technology and profit maximization, even a protected domestic monopoly would operate on its efficient production frontier; thus there is no room here either for gains in enterprise efficiency or for institutionalized technical innovation. Free trade following comparative advantage promises no more than the static efficiency gains that may result from getting prices 'right'.

If trade reforms work by altering resource allocation, in poor countries it is to be expected that enterprises would seek out those sectors which promise the greatest comparative advantage based on cheap labour. What is more, as existing capital invested in relatively capital-intensive industries seeks a way out, cheap labour will grow at the expense of well-paid labour. Resource pull and push factors both work in the same direction. A low-wage economy will have been created; but the theory provides no basis for supposing that a high-growth economy would have been secured in the bargain.

While trade liberalization in a low-wage economy may allow a nation a temporary advantage in winning entry into tight export markets, it is improbable that dynamic gains in productivity, especially in high-value added products, will be secured by this route. Such specialization may generate exports, even a large share of exports, but contribute little to relieve the syndrome of underdevelopment of which low wages are a part. Exports based on the cheap labour of women and children, such as in garment manufacture in Bangladesh or carpet-making in India, are hardly emblematic of economic success (Sanyal, 1993). On the contrary, cheap labour contributed little to the growth of the Republic of Korea's competitive efficiency in the production of such goods as steel, automobiles, and ships.

Competitiveness in global markets provides an ambiguous measure of industrial success. For the same reason, exposure to global competition provides only an equivocal *means* for inducing success, since it may be a spur to productivity growth in some industries and a deterrent in others. The build-up of organizational and technological capabilities is the basis of long-run *competitive advantage*. There is little reason to believe that the industries or enterprises that have the most learning potential will also be the ones that a liberalized trade regime will favour; that, in other words, competitive, and comparative advantage will coincide. (2) *The home market*: The growth of export competitiveness cannot be separated from the growth of the home market. This is so not only because the home market can support industries with significant scale economies during the learning phase but also because it is a critical factor governing the inducement to invest in the economy at large. In addition, the growth of home demand allows market diversification without which the risk of undertaking large-scale investment of capital and building up a Research and Development orientation would be needlessly high. For both microeconomic and macroeconomic reasons, the growth of mass demand is a powerful inducement to competitive advantage driven by mass production techniques.

Three implications are especially relevant. (i) In a static sense, an essentially "unregulated labour market" exerts a powerful downward pressure on wages and demand. (ii) Dynamically, the stagnation or slow growth of productivity outside the developing capitalist regime (i.e. the agricultural and informal spheres) weakens dynamic wage pressure and investment inducement. (iii) At the current conjuncture in most developing countries, the diagnosis of industrial failures is complicated by the fact that both macro and micro forces are involved. (3) *Public investment*: Investments in hard infrastructure such as power, transport, communications, and irrigation, and soft infrastructure such as education, research, and health are known to be strongly complementary to productive investments in plant, equipment, and land. In developing countries, these have traditionally been the preserve of the public sector to the extent that complementarity between public and private investment had been taken as the norm. For countries with poorly developed infrastructure and social sectors, the crowding-in effect is of overwhelming importance. Yet, neo-liberal theory has advocated cutbacks in public investment, in the first instance as a measure of austerity but in the final analysis as a way of getting the state out of direct involvement in production.

This urge is based on the twin assumptions that privatization in these areas is feasible (or at least far more feasible than assumed traditionally) and that market discipline would work better under private ownership than under public. In many circumstances, however, these assumptions do not hold. Under conditions of natural monopoly or pure public goods, exposure to 'market discipline' is neither feasible nor desirable. The same holds true in areas with substantial externalities in production or consumption whose regulation through fiscal means alone is difficult due to distributional or other constraints. Public regulations will necessarily be politicized because the benefits gained are large and distributive conflicts in the context of large inequalities and a high incidence of poverty will not be contained by the "market".

The demand for expanding and strengthening physical and social infrastructure cannot be adequately met by privatization and market discipline. Fiscal reforms need to be market-friendly without undermining the need for public resources to tackle these critical areas. Improved efficiency in the public sector requires de-bureaucratization and a positive programme of decentralization, grass-roots participation, and effective accountability. The regulatory apparatus in particular must be strengthened, not weakened, so that both efficiency and equity criteria can be pursued simultaneously. (4) *Financial reforms*: Deregulation of the financial system is closely linked to retrenchment in the public sector. Its main plank is to do away with statutory bank holdings of government securities and create a level playing field for private and public financing of investment. Deregulation is aimed at widening access to finance throughout the economy, increasing the competition for finance and promoting efficient intermediation and greater capital mobility. Wider access to finance is predicted to have a major impact on the capital intensity of development by permitting labour-intensive but capital-starved firms, that have hitherto been excluded from the formal financial system, to grow rapidly.

Several critical remarks are in order. First, these expectations are based on the assumption that unequal access to finance is a result of regulatory constraints alone. In fact, the segmentation and fragmentation of financial markets are largely the product of the technological and organizational differentiation of enterprises and sectors exacerbated by inequalities of wealth. Liberalization, under these circumstances, may well contribute to a further deepening of unequal access by pulling more resources into the formal financial and production sectors. As and when multi-national enterprises set up or expand their operations under the new dispensation, they are likely to displace local firms in the credit queue. Second, financial deregulation runs the risk of diverting resources to unproductive and speculative uses. Strict restraints on the allocation of funds, over and above those required for maintaining prudential norms, are required to hold this tendency in check. Third, credit allocation can be a powerful instrument of strategic economic coordination where markets fail; such failures are widespread in poor countries. Coupled with the fact that fiscal instruments may be either unfeasible or inefficient, there is no good reason why credit instruments should be shunned in pursuing both productive and distributive targets. While the power of credit allocation has undoubtedly been misused for purely political ends, reforms should aim at the proper design of allocative criteria rather than seek the mirage of a market-governed level playing field.

3. New directions

Uneven development is the basic constraint on the convergence of economic structures and labour regimes. Attempts to force convergence will not merely be frustrated but also prove counterproductive in promoting development among late industrializing countries. The new orthodoxy of development policy seeks to do just that through undifferentiated macroeconomic and structural reforms. But the most durable foundations of underdevelopment -- severely deficient infrastructure, low levels of education and health, agrarian backwardness, structural dualism, large inequalities in income and wealth, a persistent technological lag in industry, a weak home market -- are also precisely those that are least likely to be uprooted by the policy regime which is advocated. Reforms must therefore be tailored -- taking account of context and history -- to restore growth with rapid labour absorption and equity. We present some new directions for industrial and labour regime reforms in this concluding section.

Development is a local phenomenon and successful development depends on the institutionalization of continuous technical improvement within enterprises. In turn, this requires an enterprise strategy that is committed not to exploiting cheap labour but to developing cooperative forms of learning. Such a strategy entails industrial peace based on trust, not fear; bargaining that is bilateral, not one-sided; flexibility that is the result of treating workers as durable assets, not as dispensable consumables; and organization based on decentralized participation, not centralized controls. Such a strategy will inevitably promote humane working conditions, wage growth in tandem with productivity growth, and relative employment security.

What are the prospects for achieving this outcome? Optimistically, new organizations may emerge that can deliver 'flexible specialization' (Piore and Sabel, 1984). There are two lines along which such new organization might be forged: one based on the redesign of work within large enterprises; another based on the development of cooperative networks of small enterprises in 'industrial districts' (Holmstrom, 1993). The pessimistic prospect again has two possibilities: "one is Fordist or Taylorist mass production (boring, de-skilled, but well-paid for those lucky enough to find jobs)...[the other is] low-paid insecure work for as may people as possible, capitalizing on the single advantage of cheap labour". Holmstrom, M-83).

Our characterization of dualism showed that the pre-crisis regime in many late industrializing countries was an amalgam of the latter two of these scenarios. Whereas the search for alternative paradigms of work and industrial organization in industrialized countries is driven by the saturation of the growth potential of the Fordist model, in poor countries it is not the exhaustion of Fordist potentials but their frustration that seems to have held back growth.

Market liberalization does little to address this frustration. At best, it increases the scope for changing the mix between Fordist mass production on the one hand and, on the other, informal and small-scale modes thriving on cheap labour. Recent experience, we have suggested, may be moving towards the employment end of the wage/employment tradeoff that this mix embodies. This trend must be viewed as a 'premature' exhaustion of Fordism. It is driven by the search for flexibility and lower labour costs (through casualization and sub-contracting) to achieve comparative advantage.

But even this prospect must be viewed with caution for free trade applies to both goods and technologies. Aggressive acquisition of technologies by Fordist enterprises under pressure to secure exports may itself be labour-displacing and widen wage gaps between them and the informal or sweatshop sectors. This counter-tendency will be aided by the growing export of capital and the vertical parcelling out of production processes between the advanced and developing countries.[37] Thus, the Fordist sector in developing countries sits at the confluence of two opposing tendencies both of which will be aided by liberalization: if the one is driven 'from above' by the successful exhaustion of mature Fordism, the other is driven 'from below' by the premature exhaustion of frustrated Fordism. The static calculus of comparative advantage that underlies both provides no warrant for supposing that a new dynamic of technological self-propulsion will be established in the South.

What then of the optimistic prospect? Do late industrializers have the advantage of skipping in one bound the centralized and rigid technologies of Fordism and moving over to a decentralized, flexible, perhaps even a labour-intensive model? The only thing certain is that neither of the possibilities mentioned above -- developing capacities of cooperative and cumulative learning in large enterprises and creating small-firm networks of flexible specialization -- is foreclosed. Beyond this, the actual potential of these options remains largely to be explored. Large enterprises must restructure. The post-crisis situation does present opportunities to learn from the successful models of late industrialization, Japan, the Republic of Korea, and Taiwan (China) among them. Unfortunately, the rhetoric of liberalization limits restructuring to the demand for a submissive, easily dispensable work force without the protection of legislation, collective action and subject to the arbitrary rule of management prerogatives. It does not consider the fact that cumulative productivity growth and a cooperative and contented work force are not mutually antithetical. Restructuring may also provide an opening for firms run by workers' cooperatives or other forms of self-management.

Drawing on past experience, the prospect for flexible specialization in developing countries in the small firm sector is dim. That experience suggests that small firms combine the worst aspects of 'flexibility' with technological backwardness. Yet, some grounds for optimism remain. Holmstrom (1993) has constructed a preliminary balance-sheet for the Indian case summarized below:

On the negative side, civil society remains weak, the political process and business-government relations devoid of trust, and local political institutions (needed to provide both infrastructure and market regulation within the network) poorly developed. The solidarity of small firms and craftsmen, based on kinship and ethnic ties, is exclusivist, limiting the scope for wider growth. Unions are barely beginning to have a presence in small firms and there is a vast reserve of both skilled and unskilled labour so that labour is vulnerable to exploitation.

On the positive side, India has strong craft traditions and some crafts people "show astonishing capacity for innovation with limited resources." (p. M-84). These crafts may have a potential for modernization along the lines of the 'third Italy'. There is also a numerically large complement of workers with diverse engineering and other modern industrial skills learnt formally or at work in public and private firms. There are concentrated pockets of small firms dependent on each other and on large firms; many are led by engineers or experienced workers from large firms who have been able to adapt well to modern machinery; some have even banded together in production associations or consortia. These appear to have the potential of the Marshallian industrial district. The state already provides significant institutional support in training and technical services.

[37] This manifests itself as assembly plant investments in the production of machines, electronic equipment, photographic equipment, ready-made clothing and finishing processes. It is also observable as putting-out networks of small firms particularly in such labour-intensive consumer goods as textiles, clothing, toys and some electric appliances (de Estrada and Reddock, 1987).

Holmstrom draws the cautious conclusion from these observations that a state policy of assistance and coordination carefully targeted to the innovative and advanced small firm concentrations will provide some scope for flexible specialization.

Flexible specialization in either of the above two variants may prove a viable alternative to both the Fordist and cheap labour models. It requires a mechanism of coordination that effectively combines both market and state. The alternative to free trade is selective interventions, not autarchy. Technology imports will remain important under all of the above scenarios. The need for achieving export competitiveness is also self-evident. For both, decentralized coordination afforded by the market mechanism is valuable. But, there are weighty riders attached to these propositions. First, the one-way flow of purchased technology must be self-liquidating. Second, exports must be based on competitive, not comparative, advantage. The third qualification, the need for an industrial policy, derives from the case already made that free trade cannot be expected to meet the first two riders.

Allocating resources within the industrial sector requires selectivity to ensure success in achieving competitive advantage across a narrower spectrum -- in two words, industrial policy. This can only be achieved by interventions in the market place that recognize, promote, and reward flexible specialization. Selectivity has to build on existing and prospective areas of strength and will require a variety of instruments including appropriate fiscal policy, preferential credit allocation, long-term programmes for R&D in both public and private spheres, and the selective import of foreign technology. Institutions and programmes that develop cooperative networks among firms, unions, educational institutions, and local governments will need to be supported. In short, *laissez faire* and *dirigisme* are not the only regime options; the drawbacks of both can only be transcended through state-market symbiosis.

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