



# Labor Standards and Informal Employment in Latin America

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**Summary.** — This paper addresses the hypothesis that higher labor standards—in particular freedom of association and collective bargaining rights—and higher wages in the formal sector reduce employment in that sector and thereby contribute to the informalization of employment. This issue is explored using panel data on specific categories of formal and informal employment for 14 Latin American countries in the 1990s, evaluating both crosscountry and time-series variation. Our most robust finding is that countries with higher labor standards tend to have higher shares of formal employment and lower shares of informal employment.

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*Key words* — informal sector, labor standards, Latin America, panel data

## 1. INTRODUCTION

Latin America has experienced in recent decades a steady and substantial increase in the share of workers characterized by informal employment status. During 1990–97, for instance, the share of informal employment for a group of 14 Latin American countries increased from 51.8% to 57.7%, based on a definition of informal employment used by the International Labour Organization including nonagricultural employment in small firms, self-employment and domestic service (PREALC, 1998). One reason for concern regarding the growing share of informal employment in Latin America is that such employment is often characterized by poor work conditions, including low labor standards.

A number of explanations have been offered to account for the rise in informal employment. Portes and coauthors provide a dynamic view of the growth of informal employment in the context of import substitution and export-oriented development strategies (Portes, 1989, 1994; Portes & Schauffler, 1993). They argue that the policies of import substitution indus-

trialization adopted in the 1950–70s led to the concentration of industry in just one or two cities in each country in Latin America. Together with a lack of prospects in rural areas, the urban concentration of industrialization led to a massive rural to urban migration, with the share of the population living in urban areas increasing from less than half to three-quarters over 1950–90. Though a large number of industrial jobs were created in cities, these were insufficient to provide formal employment for all migrants. It was this labor surplus that contributed to the rise of informal employment. In the 1980s, the debt-induced crises led countries in the region to implement export promotion strategies. The decline in formal employment that followed was partly absorbed by informal employment as large formal firms decentralized production through subcontracting to small firms, but also resulted in a steep

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rise in open unemployment, as “masses of citydwellers found themselves lacking access to even the meager earnings once drawn from odd-jobbing, street vending, and other informal activities” (Portes, 1989, p. 25).<sup>1</sup>

Other studies similarly describe the linkages between export-oriented and multinational firms and informal employment through, for instance, subcontracting arrangements and export-processing zones, and thus the linkages more generally between globalization and informality (Carr & Chen, 2001; de Oliveira & Roberts, 1994; Maloney, 1997). Among the other factors argued to contribute to growing informal employment are the decline in public sector employment, the increase in the female supply of labor, and the growth of the service sector, in which a large share of informal workers are employed (Carr & Chen, 2001; de Oliveira & Roberts, 1994; Saavedra & Chong, 1999, respectively).

Another explanation argued to account for the growing share of informal employment is that higher labor standards in the formal sector may lead to a higher share of informal employment. This view has been put forth in a number of studies. For instance, a World Bank report argues that the extent of informal employment in Latin America is partly determined by “labor policies that overlooked the role of wages and working conditions as incentives and market signals, reducing the number of formal jobs and encouraging the development of the informal sector” (World Bank, 1995, p. 6). This view, however, is not backed by a theoretical consensus or by systematic empirical evidence.

First of all, in addressing these issues, it is useful to distinguish among different labor standards that may well have different effects on formal and informal employment. Valuable in this regard are categories of labor standards proposed by Portes as regards “basic rights,” “survival rights,” “security rights” and “civic rights,” elaborated in Table 1 (Portes, 1994). Portes’ view is that while stronger “security rights” may result in increased informalization, stronger “civic rights” by themselves do not have this effect, even if stronger “civic rights” result in higher wages. Summarizing his view in reference to prior studies, Portes writes as follows:

Studies in several Latin American countries indicate that the drive to informalize by modern firms is motivated primarily by the desire to avoid adding to a reg-

Table 1. *Types of labor standards*

Type	Examples
Basic rights	Right against use of child labor Right against involuntary servitude Right against physical coercion
Survival rights	Right to a living wage Right to accident compensation Right to a limited work week
Security rights	Right against arbitrary dismissal Right to retirement compensation Right to survivors’ compensation
Civic rights	Right to free association Right to collective representation Right to free expression of grievances

Source: Portes (1994).

ular plant of workers that, once hired, can seldom be let go. Hence, apart from basic and civic rights that may become amenable to internationally enforced standards, the implementation of others also requires fine tuning, lest they act as a brake on economic development or on the extension of minimal protection to greater numbers. . . The Latin American studies cited previously indicate that it is not high wages per se, but rather high wages to an immobile labor force regardless of business conditions, that constitute the main incentive for widespread informalization (1994, p. 125).<sup>2</sup>

Our primary interest is with “civic rights,” particularly regarding freedom of association and collective bargaining rights and civil liberties more generally. In contrast with Portes, Singh and Zammit (2000) argue that stronger freedom of association and collective bargaining (FACB) rights may hinder economic development and lead to increased informalization. They write:

[I]f in accordance with the advanced countries’ proposals, the two labour conventions under discussion [ILO Conventions 87 (“Freedom of Association and Protection of the Right to Organize”) and 98 (“Right to Organize and Collective Bargaining”)] are imposed in a “big bang” manner in a developing economy (through, for example, international trade sanctions), it is more than likely that this would lead not to conflict resolution, but rather to strikes and consequent economic disruption. . . The consequent economic and social disruption discourages investment, both foreign and domestic, and therefore does not help the cause of economic development. . . Further, to the extent that formal sector unions succeed in getting higher wages and employment guarantees for their members, this is likely to reduce, other things being equal, the demand for labour in that sector, forcing

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