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**SEPTEMBER/OCTOBER 2006****Trading Up**

An embryonic model for easing the human costs of free market *Michael J. Piore and Andrew Schrank*

Latin American economic and social policy is at a turning point: the emblem of that turn is the growing list of successful presidential candidates who have run against neo-liberalism—Hugo Chávez in Venezuela, Luiz Inácio Lula da Silva in Brazil, Tabaré Vázquez in Uruguay, Néstor Carlos Kirchner in Argentina, Michelle Bachelet in Chile, and Evo Morales in Bolivia—and the near misses of populist candidates in Peru and Mexico. In many of these countries, presidential campaigns have turned into social movements that have continued after the elections, with peasant marches in Ecuador and Bolivia, enormous rallies in urban Mexico, factory takeovers in Argentina, and mobilization in the slums of Venezuela, revved up by weekly presidential addresses. The battle cry that unites these movements is a call to end the so-called Washington Consensus, with its commitment to markets as the arbiters of economic activity. The new regimes are riding a wave of discontent directed against the market, but are they simply reverting to the past practices against which the Washington Consensus was a reaction? Or are they creating something new that might temper or replace market mechanisms? And if they are innovating, what are the new institutions and how are they likely to evolve?

It is hard not to be reminded here of Karl Polanyi's *The Great Transformation*. Polanyi described the economic policies of industrial society as the product of a "double movement." The first movement is toward a free market, particularly in labor and land, and also in international trade. But free markets generate enormous pressures for the continual redeployment of resources, especially human resources. So Polanyi's second movement is a response, an attempt to protect society from these pressures. While the movement toward the market is guided and directed by a coherent theory and the ideology of political and economic liberalism (the Washington Consensus is but its most recent expression), the second movement is visceral, an instinctive effort to rescue society from the ravages of unfettered economic competition and the constant redeployment of resources that destroys the context in which people understand themselves and create meaning and purpose in their lives.

Our age is distinctive in offering no alternative vision of institutions or terms that might ease tensions between economic and social needs. In the past, there have been a number of visions, perhaps too many. Polanyi himself saw the makings of alternatives in Robert Owen's factory organization in the early 19th century and in the International Labour Organization in the early 20th. Another, much more articulated vision was, of course, Marxism. When Polanyi was writing, in the 1930s, fascism also constituted an influential alternative. By the time his book was actually published, in 1944, Keynesian economics had captured the public imagination and seemed not only to complete his argument but to provide a framework for the reconciliation of social and economic forces that avoided the twin pitfalls of Marxism and fascism. But each of these philosophies has since been discredited.

In this unprecedented intellectual vacuum, one way to begin creating a coherent alternative would be to try to construct such a vision inductively, working from the changes that are actually happening on the ground. In studying what people are already doing locally in response to the conflict between market and social forces and identifying the particular institutions that are emerging in that process, we might find a way of working those institutions into the broader structure of the economy, using them as the starting point for an alternative model of social and economic organization. A number of domains lend themselves to this kind of inquiry, but Polanyi devoted a good deal of his attention to the construction and regulation of the labor market and to the birth of factory inspection in particular, and we therefore follow his lead.

inquiry, but Polanyi devoted a good deal of his attention to the construction and regulation of the labor market and to the birth of factory inspection in particular, and we therefore follow his lead.

The operation of the labor market affects workers concretely and immediately, and hence is a flashpoint for clashes between social forces and economic exigencies. While many of the policies promoted by the Washington Consensus are only now beginning to encounter determined resistance, Polanyi's second movement has been underway for some time in the labor market—and labor-law reform therefore constitutes something of a Waterloo for the forces of neo-liberalism. In fact, the labor-law reforms anticipated by proponents of the Washington Consensus have not only been “limited to a few countries,” according to Eduardo Lora and Ugo Panizza of the Inter-American Development Bank, but have arguably been more likely to expand than to curtail the scope of worker protection. For example, Brazil, Chile, Costa Rica, and the Dominican Republic have rededicated themselves to labor-law enforcement in recent years. And potentially more fundamental reforms are underway from Argentina, where they are motivated by domestic party politics, to Central America, where they are a product of transnational pressures emanating from the campaign for a U.S.–Central America Free Trade Agreement.

The results are neither trivial nor cosmetic. In the 1990s the Chileans hired new inspectors and thereby doubled the size of their enforcement division. And the Dominicans not only tripled the size of their own enforcement division but simultaneously adopted new hiring criteria—including legal credentials and competitive examinations—as well as wage and employment guarantees. By the early 21st century, therefore, one of the Dominican Republic's least reputable regulatory agencies had been transformed into a model of administrative reform, and the island nation's inspectors were fanning out across the region to impart their lessons to their neighbors.

By examining the process of labor inspection in greater detail we can begin to talk in a specific way about how these reforms might be reconciled with economic efficiency, what kinds of compromises it is reasonable to promote, and, most importantly, what larger project might emerge. For the past four years, therefore, we have been studying Latin American labor inspectors at a close level. We have observed and interviewed dozens of inspectors, as well as their private-sector interlocutors, in Costa Rica, the Dominican Republic, Guatemala, and Mexico; participated in conferences with inspectors from Brazil and the Southern Cone; and studied the history and practice of labor inspection in France and Spain, where Latin American labor ministries find their primary intellectual inspiration. We actually do see an emergent model for reconciling market and social forces, particularly in Mexico and Central America, where the adjustment to an open trading regime has been particularly brutal. We see hope in the street-level practices of labor inspectors in the so-called CAFTA countries of Central America and the Dominican Republic. We will argue, in fact, that the Latin approach to labor-market regulation is not only distinct from the prevailing U.S. approach but is also better able to reconcile the need for regulation with the exigencies of economic efficiency. Indeed, it offers the possibility for a country to shift from a strategy of competing in world markets through cost-cutting and labor exploitation to a strategy of upgrading business practices to raise productivity, reduce inventory levels, and improve quality.

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Labor-inspection systems in Central and South America are basically variants of the Spanish model, which originated in France. The Spanish model is a general, or unified, system: virtually the whole of the labor code is administered by a single agency, the Inspección de Trabajo. The inspectors also enforce various provisions of private collective-bargaining contracts. In the United States, in contrast, each regulation, or type of regulation, falls under the jurisdiction of a separate administrative body (the Department of Labor's Wages and Hours Division enforces minimum wage and overtime regulations, OSHA takes care of occupational

health and safety, ERISA covers pension regulations, and so on). And there is a separate and totally private system for the enforcement of collective-bargaining agreements.

General work-inspection agencies also operate in the Spanish model as “street-level bureaucracies”—the line officers have considerable discretion and decision-making power and are very difficult to control and direct from above. Policemen on the beat, classroom teachers, and social-welfare case workers are typical street-level bureaucrats. In the United States street-level bureaucracies typically arise inadvertently in regulatory agencies, when the agency is underfunded relative to its mission and the regulations it administers are too complex or too extensive to be applied literally. But in the case of Latin American labor inspection, the discretion is present by design; it gives the inspectors the capacity to adapt the system to the exigencies of particular enterprises. It also allows the inspector to judge the burden the regulations impose on the enterprise, and where this is excessive, or threatens the enterprise’s very solvency, to balance particular regulations against each other and against the broader role of the enterprise in providing employment and goods and services. In the United States, where each regulation is essentially considered in isolation, there is no place in the system where the total burden is weighed.

The second characteristic that distinguishes Latin American labor-market regulation from the North American system is the fact that it is a compliance system. The United States takes the sanctioning approach: violations are punished, usually by paying a penalty, and the employer’s obligation can generally be discharged in this way. In the Latin American system, the enterprise is expected to come into compliance: its obligations cannot be discharged by paying a penalty. Compliance is a process, and the inspector is empowered to work out a plan that brings the enterprise into compliance gradually over time. Penalties are viewed as an instrument designed to force compliance. But they are only one instrument, typically invoked when the violations are willful, repeated, and deliberate. When they are inadvertent, growing out of ignorance or lack of technical background, or, as is very often the case in Latin America, the attempt to remain competitive in an increasingly inhospitable environment, the inspector operates more as an advisor or consultant than as a policeman.

The “minimalist” version of the Latin model of labor inspection, and the one in the minds of the critics, uses the inspector’s discretion simply to protect the worker and maintain social peace, but often at the expense of economic efficiency. For example, in Guatemala we accompanied a pair of inspectors responding to a complaint in one of the countless Korean-owned garment factories that ring the capital and, to some observers at least, constitute the visible manifestation of the metaphorical “race to the bottom.” According to the complaint, the owners had denied a skilled machine operator his legally mandated vacation time. The inspectors visited the factory and took testimony from both sides. The Guatemalan worker described the situation; the Korean owner pleaded ignorance of the law; and the Guatemalan plant manager admitted that the worker in question had been denied his request for time off because he was at least 50 percent more productive than the next available candidate for the job. While the inspectors were able to guarantee the worker his vacation, they did nothing to help the manager solve his impending productivity shortfall. Asked what he would do when the worker—who was quite literally on the way out the door—was on vacation, the manager looked despondent, shrugged, and said, “Slow down.”

In the cutthroat international garment trade, the cost of a slowdown could be enormous, not only for owners and managers but for workers as well.

Elsewhere in Latin America, though, inspectors have recognized the potential tension between social protection and economic welfare and are using their discretion to address this problem in embryonic but by no means unimportant ways. A number of the inspectors we interviewed in the Dominican Republic, for example, not only inform owners and managers of their legal obligations but also disseminate information on the most efficient ways to comply with those obligations, and thereby build bridges between individual

employers and publicly subsidized human-resource development programs designed to resolve the very dilemmas that emerged in the Guatemalan case.

Inspectors are in a good position to play this role because they visit a wide variety of enterprises and perhaps better than anyone else can compare business behavior and disseminate best practices that reduce conflict between standards and efficiency. But unified labor inspection agencies do not rely on the experience of the inspectors alone to develop compliance plans. They usually also have specialists who play a staff function, providing expert advice when called upon by the line officers. Typically, these specialists include not only labor lawyers but doctors, engineers, and industrial hygienists who are intimately familiar with the production process and therefore particularly adept at reconciling the needs of workers with the demands of the market. An initiative financed by the U.S. Department of Labor called the Regional Center for Occupational Safety and Health (Centro Regional de Seguridad y Salud Ocupacional, or CERSSO), has endeavored to exploit these advantages by training more than 600 inspectors and technicians in eight different Central American and Caribbean labor ministries over the course of the past few years, and a growing body of evidence suggests that their efforts have paid off. A recent study of garment factories in El Salvador, Guatemala, and Nicaragua, for example, found that returns on safety and health investments engendered by the program ranged from four to eight times the costs of the initial interventions.

Even modest improvements such as better lighting or noise reduction can have a positive impact on output, absenteeism, and turnover. More substantial interventions can yield even greater payoffs. And even costly reforms can be rendered palatable if adopted throughout a given sector or labor market—thereby taking worker protection out of competition. But price signals alone will not lead employers to protect their workers. Nor will altruism. In the absence of meaningful government intervention, ignorance, self-interest, and short-term thinking will rule the day. And professional labor inspectors are therefore needed not only to block the low road but to pave the high road as well.

The flexibility of the Latin model in particular contradicts the image of labor-market regulations as bad for business. A telling example comes from our interviews with inspectors in France, where the Latin model originated but where it is currently under attack for its alleged rigidity. One inspector discussed his approach to the limitations on the use of temporary help and gave as an example the case of a large firm that he knew to rely excessively on temporary employees. He also knew, however, that it had an informal agreement with its unions to periodically move a certain number of temporary workers onto its permanent payroll, and in light of this agreement he simply ignored the temporary-help violations. His reasoning, he explained, was that the goal of the temporary-help restrictions was to expand permanent employment, and he thought he would be unable to obtain more permanent jobs by enforcing the existing regulation than by tolerating the admittedly illegal informal arrangement with the union. The law, he pointed out, is a means, not an end in itself.

Other interviews in France and Spain suggest that this kind of discretion gives the system considerable flexibility over the business cycle. In applying the rules governing economic layoffs, for example, the inspectors weigh the immediate cost to workers of unemployment against the burden their continued employment poses to the viability of the enterprise, and thus jobs, over the long run. In this sense, it has some of the flexibility of the market but does not simply mimic a market system. Both of these costs rise in a downturn, and the balance might favor easing restrictions, as it would in a market system, or it might favor tightening them.

In Latin America, of course, the chief problem is not cyclical unemployment but adjustment to the global economy and the pressures of the international marketplace. The problem is more often ignorance than lack of flexibility. The Washington Consensus emphasized putting the firm under competitive pressure, internally through deregulation and globally by opening the economy to trade and investment. The economic theory

upon which the consensus rested had very little to say, however, about the adjustment process, and the policy implicitly assumed that firms would know or learn how to respond to these pressures on their own. In reality, however, many firms were completely overwhelmed by competitive pressures. Unable to survive in the international marketplace by adjusting production and marketing techniques, they responded almost inadvertently in a blind attempt to lower costs, and this led to health and safety violations, longer hours, and the use of unqualified labor.

This is very noticeable in small family firms, where the shop is often in the household or in outbuildings directly connected to the household and work and family roles are narrowly intertwined. Because the shop is in the household, the workspace is typically full of young children who are watched over by women also engaged in income-generating activities. But as the shop struggles to survive, the women work harder and harder, providing less supervision for the children, and the children themselves are often drawn prematurely into production. The result is both child neglect and child labor.

In larger industrial enterprises, particularly those operating directly as subcontractors for international clients, adjustment was aided by professional consultants or engineers sent from the client abroad to upgrade quality and ensure compliance with delivery schedules. But there, too, labor standards have frequently deteriorated. Recent studies of efforts by large transnational companies to monitor labor standards among their subcontractors suggest that their own business practices are heavily implicated in the deterioration of working conditions that has taken place, especially those associated with the pace of work and with working time. The transnationals wait until the last moment to place their orders, in order to keep up with the latest turn in fashion, or work from last-minute data on consumer buying, which they track daily in their stores. They then demand rapid delivery of orders that often exceed the subcontractor's capacity and can only be met by pressuring the labor force to work at an excessive pace and for inordinately long hours.

It is precisely in these areas of structural adjustment that the compliance model of labor inspection should be most effective. It gives the inspectors the power to help firms identify the business practices that are the underlying causes of their problems, and then the latitude to allow them time and space to correct them. What is needed is the expertise required to make these corrections. We have argued that part of this expertise already resides in the inspectors themselves, who see a larger range of business practices as they move from work site to work site than perhaps any other actor in the economy. They are thus already in a position to recognize best practices and spread them to non-compliant enterprises. The ability to use what is now essentially a kind of tacit knowledge, acquired inadvertently and informally, could be increased through specialized training and augmented by a growing body of research on the relationship between standards and business practices of the kind just cited. The underlying Latin model allows for additional expert support in the staff functions to which the line inspectors turn for advice and specialized assistance. And one sees traces of this model in almost all of the labor inspection organizations in Latin America.

The range of policy instruments available to the labor inspectors in promoting compliance could be broadened still further by enabling them to draw on the full gamut of programs for economic adjustment that are now housed in other parts of the government: labor-force training and education programs, financial assistance and tax credits, and industrial extension services.

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This last step crosses the threshold from a conception of labor inspection narrowly focused upon work standards to a notion of labor inspection as a much broader approach to social and economic policy. The agency then becomes a bridge between economic and social forces, at least one piece of an alternative to the Washington Consensus, or rather to the vacuum in which the reaction to the Washington Consensus is emerging.

There are actually signs of movement in precisely this direction. In Guatemala, the national labor inspectorate has established a special maquila division, which is taking an active approach to labor standards and labor relations more broadly. To facilitate a collective-bargaining agreement, for instance, inspectors have actually designed in-plant experiments on the effect of shortening the work week and lengthening the work day on labor productivity and worker satisfaction. In the Dominican Republic, as we have noted, inspectors have begun to use government training programs to facilitate compliance planning. For example, training was recently used as a key instrument in an agreement with a large Italian firm to create a cadre of skilled nationals as substitutes for illegally hired Chinese immigrants. And in Mexico, the Ministry of Labor is working with the ILO at the Volkswagen plant in Puebla to train labor inspectors to upgrade both production practices and labor standards in the company's Mexican suppliers.

These examples, it is to be emphasized, are of interest not because of their quantitative significance. Indeed, their number is actually quite limited. But they point to the ways in which the Latin model of labor inspection might constitute the vehicle for a much broader approach to economic development—one that brings firms up to the standards imposed by their regulatory obligations rather than bringing regulatory obligations down to the productivity levels characteristic of firms.

Moreover, they are particularly noteworthy examples because the inspectors offered technical assistance to sophisticated transnational companies that presumably had access to the best international consultants. The fact that they have emerged even in countries with a relatively weak government apparatus, like Mexico and Guatemala, suggests that this approach is consistent with, even in some sense inherent in, the logic of the system. But before it could play this role more generally, most Latin American countries will have to combat a legacy of studied neglect in which these governmental functions have been starved for resources and qualified and well-trained personnel. Low salaries and insecure tenures constitute threats to the integrity of inspectors throughout the region, and operational resources are at best scarce. In Mexico and in most countries of Central America, for example, inspectors have neither transportation nor computer facilities of their own. They take public transportation when making inspections and write up their reports on manual typewriters. And Mexico, in particular, suffers from the draconian and arbitrary way in which the government has sought to control expenditures: the number of posts has been reduced through a system of special incentives for early retirement, but the remaining staff has been redeployed neither functionally nor geographically. The results are that federal offices, like that in Yucatán, have staff positions (doctors in occupational medicine and safety engineers) that are filled with experts, but most of the inspectors whom they are supposed to advise are gone.

Nonetheless the effort to revitalize labor inspection has been underway in a number of Latin American countries for some time, and there is a collective fund of experience with innovative ways to upgrade personnel and to provide the missing infrastructure. In the Dominican Republic, the constraints imposed by salary structure have been circumvented by linking the careers of young inspectors informally to more lucrative positions in the private sector. In Guatemala, the labor ministry obtains educated inspectors at low cost by hiring the equivalent of law students who have yet to be admitted to the bar. And in Costa Rica, an agreement with the social-security inspectors who collect revenue, and therefore have claim to greater physical infrastructure, provides labor inspectors with transportation that their own budget does not cover. The question is, can these still dispersed efforts to revive labor-market regulation and the isolated forays into upgrading production and management be consolidated into a program that the political class can offer as an alternative to the Washington Consensus? Will it convince an electorate exasperated by the impact of 20 years of neo-liberalism that it offers real change?

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To realize this potential would require a concerted and organized effort beyond national boundaries to articulate the broader implications of existing practice and to disseminate both the practices and the underlying model of regulation. What is called for is leadership that can play a role in developing and disseminating the new model analogous to the role played by the World Bank and the IMF in the diffusion of the Washington Consensus. The obvious agency to play this role is the International Labour Organization.

The ILO is the oldest of the UN agencies. It was founded by the League of Nations—according to Polanyi “partly in order to equalize conditions of competition amongst the nations so that trade might be liberated without danger to standards of living.” It is thus older than the UN itself. It is also unique among international organizations in having a tripartite structure in which each country is represented not only by its government but also by delegations composed of employers and unions. Over the years, it has promulgated a series of workplace norms and regulatory standards, and is historically the repository of expertise in how labor regulations are administered. The long list of legal norms is in many ways a caricature of the kind of government regulation that the Washington Consensus fought with its campaign against “labor-market rigidities,” and the debates among lawyers at meetings in Geneva often seem to validate this view. But as we have seen, the administration in the field is much more complex and subtle. And even casual contact with inspectors in the field in Latin America reveals that the ILO retains the respect and allegiance of the officials on the ground and the political appointees who supervise them, who look to the organization for advice and leadership and closely follow the pronouncements and publications that come out of its headquarters in Geneva. If it took up the challenge we are suggesting, it would have an audience.

To move in this direction, however, the ILO would have to reinforce, reemphasize, and integrate several activities in which it is actually engaged. One division of the ILO, now quite small but once considerably larger, is dedicated to labor inspection itself and offers advice on administration and comparative experiences. There are also a series of programs spread widely throughout the organization that are focused on particular business practices and their impact on employment, labor standards, and competitiveness. In this sense, the project in Mexico upgrading VW contractors is emblematic of a much larger class of activities. The ILO has been particularly active in studying the development potential of small and medium-sized enterprises. These activities have developed largely independently of the unit concerned with labor inspection, but they certainly could be integrated in a way that created the base for a systematic effort to link labor inspection and economic development.

But the ILO has not moved in this direction. Instead, it has responded to its neo-liberal critics by retreating from its historical role. It has not repudiated the accumulated body of labor standards. But it has attempted to shift the focus of the debate toward a set of “core” labor standards, most notably against child labor and forced labor, upon which it appears possible to achieve a consensus that encompasses even its critics. It has also promoted the notion of “decent work,” a much more ambiguous concept but one that holds the promise of rising above the bare minimum suggested by the “core.” In the process, it has moved resources and personnel within the organization away from labor inspection and tried to reshape its external image around these new concerns.

It is almost impossible to argue with these concepts; indeed, that is the point of focusing on them. And it has in fact proved possible to find shocking examples of child labor and forced labor even in advanced developed economies, notably the United States. But these are hardly the central issues in labor-market regulation, the ones that touch the daily lives of the bulk of the labor force in an industrial society, and certainly not the ones that have triggered the political reaction in Latin America. Ironically, to play a role in the newly emergent global economy, the ILO must reclaim its core mission. Of course, nothing in all of this ensures that we can escape Polanyi’s classic dilemma; perhaps in the end we will have to choose between the social and economic. But even here, we would have to develop a new social consensus; and the tripartite structure of the ILO would

appear to be a better forum for doing so than the boards of bankers and businessmen governing the World Bank and the IMF. ■

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