Labor standards and the High Road

Although Hirschman (1958) is best known for his stance on unbalanced growth, a concept that jumped at me was his idea that income distribution is an important factor in determining the success of linkages, and his contrast of the relatively egalitarian consumer base of the US at the incipient stages of manufacturing, with Latin America's high inequality. Income distribution is important particularly to strengthen the consumption linkage, that is, the stimulus to produce certain goods domestically, once new incomes are spent on those goods (Hirschman, 1958). An important implication is that while backward and forward linkages tend to be pro-industry, consumption linkages show that as agriculture develops, expanding agricultural incomes can generate growth.

Haggblade (2007) points to a number of surprising findings about the rural non-farm economy (RNFE), dispelling traditional ideas of a backward and poor rural sector. Thus, he shows that the RNFE is not small and unimportant; that working with large firms is better to encourage growth opportunities through linkages, and that poverty-oriented agencies should focus on agriculture. Eicher (2004) shows how agriculture has taken a back seat to the more fashionable social sectors in aid efforts in Africa. An example of international institutions' attitudes to this type of lending is the controversy faced by the Inter-American Development Bank (IDB) in 1961, when it approved its first global loan for agriculture in Bolivia. As this was a "soft" loan, the US had veto power over it; it only passed because of then-president Felipe Herrera's friendly relations with the Kennedy administration. The World Bank had to wait until 1963, during George Woods' presidency, to accept agriculture as a "bankable" sector.

Another theme that appears in several of the readings is that of high quality jobs and specifically under what circumstances firms are likely to create them. What I took away from the readings was this emphasis on quality within the wider framework of upgrading, a theme that is present throughout the debate on informality, firm size, and forms of collective action among firms. That small firms are not only politically influential, but also a smaller source of jobs than we tend to think was a surprising fact from the Brown, Hamilton and Medoff (1990) piece. They point out that while most new jobs are generated by firms that just happen to be small, many of the jobs are short-lived; when we take into account the high chance of failing that these firms have, they do not grow faster than large firms. Looking at developing countries, Mead and Liedholm (1998) make a similar point about employment quality in their analysis of distinctions between small firms in high and low return activities, and their respective determinants of births, survival, closures and expansions. Specifically, they point out that during economic upswings jobs come from expanding enterprises, but during downturns job creation in existing firms stagnates, and most new jobs come from startups. Yet, expansion jobs are better in terms of quality and indicate that a firm has greater chances of survival.

With such important variations among small firms, size becomes less helpful as a category, and the public's infatuation (which is not only an American phenomenon) with supporting 'mom and pop' firms seems to be more and more misguided. Size, on its own, tells us nothing about the growth potential of a firm. Mead and Liedholm point out that if a small firm is going to grow at all, it will have shown its potential to do so by the end of the second year after its creation. Likewise, the Andrews (2004) piece warns that focusing on size obscures important differences among small: some will be ‘gazelles’ and grow, but some will not. This has important implications for lending and contracting, as they point to the inefficiency of financial instruments that classify firms by size only.

Some practices involving contracts at the Inter-American Development Bank (IDB) are a case in point; while formal requirements are concerned with demonstrating solvency, development effectiveness and adherence to social and environmental standards only, informally, selection is tilted towards smaller companies. What is more, during applications, financial statement reviews are more lenient with smaller firms, and there are few distinctions by indicators of quality and growth potential. Pressures on bank staff to move money ahead have contributed to these cursory examinations. An example is a case that took place last year, when bank staff awarded an adaptation infrastructure contract to a small Panamanian engineering firm whose capabilities had not been properly determined. The firm did not deliver, instead outsourcing part of the service with negative implications for the viability of the overall project. My point is not that ‘size matters’, but that privileging considerations about firm size over actual performance records is misleading and inefficient.

Another interesting aspect of this particular project is that it did not come not from the private sector-oriented departments of the Bank; indeed, the latter are more likely to have dismissive attitudes towards smaller firms, confirming Tendler’s (2002) point that development organizations view assistance to small firms as a “welfare” measure. Classifying firms in terms of 'growth potential' would be more helpful, and there are a number of studies that are already identifying the characteristics of such firms[1].

Tendler's "devil's deal" concept is an interesting point about the politics of small firms; while classifying firms in terms of size is an appealing way of getting around heterogeneity for associations to serve a majority of members, it reinforces burden reducing approaches that have negative implications for development. Thus, the devil's deal between small firms and local politicians trades votes for promises of no tax collection, thereby encouraging firms to remain informal and create low quality jobs rather than upgrading. This reminded me of an example, an association of small preserved fruit firms in Mendoza, Argentina. Despite ongoing labor standard violations (safety, wages, pension contributions and hiring of illegal immigrants) over the past twenty years they have had tax breaks and support from local municipal and provincial leaders of the Peronist party (ironically, a party based on labor's rights). Since they are located in Lavalle, a poor semi-rural municipality with high unemployment, they are able to argue that the jobs they bring are crucial to the local economy.

Interestingly, Fajnzylber (2007) points out is that while some firms are too small to make the transition to formality worthwhile, larger firms also engage in different degrees of informality. According to the author, some of the factors that lead

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[1] An example of this is a study by the Multilateral Investment Fund at the IDB (High Growth SMEs, Innovation, Entrepreneurship and Intellectual Assets), which looks at Brazil, Mexico and Chile. This study finds that some characteristics are associated with high growth firms: a symbiotic relationship with large firms, a certain socio-economic profile, including high levels of education and acquired experience in working for large firms in the sector before becoming an entrepreneur, etc.

firms into higher degrees of informality in Latin America are higher labor and product markets regulation, corruption and bad governance. An example of this is that in Argentina, where labor laws are comprehensive, even large multinational firms like Ford keep a portion of their formal workers' salaries under the table (in the particular case of Ford, this is up to 30 %t of wages of white collar workers). Even as the economy was doing well in 2005, 47% of the total workforce did not receive fringe benefits. While smaller companies had higher shares of semi-informal workers, the lower shares of informality in larger ones were misleading because the latter outsourced contracting of semi-informal labor to employment agencies[2].

The argument that stringent labor laws affect firm's competitiveness is a frequent. I was struck by Almeida's (2010) finding that in the three cases of cluster upgrading he examined in Brazil, this tradeoff had not taken place. Of the three reasons he gave, what I found most intriguing was the aspect of collective action in terms of public-private cooperation. Indeed, without it, it would have been impossible to upgrade first and then comply; finally, compliance in this framework was part of a larger process of public-private interaction. Schneider's (1998) concern with reciprocity (embodied in performance standards, monitoring, and sanctions) as an element of embedded autonomy where bureaucrats have close ties with business, while retaining autonomy to make decisions is a crucial difference between East Asia and Latin America's public-private interactions. What I find most interesting is his comparative hypothesis about development strategies, and particularly how East Asia allows for easier monitoring because of export-led growth, as opposed to Latin

[2] El Empleo en negro no cede: afecta al 47% de los asalariados, Diario Clarin, June 11, 2005.

America’s old experiment with import substitution. His point is that in import substitution it is difficult to impose performance standards and monitor their efficacy. This approach focuses on the output of these businesses; the one thing that could be added is that in the case of East Asia and particularly Japan. At the beginning of industrialization, because of severe capital constraints the government had complete control over technological inputs, which had to be bought in the US (this was the case with transistor radios), and were later subject to import substitution. Business groups needed to make a strong case to the government if they wanted to use these inputs and develop a product; in exchange, the government enforced performance standards and careful monitoring. Sony had to wait for five years before MITI granted it permission to buy inputs for a transistor radio. In my view, part of the reason why this did not happen in Latin America (beyond the myriad organizational, policy, and structural reasons) was its “export-led” agricultural model, which fetched abundant foreign exchange. This lack of immediate liquidity constraints did not put industries under pressure and thus prevented reciprocity, learning, and encouraged rent seeking.

Coslovsky’s (2010) surprising finding of Bolivian brazil nut producers’s building a collective institution despite their internal divisions and disadvantages vis-à-vis their Brazilian competitors supports Schneider and Doner’s interesting point that business associations can help lower transaction costs and overcome obstacles to collective action. But the most striking part of Coslovsky’s paper is that the producers were able to organize despite their heterogeneity and deep-rooted distrust of each other. This is particularly striking in the face of Cammett’s finding that a shared identity is key for mobilization. The organization of Argentina’s large and small agricultural producers within the Federacion Agraria Argentina in early 2008, after six decades of internal struggles, seems to side with Coslovsky. However, the only issue that was able to drive collective action was the Ministry of Economy's decision to impose export taxes and take up to 90% of profits once soybean prices exceeded a certain amount. Once this conflict was over, fragmentation resurfaced and collective action subsided.

In Coslovsky's paper, new food safety regulations in Europe were the driving force behind the upgrade of the Bolivian brazil nut industry; I was struck by Damiani's point that cases like these could imply that concern for consumers in industrialized countries have the potential to improve labor standards in developing countries. While the argument could be made (as Rodrik mentions) that these industrialized country standards are instances of closet protectionism, cases like Damiani's, where rural workers in Brazil effectively organized and improved their situation, these concerns are an opportunity to upgrade. An example of this is how European regulations on corks in the early 2000s affected the Argentine wine industry, which sells most of its products in Europe. The European Union banned the sale of wine with natural corks because it was found that the latter could harbor a type of fungus that could affect consumers. This was an opportunity for synthetic cork firms to establish factories in Mendoza and San Juan, where there is a large concentration of wineries, thereby enlarging backward linkages. Tewari also points out that good working conditions are not necessarily inimical to growth and trade; at the same time, she link between improved working conditions and industrial upgrading is not automatic. Instead, it requires mediating actors who will negotiate on behalf of labor, even in an industry like garments, where low labor costs are key. A surprising and counterintuitive finding is that in some instances supplier firms have intervened to improve labor conditions.

By far the most interesting part of this set of readings was what Stiglitz calls the ‘high road’ of labor in the context of Rodrik’s discussion of globalization and its pressures for convergence, where it becomes harder for nations to implement social recipes that differ from those of their partners (in the case of Europe). The danger exists that social disintegration will take place, splitting nations along lines of economic status, mobility, and social norms (Rodrik). In his framework, Rodrik proposes a somewhat paradoxical role for international organizations that will both encourage convergence among nations and provide ways in which countries that need some breathing room can disengage from requirements. Elliott and Freeman’s point that there is no trade off between free trade and global labor standards, and that less developed countries do not necessarily have to adopt advanced country standards seems to illustrate the concept of this “breathing room.” Yet, the idea remains vague. As for the role of international organizations, both the Levinson and the Standing article cast doubts on the willingness (Levinson) and the ability (Standing) of these organizations to set and enforce standards, even hinting the possible obsolescence of the International Labor Organization as it fails at the three disparate roles it has set for itself.

A final note on the high road, based on the Japanese model (and my personal experience working in Japanese manufacturer Denso’s headquarters in Aichi), is that most analysts ignore the deep interconnections of that labor system with the national welfare regime. Even in Japan, even in high road companies, quality jobs are no panacea. In fact, sometimes the high road works with welfare systems to segment markets. Additionally, traditional high road jobs privilege job security over wage growth; the fascinating part about them is that they motivate employees through non-monetary incentives, fostering a collective sense of identity and loyalty to the firm. Finally, the high road is deeply related to a corporate governance model of stakeholders, versus the more profitable American shareholder model. Yet, the stakeholder model is better to withstand downturns in business cycles. I think (and this is pure speculation) that the stakeholder model maintains the link between product and value, whereas the shareholder model artificially inflates share prices, driving a wedge between product value added and what the company is worth.