Overview

Labor markets in Latin America are ailing. Unemployment is at its highest in many years and although wages have improved in some countries, they have done so at a very slow pace. Many workers receive pay that is too low to escape poverty, and wage inequality, which is among the highest in the world, is not getting any better. Instead, unskilled workers have seen their wages decline relative to the wages of skilled workers. Moreover, while the probability of losing a job is high, only a dwindling minority of workers is insured against this risk. Not surprisingly, public opinion surveys, such as the Latinobarometer, have identified unemployment, low wages, and job instability as the most pressing problems in the region, ahead of corruption, crime, and other difficult social problems.

Employment-related concerns are not new in the region. For years, population dynamics and increasing labor force participation rates have resulted in a rapidly growing supply of labor. Employing this ever-increasing reserve of workers at a decent wage and with the benefits prescribed by labor laws has been a perennial challenge for policymakers. What seems to be new is that unemployment, a problem that was only supposed to occur in richer countries where workers can afford to search for jobs, is now reaching levels above those of developed countries. Moreover, many indicators of the quality of jobs seem to have deteriorated during the 1990s. Employment in small firms increased and the share of workers with the protection mandated by labor laws declined from levels that were already low.

Many explanations have been proposed for this state of affairs. Some analysts argue that trade reforms and the privatization of state-owned firms have displaced workers from noncompetitive manufacturing sectors and public jobs, while new jobs have been created in low-productivity sectors.[1] Others claim that trade reforms and the process of globalization of trade are behind the increasing demand for skilled workers and the declining relative wages of the unskilled.[2] Some observers blame the process of trade integration—globalization—for the decline in the proportion of workers with social protection as firms seek to reduce labor costs to stay competitive.[3] Some point to the increasing adoption of new technologies—in part fuelled by trade and other structural reforms—as part of the explanation since, on the one hand, new technologies are less labor intensive and, on the other hand, they use more skilled labor than older technolo-

[1] ILO (1996). Saavedra (2003) makes the case that many changes observed in Latin American markets are likely to be associated with sector reallocations of output and employment induced by structural reforms.

[2] See, for example, Robbins and Gindling (1999).

[3] Stallings and Peres (2000); Goldberg and Pavcnik (2003).

gies.[4] Other suggested explanations for increasing unemployment are increasing female labor force participation and the rapidly increasing labor supply. Excessively rigid labor regulations and increasing wage rigidities are also often mentioned as the cause of labor market problems.

How can Latin America and the Caribbean improve the availability and quality of jobs? The treatments to be prescribed depend on the diagnosis of the problems. While it is often claimed that it is necessary to focus on solutions, this Report contends that the solutions must be based on a clear understanding of the way labor markets work, the tasks they perform, and the effects that policies and institutions within and outside the labor market have on them. Labor markets, that is, the daily exchange of productive skills between workers and firms as well as the institutions that govern them, perform the key task of allocating resources and incomes across firms and workers. While well-designed institutions and policies can enhance the performance of labor markets, poorly conceived policies and institutions may slow down economic activity and reduce social welfare. Therefore, this Report explores the anatomy and dynamics of labor markets in the region as well as the effects that demographic and labor force participation trends, migration, macroeconomic shocks, structural reforms, education, technology adoption, and policies and institutions have on the labor market. In doing so, some popular assumptions regarding labor market behavior are reexamined and new data sets are uncovered and analyzed.

Several Important Findings Emerge

Increasing labor supply is neither the cause nor the consequence of worsening labor market conditions.

In a typical workday, more than 210 million Latin Americans offer their skills to the labor market, and about five million additional workers join the labor supply every year. At 2.5 percent, the rate of growth of the labor force is among the highest in the world. Demographic trends and higher female participation rates are the main two factors behind these trends, while emigration—the highest in the world—is responsible for only a slight decrease in the rate of growth of the labor force.

In spite of its rapid pace, growth in the supply of labor is not the cause of the increase in unemployment or unregulated employment. Nor are the changes in the characteristics of the labor force that are taking place in the process. The labor force is becoming older, more gender balanced, more urban, and more educated, but there is no basis to argue that any of these changing patterns is an important explanation for the ills of the labor market.

Female labor force participation rates are growing fast from levels that are still low by international standards. However, there is no evidence that across countries increasing female participation is causing increasing unemployment rates. Instead, it has been the most important source of growth of income per capita in the region. There is no evidence that in general women are being forced into the labor market by the dire economic situation of their families, although that may be the case in a few countries. Over the medium term, relative wages, although still unfavorable to women, have been moving in their favor, which suggests that the reason for their higher labor force participation has been the improvement in their relative labor opportunities. In some countries and periods, short-term participation rates increase when macroeconomic conditions deteriorate, adding pressure to the labor market and probably contributing to an increase in temporary unemployment.

Structural reforms did not alter the labor market in the expected ways.

The 1990s witnessed major changes in economic policies aimed to facilitate the operation of markets and to improve efficiency and economic growth. Inflation and fiscal deficits were reduced, govern-

[4] See de Ferranti and others (2003) for a link between trade, technology, and increasing returns to education.

ments lifted restrictions on trade and capital markets, tax systems were reformed, and many state-owned firms were privatized.

Reformers predicted that these reforms would stimulate the demand for labor and lead to wage gains, although, in the short run, there could be a temporary increase in unemployment because jobs in noncompetitive sectors would be lost. The reformers also predicted that wage inequality between skilled and unskilled workers would be reduced as the demand for unskilled workers—the most abundant factor in the region—would increase relative to the demand for skilled workers. Instead, critics claimed that reforms brought sizable losses in employment, particularly in small and medium-size firms and good public sector jobs, as well as losses in the quality of jobs because many employers stopped offering benefits as the pressure to remain competitive increased.

The reality is that, contrary to the critics' predictions, employment losses were small and when they occurred they had no discernable effects on the unemployment rate. There were no massive losses in employment because, surprisingly, contrary to the reformers' predictions, there were limited shifts in resources to potentially more efficient sectors, which may explain why productivity and earnings increased at such a slow pace.

There were more surprises. For example, the wage gap between skilled and unskilled workers widened. However, the relative demand for skilled labor increased in all sectors, and not only in those that were affected by trade reforms, suggesting that other factors were at work. Contrary to the expectations of some reformers, in some countries, wages in the manufacturing sector fell as workers lost part of the rents they used to share with employers as a result of trade protection. But contrary to the critics of globalization, new jobs in the export sector have usually offered comparable and sometimes better wage and employment conditions than other jobs. Unfortunately, as trade barriers came down, some countries—particularly those with restrictive labor laws—have reported a reduction in jobs that provide the benefits mandated by law.

Although it eliminated many jobs in some specific sectors, the privatization of state-owned firms had little effect on unemployment. In Argentina, the most extreme case, close to 150,000 workers were made redundant as a result of privatizations between 1987 and 1997. Although large in number, these redundancies accounted for only 13 percent of the increase in unemployment in the period. In Bolivia, privatizations explained just 3 percent of the rise in unemployment in 1995-2000. Furthermore, the private firms created in the privatized sectors directly or indirectly rehired many of the laid-off workers.

In sum, the picture of the effects of the reforms is full of surprises and lessons for reformers and critics alike.

The problem is not technology, but the lack of it.

It is often stated that modern technology reduces the demand for workers, particularly those with low levels of education, but history and the evidence for Latin America indicate that this is not the case. There is no evidence that employment rates have declined in countries that adopted new or better technologies. Nor is it true that industries that experienced fast technology growth had slow employment growth. Indeed, higher productivity growth, the best indicator available for technological improvements, has been associated with faster employment growth at the industry level.

It is not technology, but the lack of it that has been behind some of the unsatisfactory labor outcomes. On average, labor shares were constant in the region during the 1990s, indicating that the slow growth of wages has been due to meager growth of labor productivity, a direct consequence of the slow pace of technological change. During 1985-2000, the average productivity of physical capital, labor, and skills combined declined 0.1 percent a year in the Latin American and Caribbean countries. This implies that technological progress did not contribute to improving labor productivity and wages in the region. Thus, the problem has been not so much that labor markets have allocated incomes in a way that has hurt workers, but the fact that economies have failed to generate incomes that can be allocated to workers.

Demand drives the increasing skill premium, but it is unclear what drives this demand.

To some extent, increasing returns to tertiary education are driven by the region's success in increasing the supply of workers with secondary education relative to workers with primary and tertiary education. However, changes in supply alone cannot explain why returns to tertiary education are increasing relative to those for secondary education, or why returns to secondary education have not plummeted relative to returns to primary education. Therefore, changes in the relative returns to education are also driven by increasing demand for skills.

Although some of the rise in the demand for skills is due to the shift in employment toward services, overall this effect tends to be small. Instead, most of the effect comes from an increase in the demand for skills that occurred within both the manufacturing and service sectors. However, the evidence on what explains this rising demand for education within all sectors remains inconclusive. The popular claim that skill-biased technological change is the cause of recent increases in the returns to education has proved difficult to substantiate.

For instance, there is no evidence that countries with faster technological growth—as measured by total factor productivity—have increasing demand for skills, nor is there evidence that the skill premium is explained by the evolution of the ratio of human to physical capital as some recent theories have suggested. Moreover, the evidence at the plant level is not supportive of the thesis that plants (or firms) that adopt production automation technologies demand more skilled workers. If anything, the reverse is true. Plants with more skilled workers tend to adopt more automation technologies, suggesting that the low levels of education in the region may slow down technological growth. And even if the evidence supported the hypothesis that automation technologies explained the increasing demand for skills, this could not account for the increasing demand for skills in the service sector where automation technologies are less common. The alternative hypothesis that the use of information technologies leads to increasing demand for skills in both services and manufacturing awaits confirmation for Latin America.

The popular hypothesis that trade reforms of the magnitude experienced in Latin America have fostered increasing imports of skill-intensive technology is also difficult to substantiate. Tariffs on capital goods were already low before the trade reforms, and while the share of imported capital in the capital stock is increasing, there is no clear relationship between this trend and trade reforms. And although there is some evidence that higher import penetration is associated with increasing demand for skills, other measures of trade liberalization, such as tariffs, do not show a relationship with the demand for skills.

More research is necessary to understand whether and how technology affects the returns to education. Meanwhile, a more important issue concerns why the region has not been able to benefit more from technology to increase the incomes and standards of living of all workers.

Many workers are poor, but focusing on informal work may be misleading.

Many workers are having a hard time in the labor market. Many are unemployed and many are employed in jobs that pay very little or offer little protection against the risk of unemployment, sickness, work accidents, or old age. Over the years, labor market analysts in developing countries have focused on following the evolution of informal labor as a measure to track the quality of employment and well being of workers. However, focusing on informal work may be misleading and risk turning a blind eye to other serious maladies.

An emphasis on informal work may be misleading because it is both unclear who informal workers are and whether they are suffering more than formal sector workers. Some analysts define informal work as noncompliance with official norms (for instance, the share of unregistered businesses); others identify informal work with certain types of employment assumed to be low-paying, low-advancement jobs (such as self-employment, unpaid family work, or employment in firms with five or fewer employees). There is some overlap among these categories, but many workers fall in only one category.

The evidence challenges the popular notion that workers are in the informal sector against their will and would prefer to move to the formal sector if given the opportunity. Recent studies for Brazil and Mexico document that a large majority of self-employed workers prefer this status to a formal sector job because they earn higher wages and enjoy more independence. And although many jobs in the smallest firms fall into the low-advancement, low-productivity category, there are also thriving new small enterprises. Consistent with this idea, there is no indication that the differences in wages between small and large firms are larger in Latin America than in the Unites States. This observation also challenges the notion that labor markets in Latin America are abnormally segmented. In reality, there is substantial mobility between sectors traditionally considered formal and informal in the labor market.

Given these complications, the Report tracks the quality of jobs by using direct measurements of the wages and benefits received by workers. This has the following advantages: first, it clearly defines the phenomenon of study; and second, it avoids attaching a value judgment to sectors of the labor market based on predetermined criteria of the welfare of those employed in a given sector. These measures indicate that on average one in every two workers earns wages that are too low to lift an average family out of poverty, and that more than half of all workers are not protected by labor laws or social security programs. However, the evidence also suggests that, to a large extent, low earnings and lack of social protection reflect low worker productivity rates in the region. Higher rates of productivity growth would increase the earnings of the poorest workers and improve coverage of labor laws and social security programs.

Focusing on wages and benefits shifts the emphasis of labor policies toward increasing labor productivity and reassessing the structure of social protection so it can cover more workers. It also brings attention to those workers who, despite being employed in sectors considered formal, still earn very low wages or are not covered by labor laws. And it is a way out of the contradiction in the widely shared view that laments the growth of the informal sector, but also laments the destruction of many small and micro enterprises when the informal sector shrinks.

Earnings inequality reflects inequality in education, but education alone is not enough to solve the problem of low wages.

The level of earnings inequality in Latin America is among the highest in the world, but this inequality is not so much created in the labor market as reflected by it. A large share of earnings inequality is associated with large differences in endowments, such as education and experience that workers bring to the labor market. Only a small fraction of earnings inequality is explained by the fact that similar workers obtain different pay depending on the characteristics of their jobs. Differences in the wages of workers employed in small and large firms, as well as interindustry wage differentials, are within the range observed in the United States, a country with substantially lower earnings inequality than Latin America, but higher than that in most other developed countries. Moreover, the share of national income that goes to workers falls within the range observed for more developed countries and has been stable for the past decade.

Thus, addressing the problem of earnings inequality is more a matter of leveling the playing field in terms of endowments rather than altering prices in the labor market. The observed increasing returns to education may raise the incentives for families to keep their children in school longer, or for adult workers to go back to school. However, increasing returns also contribute to further increasing the earnings differences between those who have high levels of education and those who do not. More resources should be devoted to reducing early age dropout rates and improving adult education.

Although more education for all could help to reduce inequality substantially, it would not necessarily diminish poverty in a substantial way. Inequality would be reduced if all workers attained similar years of education, but poverty might still affect many of them if education does not allow workers to escape poverty. Of course, education does increase earnings, and returns to education in most Latin American countries are high by international standards. However, if workers without education earn very little, increasing wages by a fixed percentage would still leave workers with low wages in absolute terms. Since the basic level of productivity of all workers largely depends on the quality of the institutional and economic environment in which firms operate, efforts to raise the average level of education may turn out to be a slow (and even inefficient) way to eliminate poverty, unless efforts are also made to improve the conditions for firms to invest, innovate, and achieve higher levels of productivity.

Labor markets in the region appear to be losing their traditional mechanisms of adjustment to macroeconomic shocks.

The region's labor markets operate in a volatile environment. Over the past 30 years, only Africa and the Middle East have been more volatile than Latin America. This pervasive aggregate volatility requires large adjustments in the labor market. Thus, even if the share of national income that goes to workers did not vary much, a reduction in national income would manifest itself in a decline in employment or wages.

Is it better to adjust to shocks through lower wages or higher unemployment? Although it is difficult to make value judgments regarding how to adjust to a crisis, the reality is that wage adjustments help to spread the cost of a recession while unemployment concentrates it among a few. In Latin America, despite large volatility in output, volatility in employment has not been higher than in more stable regions. This is because, with a few exceptions, shocks have been traditionally absorbed through very high wage volatility. This has helped to spread the costs of crisis more evenly among the employed, which is an important feature in countries where only a minority of workers has access to unemployment insurance or severance pay.

However, the traditional adjustment mechanisms appear to be changing, and this change can explain why unemployment rates have reacted so virulently to the decline in economic activity in the past few years. In Latin America, high wage flexibility seems to be the result of two bad outcomes: high inflation and low enforcement of labor regulations. As inflation levels have dropped to single digits, less adjustment via wages has implied a larger reaction of employment and unemployment to macroeconomic shocks. Higher investments in improving the enforcement of labor laws might produce a similar effect.

As economies grow, joblessness will subside. However, to the extent that unexpected and unavoidable shocks will continue to occur, unemployment will continue to react strongly unless policies and institutions facilitate wage adjustments. This is not to say that Latin America should go back to the days of high inflation or weaken enforcement of labor laws. Instead, the mix of recurring shocks and low inflation should be accompanied by institutions that facilitate wage adjustment—helping to contain the consequences of macroeconomic shocks on unemployment—and ameliorate the welfare costs associated with job loss.

At the micro level, there is a large but not atypical amount of reallocation of workers and jobs.

While changes in unemployment during the 1990s seem to be mostly explained by the interaction of macroeconomic volatility and declining wage adjustment, unemployment is only the tip of the iceberg of the vast majority of activity that occurs in the labor market. In any given year, a large number of firms expand their workforces while others trim their payrolls. This activity occurs in recessions and booms, and within all sectors of the economy regardless of how narrowly they are defined. To give an idea of the magnitudes, every year in the countries studied about one in every four jobs is either created or destroyed. This implies that at any given moment a large number of workers lose their jobs, while at the same time many workers are hired.

Focusing only on unemployment rates assumes that all workers who both lose and find jobs are winners. However, this may not be the case. There is a large probability of job loss for all workers, particularly the unskilled. Many workers, especially the poorest, cannot afford periods of job search and therefore are forced to accept the first job that comes their way, even if waiting would have meant finding a job in which they were more productive and would earn higher wages. Workers who are involuntarily displaced from their jobs tend to find jobs that pay lower wages than the ones they had before. The fact that workers who shift sectors, have higher skills, or have higher tenure tend to suffer higher wage losses suggests that some specific skills are lost in the process and that some inefficient churning may be taking place. Imperfect or insufficiently developed capital markets may explain why employers are forced to lay off workers who, given their particular skills, are difficult to replace.

Should layoffs be forbidden or indemnities for dismissal be increased? Although it is true that stringent job security measures reduce reallocation, they may have adverse consequences for productivity and earnings growth. In all economies, productivity growth is associated with productivity gains within existing firms and productivity increases because workers move from less productive firms to more productive ones. The latter component explains between 20 and 50 percent of total productivity growth. By inhibiting the process of allocating workers from less productive uses to more productive ones, economic growth could be stalled. Indeed, it is possible that the stringent job security provisions found in the region hold up productivity growth. The solution to this dilemma is not simple. Policies designed to contain the welfare cost of this perennial motion should be crafted with extreme care; otherwise, the cure might be worse than the disease.

Labor regulations are not cost-free, but deregulation is not the answer.

Across countries, labor regulations govern the rules of the game in labor markets, which are complex and cannot function properly without regulations. Yet, this is not to say that the more regulations the better. The fact is that regulations come in many forms and although some might bring clear welfare gains, others might not. Although the dogma is often that workers' welfare can be improved by legislating benefits and labor warranties, workers' welfare also depends on how well labor markets work. Benefits associated with regulated jobs are of little use to unemployed workers or workers excluded from the system of social protection.

Although it has been argued that labor regulations have little costs in terms of employment, unemployment, and other labor market variables, the empirical evidence gathered in this Report suggests that this is not the case. The implication is not that all regulations should be eliminated, because in most cases they serve an important role. Instead, it is important to recognize that when regulations are not cost-free, their effects should be continuously monitored and balanced against their benefits. In the medical sciences, some illnesses have treatments that can greatly disrupt the life of a patient. Such treatments, if unchecked or provided without care, can even kill. As in that discipline, the dilemmas posed by social policies can be resolved by constantly evaluating the health of the labor market and changing treatments when the risks become too large.

Unions are neither the sand in the wheels of the labor market nor the solution to low wages.

Labor unions have made possible substantial gains in working conditions for significant groups of workers. However, similar to other institutional arrangements in the labor market, union action can bring substantial benefits but also important costs for society. On the benefit side, unions increase their members' earnings between 5 and 10 percent. Although this is a sizable number, these gains are small when compared with the gains associated with experience or education. Thus, typically, every year of secondary education increases earnings by 11 percent relative to the earnings of workers with primary education; therefore, a five-year degree increases earnings more than 50 percent. These numbers suggest that few workers would be able to lift their wages above poverty relying solely on union activity.

However, unions also bring important benefits to their members in terms of reduced turnover and higher employment. Unions may also open important channels of communication between workers and management and contribute to productivity. Collective bargaining can help to reconcile the interests of workers and companies in the aggregate and prevent the adverse consequences that may result from uncoordinated bargaining activities. For society as a whole, unions appear to reduce overall earnings inequality. Moreover, research suggests that countries with highly coordinated collective bargaining experience lower unemployment and higher employment rates than countries with highly decentralized wage setting.

At the same time, unions can also bring important costs. At the firm level, unions may reduce investment, a key variable for earnings growth. Thus, unions may tend to maximize current wage gains at the expense of future wage increases. At the macro level, unions may reduce the ability of economies to adjust and adopt reforms.

Whether benefits outweigh costs is difficult to foresee because the balance is sensitive to the legal framework governing unions, the level of internal and external competition, the nature of labor relations, and their degree of coordination and centralization. An element of concern is that, according to the opinions of workers and employers, labor relations in Latin America seem to be mired in conflict and distrust. This in turn may deter firms and workers from performing the long-term investments in training and new technologies that are essential for sustained growth.

What Should Labor Policies Do?

Given these lessons, what can governments do to minimize workers' difficulties and help them to lead better and more productive lives? What can labor policies do to improve the performance of the labor market?

Governments can help by adopting policies to reduce macroeconomic volatility and create stable, growth-friendly macroeconomic conditions. In those countries where real wage rigidities are increasing the response of unemployment to declining growth, mechanisms such as profit sharing or reducing the transaction costs of wage contracts could increase wage flexibility. But the quest for a better macroeconomic environment and a better response to macroeconomic shocks should not blind policymakers to the everyday demands that a well-functioning labor market places on labor policy. There is a need to readdress the labor policy agenda from temporary solutions to economic crisis to structural policies; and from the philosophy of "protecting workers from the power of employers" to an agenda driven by the objectives of expanding workers' opportunities and improving the performance of labor markets. This does not diminish the importance of workers' rights, as established in conventions on core labor standards and in national labor codes. On the contrary, they should be taken more seriously. The status quo of low enforcement and low compliance undermines the rule of law and leaves many workers ill-equipped to weather the consequences of the continuous process of labor reallocation.

However, in order for regulations to be enforceable, the philosophy of granting warranties in the legal codes, and sometimes even in constitutions, without assessing their consequences in the labor market should also be reassessed. The evidence collected in this Report suggests that there might be important trade-offs between different objectives in the labor market. For instance, full employment may not be compatible with full insurance against unemployment. But the Report also suggests that there are important complementarities. For instance, better labor market performance is compatible with lower earnings inequality. Complementarities can be maximized and tradeoffs can be minimized by paying due attention to the consequences of policies. Doing otherwise has led to the current dilemmas, in which workers are highly protected on paper, but noncompliance is the norm and, because there is little focus on policies that expand workers' opportunities, earnings grow painfully slowly. The new agenda requires a strengthened labor authority and a complex network of public and private institutions to fill the following four specific functions.

Increase the efficiency of the job-worker matching process.

A large amount of reallocation creates gaps and lags between firms that seek workers and workers that seek jobs. Policymakers, in partnership with the private sector, could increase the efficiency of the matching process by creating vacancy registries and providing job search assistance. Evaluations in OECD countries suggest that such systems are highly cost-effective mechanisms for putting workers in jobs. Although these policies do not help to create new job vacancies, they reduce frictional unemployment by more quickly filling the available openings. These policies also reduce the income losses associated with unemployment and the demand for social services or unemployment insurance, if applicable. But the main advantage probably lies in the potential to increase the quality and therefore the productivity of job-worker matches. This is because better job-worker matches would likely result in greater investment in training by firms and learning by workers, which are essential for achieving growth in earnings.

Labor intermediation services in the region are less extensive than their counterparts in OECD countries. Nonetheless, there are a number of public national employment services and a growing private sector market in labor intermediation and placement. The reform of these systems requires fostering an appropriate regulatory environment for nonprofit providers, improving information systems, and expanding the range and coverage of the services provided.

Insure workers against the risk of job churning.

Macroeconomic volatility and vigorous job churning have created strong demand for mechanisms of protection against income loss. This demand has been met by regulating employment stability mechanisms that are more stringent than those encountered in more developed countries. However, such mechanisms constitute a primitive method of insurance and can be costly. In addition, more than half of all workers do not participate in such systems and therefore are not covered against the risk of loss of employment.

Although the current system is flawed, the main question is whether alternative forms of insurance would be better suited for the particular characteristics of the region. Most countries in Latin America have reached a level of development that is comparable to the level the developed countries had reached when they implemented unemployment insurance mechanisms.[5] However, the creation or expansion of such systems is challenged by the lack of adequate registries of firms and workers, the high degree of informality in the labor market, the small size of the state, and the lack of fiscal room to pursue countercyclical social expenditures. Under these conditions, the type of unemployment insurance systems in place in developed countries may be infeasible in the region. Moreover, although unemployment insurance does not impede the reallocation of resources, the experience of developed countries suggests that it could have adverse side effects on the labor market.

It is clear that the road to better insurance mechanisms is plagued with obstacles. An important criterion should be to promote the sound functioning of the labor market. After all, the best unemployment insurance is the possibility of quickly finding a good job. But when this is not enough, each country needs to find a solution to

[5] Average per capita GDP in 20 developed nations when they first enacted unemployment insurance law was US$3,539 (Maddison 1995), and the average per capita GDP for 22 countries in the region was of $3,964 in 2000. Most developed countries enacted their first unemployment insurance laws between 1900 and 1944.

these dilemmas that adequately reflects the characteristics of its economy and the preferences of its citizens. In the process, policymakers and legislators should continuously monitor the potential risks that insurance systems bring to the performance of labor markets.

Enhance opportunities for workers.

There is a widespread perception that globalization and trade integration are making training policies more important. At the same time, however, increasing use of temporary contracts and other measures to achieve flexibility are reducing firms' and workers' incentives to invest in skills. Therefore, any policy that seeks to expand the supply of training must foster a regulatory and institutional environment in which incentives for training exist. In this new paradigm, training reforms go beyond the objective of overhauling public training institutions or making training more responsive to the needs of the market. The reforms involve changes in taxes, regulations, and collective bargaining. The objective is to move away from the direct provision of training and improve the incentives for firms, workers, and training providers to fund, seek, and provide high-quality training.

Another promising area for policy is adult education. Although it has been a low priority in most countries, research suggests that bringing adults back to school can be an effective policy for increasing productivity (particularly compared with the results of public job training for unskilled workers). Latin American governments should devise ways to bring adults back to school. Possible measures include issuing tax credits to employers that provide time or resources for employees to attend school or giving tax relief to adult workers while they complete their formal schooling.

Monitor labor policies, enforce regulations, and promote harmonious labor relations.

Countries should invest in developing institutions that collect, analyze, and process information, and those that implement policies and enforce regulations. Assessing the benefits and evaluating the costs of labor policies requires skills that most labor administration authorities (normally the ministry of labor) do not have. Although researchers at universities and specialized firms can perform such monitoring, labor authorities ought to be the ones that contract the analysis, weigh the benefits and costs, and decide on and design the treatments to follow. This requires rebuilding the capacity of the labor administration authority and staffing it to perform such new roles.

The tasks of the authorities are challenged by massive noncompliance. To some extent, noncompliance is the response to poorly designed regulations, but it also reflects the government's lack of effectiveness in enforcing labor laws. Countries with more effective governments tend to exhibit more compliance with social security regulations.[6] New approaches are needed to improve regulations and expand the coverage of inspections and other mechanisms to increase compliance.

Labor authorities should also pay close attention to the quality of labor relations. Labor policies require cooperation between unions and employers to be successful. More transparent wage and collective bargaining rules would go a long way toward improving these relations.

The good news is that many countries are already working hard in these new directions. They have to. Discontent with the current state of affairs is too high to be left unattended. The hope is that the set of policies and institutions that will emerge from the crisis will go beyond quick fixes and help establish a new labor market agenda.

[6] For instance, regressing the percentage of workers that are affiliated with (and make contributions to) social security programs on income per capita and the index of the quality of the government (collected by Kaufman, Kraay, and Zoido-Lobatón [1999]) indicates that while compliance increases with income per capita, the quality of the government also contributes to expanding the coverage of labor regulations.