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# **LABOR MARKET INSTITUTIONS IN THE CARIBBEAN**

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# **Labor Market Institutions in the Caribbean**

**René Cortázar**

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## FOREWORD

The objectives of improving competitiveness and reducing unemployment, in particular among the young and women, are a part of the economic and the political agenda of most Caribbean countries. Labor market institutions play a crucial role. This study analyzes six types of institutions: (i) labor legislation, related to collective bargaining and termination of contracts; (ii) minimum wages (iii) vocational training; (iv) industrial relations; (v) social dialogue, and (vi) the role of the Ministry of Labor, and proposes policies that could contribute to employment and competitiveness.

The report adopts a political economy approach and puts forward a characterization of reforms in terms of their potential impact and viability. It concludes that the Caribbean countries have many assets and also some liabilities. Among the assets, it is worth underlining that collective bargaining takes place mostly at the firm level and is a bipartite affair. Moreover, social dialogue is well developed in several countries and provides an instrument for consensus building. Among the liabilities, it emerges that these are “high wage” economies, when compared with labor productivity; in all of the countries with respect to minimum wages, and in some of the countries with respect to public sector wages.

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## 1. ELEMENTS FOR A NEW APPROACH

We start by recognizing that there is a sense of frustration with respect to the degree of implementation of the policy recommendations, related to labor institutions, made by most analysts<sup>3</sup>.

In part it has been the result of the approach followed by many of those same analysts. After making a diagnosis of the situation of the country, it is frequent that a list of first best policies is presented. The recommendation is, normally, to try them all at once.

### 1.1 Scarce political resources

What this approach skips is the fact that reforms are not the result of the action of exogenous social planners (or of the so-called "benevolent social guardians"), but the outcome of the strategic interaction of policy-makers, the rest of the political actors, organized society (unions, business associations), and the public (never forget opinion polls). Policy-makers have certain "objectives" in mind (even though, sometimes governments are internally divided around these issues; also policy-makers sometimes act on the basis of their own interests), but they face "restrictions" and "incentives". That is why a new perspective, should be characterized as one of political economy.

Governments not only have budget restrictions in relation to government spending but also with respect to the political resources they have at their command<sup>4</sup>. And many of the labor recommendations are very expensive, in the use of those resources. Take, for example, the suggestion to reduce severance pay or minimum wages. They are, politically, very expensive propositions.

One simple way at looking at this is through Figure 1. It indicates that given a certain amount of political resources (indicated by curve S1) the more one wants to attain objective X, the less one will attain objective Y (compare points A and B).

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<sup>3</sup> Among them some International Organizations (IO).

<sup>4</sup> See: Hausmann, R, D. Rodrik and A.Velasco (2005). They argue that “ governments face administrative and political limitations , and their policymaking capital is better deployed in alleviating binding constraints than in going after too many targets all at once”. On the other hand “binding constraints .... differ from setting to setting”. One has to search for “the biggest bang for the reform buck”.

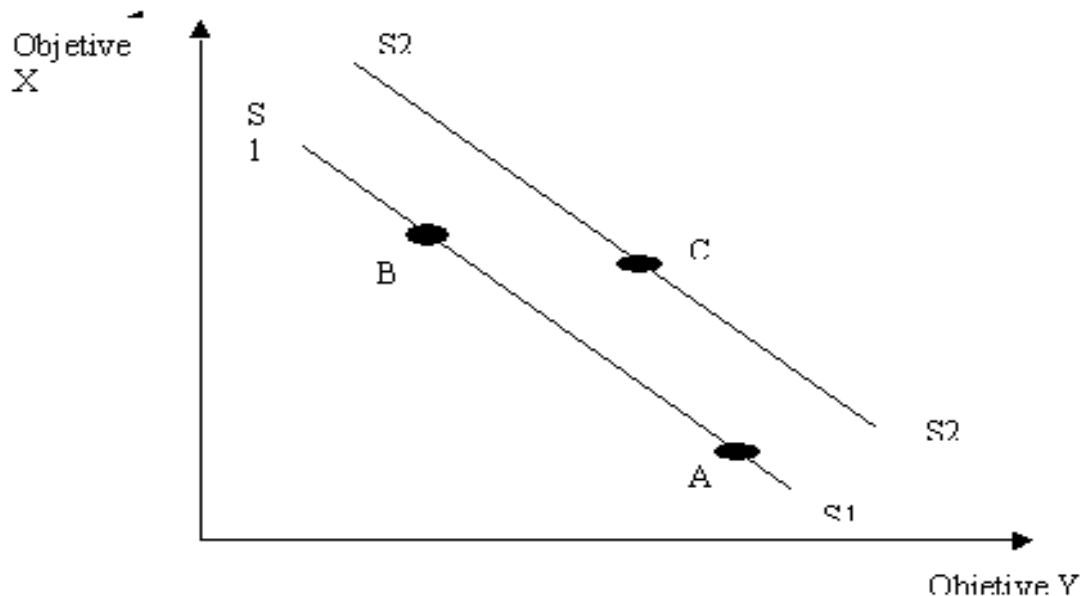


FIGURE 1

### 1.1.1 Windows of opportunity

This description is valid for “normal” situations. But there are special circumstances that increase the political budget, especially: the presence of a big crisis or the presence of a big opportunity. Two examples of the former are the wage freeze agreements of Barbados in 1993 and Jamaica in 2004. In both cases there existed a big threat that had to be overcome, a devaluation and a fiscal crisis. That created a disposition in social actors that was not there before. In terms of Figure 1 this can be viewed as a movement from restriction S1 to restriction S2. The great terms of trade of the economy of Trinidad and Tobago, could offer that big opportunity that is needed.

It is sometimes more difficult to utilize political resources, and to mobilize political will when things are not too bad, even though not too good. A description that fits most of the countries of the region, at least according to the most widespread perceptions about their own economies<sup>5</sup>.

### 1.1.2 Build a consensus

Another way to increase political resources is through the construction of basic consensus in society. Or at least an effective coalition for reform<sup>6</sup>. Part of it can be done through social dialogue.

<sup>5</sup> Some people argue that the low growth and high indebtedness of these economies will eventually take them to a crisis, but the subjective perception of a crisis is certainly not there.

<sup>6</sup> One has to consider who wins and who loses from reforms, and build a coalition among the winners.

### **1.1.3 Induce cooperation**

To build a basic consensus in society it is normally necessary to induce cooperation among social actors. One way to do this is through the art of persuasion: preaching to them. Trying to convince them about which policies are the most convenient for competitiveness and growth, and therefore for the increase in employment and wages. But it is useful to complement this perspective with a better understanding of the short term interests of their organizations, that is of their organizational objectives. At this respect, when trying to reach agreements with social actors, about specific policies, one should distinguish between the objectives pursued by the leaders and those pursued by the rank and file. This is true for workers and also for employers. If we make that distinction we will be able to understand why offering resources for activities such as the training of their leadership, or the development of their organizational work, may create a better disposition for the policy agreement. In terms of Figure 1, a policy oriented towards favoring these “organizational objectives” would contribute to shift the political constraint to the right (from S1 to S2), making the pursuit of objectives A and B more possible, than when this alternative is not considered<sup>7</sup>.

### **1.1.4 Trigger a process**

As part of a political economy perspective, it is also useful to view reform not only as the pursuit of a certain “product” (the new policies or institutions) but as the initiation of a “process” that may eventually induce the required reforms. For example, with respect to training one could start with accreditation and certification, that will make more transparent the limitations of the training institutions. Only when that stage is over, maybe the political conditions will be there to move to a “dual system” and to incentive the supply of training by private institutions. This view of reform as a process, where each stage may trigger the next one, is a perspective that is seldom found in the propositions of most analysts.

### **1.1.5 Gradualism**

At any rate it is the existence of a trade-off between different objectives, as consequence of scarce political resources, that makes more intense reforms less probable than the more moderate ones, as shown in Figure 2. This is an argument, in many cases, in favor of gradualism<sup>8</sup>.

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<sup>7</sup> The need of resources for organizational objectives is illustrated by the comments of a Jamaican union leader: “together with the fall of the iron wall, our foreign resources also disappeared, and we ended up without enough tools to do our work”.

<sup>8</sup> When these analysts realize that they cannot introduce all first best policies at once, they normally opt for suggesting to do “as much as you can”. This is not necessarily a good prescription since “no given reform taken on its own can be guaranteed to be welfare promoting, in the presence of multitudes of economic distortions” (Hausmann et. al, 2005). On the other hand, a second best strategy that would “give priority to reforms that engender positive second-best effects, and downplay or avoid altogether those that cause adverse effects” is not a very practical one, since “most of the second-best interactions remain obscure” (Hausmann et. al., 2005).

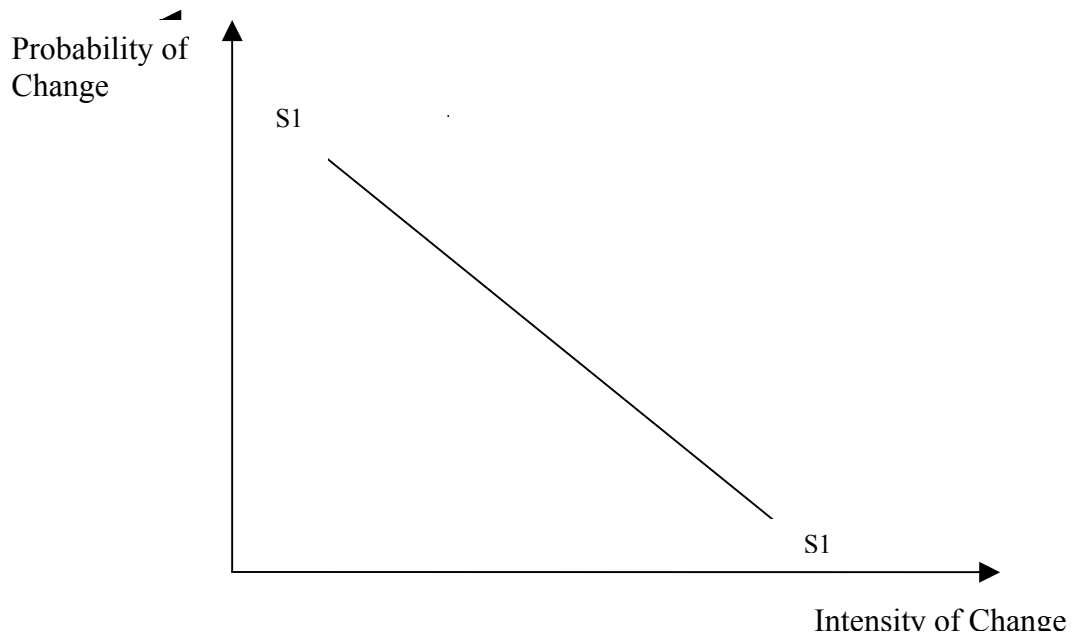


FIGURE 2

## 1. 2 Competitiveness and social protection

Where many of the analysts do perceive a trade-off is between competitiveness and social protection. The bottom line of many recommendations in this area is that you have to try to lift up as many protection schemes as you can get away with, to let markets function in a more effective way, as well as to save public resources.

One simple way to looking at this is through Figure 3, that's very similar to the one we presented in the previous section. It reflects the common belief, among certain analysts, that the only way to increase

competitiveness is through a reduction in social protection (compare point A with point B). And, as a matter of fact, that would also offer the main explanation as to why so few of the policies recommended by them have been put in place. The most simple story would be that since most of the countries in the Caribbean are not going through a deep crisis<sup>9</sup>, and unions are strong, governments are not willing to pay the political price of reducing the degree of protection of workers. In some situations the trade off may exist. And it is better to recognize it. But in many cases a good policy design should be able to displace the trade-off to the right (S2 instead of S1).

<sup>9</sup> At least the perception of a crisis is not there.

The degree of compatibility of increased competitiveness and social protection depends crucially on the strategy followed. For example, if you pursue a strategy that protects workers on the basis of an adequate combination of policies that create an effective system of insurance and concentrates on increasing labor productivity (point C on the strategy curve S2) versus a strategy that protects workers by creating all kinds of rigidities and administrative regulations (point A on curve S1), you may get the same or more social protection with an increase in the competitiveness of the economy, that will guarantee, through more employment creation and better wages, a higher degree of social protection in the future.

The possibility of having, simultaneously, more competitiveness and social protection, creates the conditions for the establishment of a new “social contract”, that may offer a “positive sum” solution for the aspirations of labor and management or, more broadly, of society. The elements of this new “social contract” would have to be expressed in different instruments of labor policy, the six type of labor institutions.

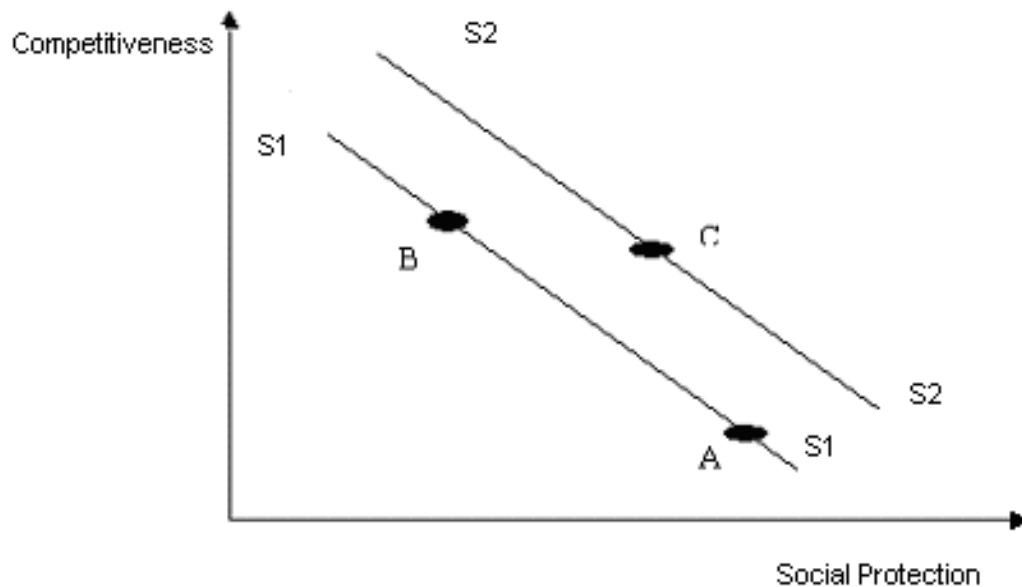


FIGURE 3

### **1.3 If to protect? What to protect? How to protect?**

To put the issues in the framework of a competitiveness-social protection trade-off that cannot be avoided is for many countries, especially in the Caribbean, a non-starter. Especially when things are “not too bad”. A more useful way to approach the problem is not to discuss “if” to protect, but “what” to protect and “how” to do it.

Given the restrictions, in terms of financial resources, this is typically a relevant issue when we refer to protection as the access to social services, such as housing, education or health. There is the question of “what” to protect, education, housing, health, and with what relative intensity? This is a legitimate discussion about priorities.

But also the working of the economy creates certain trade-offs that makes it necessary to choose “what” to protect and “how” to do it. For example, if you want to create strong employment stability for those already employed (objective X in Figure 1) you will probably create less protection for the unemployed (that will have less access to a job, given the impact of strong job stability over job creation), and for contract workers, since many firms will tend to change part of their permanent workers for others hired through a third party (objective Y in Figure 1). As a matter of fact, the growing presence of contract workers is a trend recognized by labor and business in most Caribbean countries.

## **2. THE OBJETIVES**

In discussing labor institutions, we will consider two main objectives: to improve competitiveness, through productivity growth; and to increase employment, so as to reduce unemployment and underemployment<sup>10</sup>.

## **3. THE INSTRUMENTS**

As we mentioned above, we will analyse six types of labor institutions: labor legislation, minimum wages, training, industrial relations, social dialogue and the role of the Ministry of Labor<sup>11</sup>.

### **3.1 Labor legislation**

In several of the countries of the region there is agreement, at least as a broad orientation, on the need of a significant labor market reform. For example, it is stated in Barbados

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<sup>10</sup> The need to improve competitiveness is especially urgent, given the possible end of some of the commercial preferences that will affect some of the countries of the Region.

<sup>11</sup> We suggest a set of polices on the basis of conceptual arguments and of our reading of the empirical evidence for the countries of the Region.

National Strategic Plan<sup>12</sup>; it is presented by the authorities of Suriname<sup>13</sup>, as the need to modernize labor laws; and it is mentioned as a necessary task in Trinidad and Tobago's Vision 20/20.

We will discuss labor legislation related to collective bargaining and termination of contracts.

### **3.1.1. Collective bargaining**

From the point of view of employment creation and productivity growth, collective bargaining is a crucial institution. In an open economy (like those of the Caribbean) the evolution of wages has to be closely linked to the evolution of productivity<sup>14</sup>. If they grow faster than productivity, firms lose competitiveness and there is job destruction. If they grow slower than productivity, workers lose incentives, and given the importance of effort and innovation in the new economic scenario, productivity starts deteriorating.

The evolution of productivity is up to a significant extent determined at the firm level, and varies between companies. That is why collective bargaining at the firm level would make it more feasible to maintain a close relationship between the rates of growth of wages and productivity.

When wages are determined at the sector level, the impact over the labor market is very similar to that of sector specific minimum wages. The latter normally have a negative impact over competitiveness and employment. When workers lose their jobs in the less productive firms, as a consequence of these sector specific minimum wages, normally they do not get hired in the more productive ones. There are two main reasons for this: either because wages in the more modern sector do not fall<sup>15</sup>, or because workers in the more productive firms are of a different type (more educated and trained) than those of the less productive ones. Therefore, bargaining at the firm level would be a positive contribution to job creation and productivity growth.

There are historical examples that stress this same point. For example, the contrast, in terms of centralisation of collective bargaining and job creation, between the US and the European Union (OECD, 1994), as well as, in Latin America, between Chile and Argentina, are illustrations of this point.

In Bahamas, Barbados, Trinidad and Tobago, Jamaica, Suriname and Guyana, collective bargaining takes place fundamentally at the firm level. Exceptions are collective

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<sup>12</sup> Ministry of Finance and Economic Affairs of Barbados (2005).

<sup>13</sup> Interview with the Labor Minister (2005).

<sup>14</sup> Marginal labor productivity.

<sup>15</sup> Because of the presence of collective agreements, or because employers fear that a drop in wages will come together with a drop in productivity (efficiency wages).

bargaining at the industry level for hotels in Bahamas<sup>16</sup>, for hotels and sugar in Barbados, and sugar, construction and shipping in Jamaica<sup>17</sup>.

From the point of view of competitiveness and employment creation, the two main objectives that we have proposed, bargaining at the firm level is an asset that should be preserved<sup>18</sup>. But, obviously, is an option that has costs in terms of other objectives. For example, bargaining at the firm level is normally associated with a lower proportion of workers covered by collective agreements, since collective bargaining that takes place at the industry level has more possibilities of incorporating small firms<sup>19</sup>. So other means to protect workers have to be considered<sup>20</sup>.

This leads us to our:

First Recommendation: maintain, as much as possible, collective bargaining at the firm level; or induce collective agreements at the firm level when they are industry wide.

A second aspect of the process of collective bargaining that is of great importance, is the mechanism through which conflicts of interest are solved. In a collective bargaining process that is decentralized, in which workers and employers must estimate the evolution of productivity at the firm level, the recommendation is to do it as a bi-partite affair. It is extremely difficult for third party (and more so a government official) to estimate in an adequate manner the productivity of different firms and jobs.

To this main argument, one could add other reasons that reinforce the argument in favour of bi-partite bargaining. First, when the “third party” is a government official there is the risk of politicising labor conflicts. Not to mention the negative impact of the process of conflict solving over democratic authorities. The government is in charge of policy making, taking care of the common good. The activity of “solving” conflicts of interest that have only a limited “private effect”, tends to distract and damage the image of the public authority. One can find numerous examples in Latin America of governments, and especially Ministries of Labor, wasting their energies and prestige in trying to solve labor conflicts, instead of concentrating on the design and implementation of labor policies, that are related to the common good.

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<sup>16</sup> Individual hotels can decide not to affiliate themselves to the employers association and bargain at the firm level.

<sup>17</sup> In Barbados there is interest in some union leaders to extend it to other sectors. In Suriname there is also interest among unions, and some government officials, to move collective bargaining to the industry level. In Guyana because of the importance of Guysuco, there is in effect a industry level bargaining for sugar.

<sup>18</sup> Some countries show that a more centralised collective bargaining system does not necessarily lead to lower employment, when several conditions exist, including the fact that bargaining takes place in a very co-ordinated fashion (Aidt and Tzannatos, 2002; Calmfors and Driffill, 1988). But, given the social and political environment of the countries of the Region, we believe that collective bargaining at a firm level is generally an asset, for competitiveness and job creation.

<sup>19</sup> This is one of the reasons why union leaders in some of the countries (i.e. Barbados and Suriname) are interested in pushing collective bargaining at the industry level.

<sup>20</sup> One of the means of protection of workers is precisely the fact that decentralized bargaining contributes to job creation, that is the basis of all labor protection.



The second argument poses a certain paradox. When governments attempt to guarantee “social peace” trying to reduce conflicts by intervening, it is frequent that they end up stimulating or aggravating social disputes, instead of solving them. Take the example of collective bargaining. Labor and business know that if they have to sit at a table with a government authority they will be hard pressed to find some sort of “intermediate solution”, to what their demands are. The government official, that is normally ignorant with respect to the internal situation of the firm but needs to “solve” the problem, will try to moderate the position of both parties so as to reach an agreement. If that is the case, and since this is known to them, both parties have an incentive to exaggerate their positions before they are called upon by the authority, so as to reach a reasonable solution when they are asked by the government official to moderate their demands. This normally increases the intensity of social conflicts. In contrast, when the government pursues a policy of non-intervention in collective bargaining, it stimulates both parties to moderate their positions from the very beginning. The fact that no one is going to come to the rescue makes it convenient for labor and business to try to overcome their differences from the very first day<sup>21</sup>.

The third reason is based on the recognition that labor relations do not start and end with each collective bargaining liturgy. They have to continue, after the conflict is “solved”, until the next collective bargaining period. If the two parties are not able to solve their disputes, by themselves, probably their capacity, and their confidence, to work together in solving the day to day issues, between the signing of one collective contract and the next, will also be damaged.

In the case of Bahamas there is direct bargaining between business and labor. If an agreement is not reached, anyone of the two parties can call for conciliation of the Minister of Labor<sup>22</sup>. If still there is no agreement a strike may take place.

In the case of Barbados there is a “voluntaristic model” that is not regulated by labor law<sup>23</sup>. And collective bargaining is, also, basically bi-partite. The process starts with direct negotiations among business and labor. If there is no agreement, anyone of the parties can ask for conciliation from the Labor Department<sup>24</sup>. If conciliation is not able to induce an agreement, the Minister of Labor will intervene, and if that doesn’t work, there may be a strike<sup>25</sup>.

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<sup>21</sup> The Chilean case is a good example of how bipartite bargaining can guarantee very low levels of social conflict, even in the midst of a transition from dictatorship to democracy (Cortázar, 1996).

<sup>22</sup> The majority of the collective agreements are reached in the first phase of direct negotiations.

<sup>23</sup> There is a demand from workers to create better procedures of union recognition. The same demand exists in Trinidad and Tobago, in what seems to be a real problem for unions.

<sup>24</sup> In a typical year, up to 40 cases will reach that stage.

<sup>25</sup> In a typical year, about two cases are handled by the Labor Minister. As we argued above, there is a downside to this kind of intervention. Anyway, business does not seem very worried about strike activity in Barbados; in their view, as of today, 5 to 10 firms have a strike each year, and most of them do not last more than a day (there is a labor peace during the period considered in the collective agreement)..

In Trinidad and Tobago, there is a first phase of direct negotiation among the parties (a bi-partite procedure), but if an agreement is not reached the matter is sent to the Ministry of Labor (MOL) for conciliation. On the other hand the Minister can also intervene on his (or her) own discretion. If the Ministry is not capable of reaching an agreement after fourteen days, the possibility of a strike is contemplated, and/or the dispute is sent to the Industrial Court (IC), for conciliation and adjudication. So there is a combination of bi-partite bargaining with mechanisms for “third party” interventions, even though bi-partite agreements predominate.

The case of Jamaica is very similar to that of Trinidad and Tobago. If workers and business do not reach agreement after direct negotiations, any one of the parties can ask for conciliation of the Labor Ministry. If no agreement is reached, normally the Minister of Labor will send the case to the Industrial Disputes Tribunal, for arbitration. But in most cases collective bargaining ends as a result of a bi-partite agreement.

In Suriname, collective bargaining is also, basically, a bipartite affair. But, when business and labor are not able to reach an agreement, any party can go to the Mediation Board, that is tri-partite. In any case, at the end, it is labor and business that have the final word<sup>26</sup>.

In Guyana, there are direct negotiations between labor and business. Any one of the parties can ask for conciliation from the Labor Department. If that fails, it is frequent that existing collective agreements contemplate arbitration, at the request of one or both parties. If that is not the case there can, eventually, be a strike<sup>27</sup>. The Minister of Labor may intervene when there is a national interest, and call for arbitration<sup>28</sup>.

The fact that the Industrial Court, in the case of Trinidad and Tobago, or the Industrial Disputes Tribunal, in the case of Jamaica (a “third party”) can have the final word on a conflict of interest, putting an end to the process of collective bargaining<sup>29</sup>, even if both parties do not agree with the resolution, could be seen as mayor drawback of the collective bargaining process. But, in practice, most collective bargaining comes to an end by a bi-lateral agreement. During the last 20 years, the awards on pay, of the Industrial Court of Trinidad and Tobago have been, on average, between two and three per year, representing less than 3% of all collective agreements (George-Marcelle, 1999)<sup>30</sup>. In the case of Jamaica, less than 10% of the cases end in arbitration (MOL Jamaica, 2005)<sup>31,32</sup>.

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<sup>26</sup> In general, there is the perception that there are not many strikes.

<sup>27</sup> There is not much industrial action. The country loses less than one sixth of a day per worker, a year, as a consequence of strikes. Although there were 229 strikes in 2004, 175 of them lasted only one day (Ministry of Labor, 2005).

<sup>28</sup> Some union leaders complaint that this is done more frequently than justified.

<sup>29</sup> The resolution can only be appealed on a “point of law”.

<sup>30</sup> The information of this publication was complemented in a meeting at the IC.

<sup>31</sup> Most strikes are, therefore, wildcat strikes.

From what we have said above we favour bi-partite mechanisms of conflict resolution. This takes us to our second recommendation:

Second recommendation: strengthen the bi-partite aspects of collective bargaining<sup>33</sup>.

Therefore, the Ministry of Labor (MOL) should avoid, as much as possible, intervening directly in this process<sup>34</sup>. If there is going to exist a “third party” intervention, we would favour conciliation (that helps build an agreement between parties) over adjudication by the Industrial Court (IC) (in the case of Trinidad and Tobago) or by the Industrial Disputes Tribunal (IDC) (in the case of Jamaica)<sup>35</sup>.

There exist some proposals to “rationalize” the conciliation function that is now exercised both by the Ministry of Labor and the Industrial Court (IC), in Trinidad and Tobago (Pegus, 2003). The alternatives are, to put it at a strengthened Conciliation Unit of the Ministry of Labor (MOL) or at the Industrial Court. Our arguments favour to leave this role to the Industrial Court, which has more autonomy from the political process<sup>36</sup>.

### **3.1.2 The termination of contracts**

The impact of severance payments on the labor market is a topic that has been widely studied (Heckman and Pagés, 2000). Severance payments increase the cost of firing and, therefore, contribute to “job security”. But they also increase the cost of hiring. The net result is lower employment and lower turnover rates. To this one has to add the increase of the “insider” power of incumbent workers, who pressure for higher wages, reducing employment creation. There is also an impact on the composition of employment: a bias against younger and unskilled workers and an expansion of the informal sector.

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<sup>32</sup> This labor legislation not only refers to collective bargaining. It also refers to the settlement of disputes by negotiation, conciliation and arbitration. For example, in the case of Trinidad and Tobago, labor legislation does not permit workers of firms that are not unionized to go directly to the IC without registering with a union (except in the case of retrenchment and severance payments). But more than 70% of workers are not unionised. For them there exist two possibilities. The first one, is to remain without a mechanism to settle disputes with their employers. In this case they may end up perceiving labor rules as unfair. And this would affect the social legitimacy of labor legislation. The second possibility is to feel forced to belong to a union. In this case they may perceive that there is no due respect for the right of workers not to unionise, if that is their desire. In this case our recommendation would be to authorize workers that are not unionized, to go directly to the Industrial Court, without having to register in a union. The fact that a worker that belongs to a union may have more “resources” to defend himself, or herself, at the IC, should not take us to leave those that are not unionized without access to the judiciary system.

<sup>33</sup> This emphasis in bi-partite collective bargaining and labor relations should be accompanied by an amendment of the procedures for the recognition of trade unions, to make it more expeditious.

<sup>34</sup> To overcome the fears of a sharp increase in industrial action, this interventionism could be lifted in a gradual manner.

<sup>35</sup> In those situations where arbitration exists, as is the case of Trinidad and Tobago or Jamaica; or in the case of essential services that cannot be interrupted, “final offer” arbitration is recommended. According to this procedure the arbitrator can only choose between the offers of the parties in conflict. Final offer arbitration induces moderation on both sides up to the point of making bi-partite agreements more possible. The arbitration service can be privately provided.

<sup>36</sup> There are also some interesting proposals to give more autonomy to the Industrial Court (Pegus, 2003). Union leaders in Bahamas also suggested the possibility of an independent conciliation board.

The facts that it is costly for the employer to fire a worker and it is costly for the employee to quit<sup>37</sup>, has an impact over the quality of labor relations. It may oblige them to maintain a relationship that they would rather avoid. This does not contribute to productivity growth<sup>3839</sup>.

First, lets describe the labor institutions in each country and the cost of job security regulation.

In the case of Bahamas, redundancy payments consider a notice period of two weeks, when the worker has been employed for more than a year, and a severance pay of two weeks per year<sup>40</sup>. If the worker had a supervisory or managerial position, the notice period and severance pay are doubled.

In Barbados, in the case of retrenchment, if the worker has been employed for more than 104 weeks but less than five years there is a notice period of two weeks, that increases to four weeks in the case that he has been employed more than five years; and a severance pay of two and a half weeks per year, if the worker has labored more than one year and less than ten, three weeks for each year over ten, and three and a half weeks for each year over twenty<sup>41</sup>. Barbados is the only Caribbean country that also has an unemployment insurance (UI) that guarantees up to 26 weeks of benefits, that represent over 50% of the wage, for workers of the private sector that have labored at least 26 weeks in the previous 9 months<sup>42</sup>.

In the case of Trinidad and Tobago, when the cause is retrenchment, the employer has to give a notice of 45 days (9 weeks)<sup>43</sup> and pay two weeks per year, if the worker has been less than five years in the firm. In the case that the worker has been for more than five years in the firm, he or she is entitled for the fifth year and for each succeeding completed year of service to three weeks of pay. In case of “unfair” termination of the contract the IC may increase the compensation<sup>44</sup>. When an employer proposes to terminate the services of five or more workers for the reason of redundancy he should give formal notice of termination to each individual worker, to the recognized majority union and to the Minister (that may initiate a conciliation process). One of the shortcomings of the Act is that it does not adequately deal with the situation of workers who lost their job because of bankruptcy.

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<sup>37</sup> He or she loses the right to severance pay.

<sup>38</sup> These are the most frequent although not the only possible effects.

<sup>39</sup> Also, employers tend to restrain wage increases for senior workers, since wage readjustments not only increase future wage payments but also severance payments associated to past seniority.

<sup>40</sup> If the worker has been employed for more than six months but less than a year, the notice period and severance pay will be half of this.

<sup>41</sup> Since 1993, severance pay has been reduced, from about 4 weeks per year to 2.5 weeks per year. Now, the government is discussing with business and labor the possibility of increasing the notice period.

<sup>42</sup> The unemployment insurance was established in 1983.

<sup>43</sup> It can also pay these days of work instead of giving notice.

<sup>44</sup> There is also the possibility that the court may decide reinstatement, but that seldom occurs.

In the case of Jamaica, a worker that has been employed more than four weeks will receive a notice period of at least two weeks, if he has been employed for more than five years he will receive a notice period of at least four weeks, if employed for more than ten, fifteen or twenty years he will receive a notice period of at least six, eight or twelve weeks, respectively. With respect to severance pay, workers that have labored at least two years in the firm will receive two weeks for each year, during the first ten years of work; and three weeks, per year of work, for every year, after the first ten.

A similarly situation is that of Guyana. If the contract is terminated as a consequence of redundancy there is a notice period of two weeks, if the worker has labored less than a year and one month if he has worked for over a year. Severance pay is one week per year, if the worker has labored for more than a year and less than five, plus two weeks for each year after the fifth year and up to the tenth, and finally three weeks for every year in excess of ten years, up to a maximum of 52 weeks.

A more complex situation is that of Suriname. The Dismissal Decree, that regulates the termination of contracts, indicates that an employer needs to ask for permission to the Dismissal Commission, a tripartite board, with a detailed justification of why that worker needs to be dismissed<sup>45</sup>. If the Commission agrees to the retrenchment, because of economic reasons, the worker receives a period of notice of one month<sup>46</sup> plus one week per year of work from the fifth until the tenth year; four months if he has worked more than ten years and up to fifteen; and six months if she has worked sixteen years or more (MOL, Suriname, 1981). The employer can pay the period of notice, instead of letting the worker remain in his or her job. But if the Commission rejects the petition, the worker may stay in the firm. Still the employer can go to the Sub-district Court, but that will take two to three years<sup>47</sup>. He can also try to bargain with the worker to obtain her resignation<sup>48</sup>.

The problem with this regulation is that it creates a lot of uncertainty in labor relations. The employer cannot estimate the cost of hiring a person, since he is not sure if he will be able to end the relation in the future, or at what cost. The regulation goes against what is probably the main interest of most employers: to retain control over the working of the firm. That is why it raises such a passionate debate. One should not underestimate the impact of this regulation over the quantity and the quality of employment creation. Specially, since employers have alternatives to avoid, at least partially, this regulation. They can, and do, resort to contract labor<sup>49</sup>. When this occurs the end result is that firms

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<sup>45</sup> The board has 30 days to give its resolution, a lapse that can be extended for another 30 days.

<sup>46</sup> This is only the case for the monthly wage earner, if she is an hourly, daily or weekly wage earner this first period of notice is of one week, plus one week per year from the second until the tenth year. After that, it is the same as for monthly wage earners.

<sup>47</sup> If he loses he has to pay the salaries of all of the duration of the trial.

<sup>48</sup> Some big companies separate workers from their jobs and pursue the conflict at the court.

<sup>49</sup> There are at least three ways of doing this. Sometimes, they hire workers for a fixed number of months, and when the time expires, they renew the contract. Since they can only do this for two years, at the end of that period they leave the worker with a few weeks without a contact before renewing it. A second way of

diminish the proportion of workers that they recognize as theirs, and that are protected by their collective agreements, with a growing proportion of workers that are hired by “other” employers. Is the dual internal labor market of firms that is induced by this type of regulations, in the interest of workers and unions? One could argue that the answer is no.

The expected discounted cost of dismissing a worker, in multiple of monthly wages is, in Trinidad and Tobago, between two and three. Then comes Barbados with a little over two, and Jamaica and Guyana with about 1,8, coinciding with the average for the Caribbean countries. Finally, Bahamas is slightly below that average. Suriname is a special case, because it has an administrative restriction that makes it, because of the uncertainty of the process, the most costly system of the region. The cost in all of the countries is higher than the industrial countries average, and lower than the Latin American average (except Suriname) (Heckman and Pagés, 2000).

There are several possible areas of reform. Different alternatives can be applied to the different countries. First, there are potential benefits for both labor and business of reducing uncertainty about payments associated to retrenchment, by a modification of the administrative procedures<sup>50</sup>. The obvious case is that of Suriname. It has a system that creates a high degree of uncertainty to both parties. Nobody knows if the Dismissal Commission will authorize the retrenchment. Probably a good idea would be to replace the uncertain costs that come with the need of an authorization to dismiss, for a severance pay. The creation of this severance pay could be convenient both for workers and firms.

A second road to reform would consist of the substitution of part of severance pay for benefits to workers when they quit or retire<sup>51</sup>. This would also reduce the uncertainty of the payment the worker is to receive; and would make it less costly for the worker to quit and for the employer to dismiss him, reducing the strength of “insiders”, and eliminating one of the factors that make severance pay an obstacle to productivity growth.

A third road to reform would consist of the creation of a defined contribution system, administered by the private sector, for those payments that are received by the worker when he is made redundant, or he quits or retires. In this case, what is distributed is the fund that is created<sup>52</sup>. When a firm goes bankrupt it is frequent that workers lose their

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doing this is redefining the job of the worker after the two years have passed. A third way out of this regulation is outsourcing.

<sup>50</sup> We assume that both labor and business are risk averse.

<sup>51</sup> To maintain the cost of labor, if the benefits are going to be extended to the case that the worker quits or retires (or bankruptcy, when legislation does not deal adequately with this case, as is the case in Trinidad and Tobago), the “notice period” or the severance pay would have to be reduced.

<sup>52</sup> This fund can take the form of an individual savings account or a collective savings account. In the second case there is risk pooling among workers. But the higher the cross-subsidies among groups of workers (for example, between the old and the new ones) “the higher are the employment costs because workers with low risk are less willing to pay” (IDB, 2003). Also, the collective programs have problems of moral hazard and informality.

severance pay benefits. Especially when their payments come after those of many other creditors. This is, for example, the case of Trinidad and Tobago. In this situation, workers would probably be willing to accept a lower but more secure payment. From the point of view of firms, the present system is like having to pay for the fire insurance of a house only after the fire has been declared. Employers would probably be willing to accept a higher average payment, but that doesn't need to be paid at the moment of economic difficulties. So there should be space for a bargained agreement.

What is the probable effect of these reforms over employment<sup>53</sup>? There would be, in the first place, a reduction in the degree of uncertainty with respect to the benefits to be perceived, because there would be less uncertainty in the administrative procedures, there would be some payments in the case of bankruptcy and also when the worker retires or quits, and also because a fund would be created. Therefore workers would perceive this benefit more as part of their remuneration than as a tax on labor. Hence, they would probably be willing to work at a lower wage than under the present situation<sup>54</sup>, facilitating an increase in employment<sup>55</sup>. The exact estimate of employment growth will depend, first, on the exact reduction of the cost of labor as workers perceive less uncertainty associated with this benefit, and demand lower wages. The greater this change the bigger the impact on employment. The same is true with respect to the reduction of the strength of “insiders” and its impact over wages. Second, the impact will be greater the higher the elasticity of the demand of labor, with respect to labor costs<sup>56</sup>.

There is a need of a transition from one system to the other. There are several alternatives. First, previous seniority could benefit from the old severance payments system whereas the new years of seniority would benefit from the new one<sup>57</sup>. So the new rules of severance pay would apply only for future years. If even that is not possible, then it may be convenient to apply the new rules only to new workers. These transition formulas could improve the chances of approval of the reform.

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When compared to a “defined benefit” system that is “funded”, a “defined contribution” system reduces the risk for firms when there is an aggregate or systemic shock, because it puts a ceiling to the amount to be paid. This facilitates adaptation of firms and reduces the risk of bankruptcy. Also, a defined contribution system makes increases of wages for workers with seniority more probable. On the other hand, a “defined contribution” system does not guarantee a certain number of weeks of severance payments, per year of seniority.

<sup>53</sup> We assume that they are applied without increasing the cost of labor of those presently with contracts.

<sup>54</sup> We assume that workers are, in general, risk averse. We also assume that they prefer severance payments to administrative procedures, and that given the uncertainty in severance payments, they prefer some payments in case they retire or quit than more “job security” with higher payments only in some of the cases of retrenchment (when companies do pay). We cannot prove that these assumptions are correct (they are derived from interviews with workers, employers and labor experts).

<sup>55</sup> We assume that there is some elasticity of the demand for labor with respect to wages.

<sup>56</sup> A change from a “defined benefit” to a “defined contribution” system would probably favour employment also because, as we argued above, it reduces the risks for firms when there is an aggregate or systemic shock. This makes adaptation easier, and reduces the risk of bankruptcy.

<sup>57</sup> Except in the case of Suriname that would need to get rid of the administrative restrictions right away.

There are several countries that have funds such as the one proposed here. Brazil, Colombia, Perú and Ecuador have had these systems for many years (Heckman and Pagés, 2000). Also Chile, in recent years, has created a system of individual accounts for the protection of the unemployed. The employer and the worker contribute 1,6% and 0,6% of the wage, respectively, to the individual account. When the worker is fired or quits, he or she can draw up to 50% of his or her salary each month, for up to five months.

Finally, the creation of a “defined contribution” system for severance payments could open the way to discuss, in the future, the creation of “defined contribution” systems in other areas, such as pensions.

We have recommended a partial reform, and not the total elimination of the “notice period” and severance pay associated with retrenchment, among other reasons, because labor institutions are also social institutions, and most societies find that the pursuit of some degree of “job security”, and specifically severance pay, is an ingredient that makes their social consensus possible<sup>58</sup>.

This takes us to our third recommendation:

Third recommendation: reduce uncertainty about payments associated to retrenchment; substitute partly severance payments for benefits to workers when they quit or retire; create a “defined contribution” system, administered by the private sector, for those payments that are received by the worker when he is made redundant, quits or retires; and change the rules of severance pay only for future years.

### **3.1.3 Enforcement**

As important as labor legislation is the way those norms are enforced. We are interested in legislation inasmuch as it affects the behaviour of workers and employers. And for that to occur these rules of the game have to be enforced.

It is essential to accept that the “rules of the game” relevant for the working of labor markets are of two types: the “formal” (laws, contracts) and the “informal” (conventions, norms and codes of behaviour of the different “players”, including the public sector). The kind of enforcement that exists is, up to an important degree, the result of the “informal” rules of the game applied in this area.

In the case of most of the Caribbean countries there seems to be an agreement that enforcement is fairly weak<sup>59</sup>. In general, enforcement occurs only when unions complaint. There are insufficient officers, that normally lack the resources to do their job.

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<sup>58</sup> I believe this is also the case of most of the Caribbean countries considered.

<sup>59</sup> This was a common opinion among labor and business leaders in most of the countries. Especially in those cases where workers are not unionized.



This is clear with respect to minimum wages, but it also seems to be the case in other areas. For example, in the case of Trinidad and Tobago, it has been argued that the fact that the new minimum wages, put in place in 1998, were not enforced reduced the negative impact that they would have had on employment (Strobl and Walsh, 2001). But, as the country develops there will eventually be a greater enforcement of legislation. For that to occur, more resources will have to be dedicated to this purpose. But more resources are only part of the answer. To be effective in this area it is not just a question of resources but also of policy design.

The rule in Latin America has been that enforcement institutions have followed basically a “police approach”, which has had only limited efficacy (Tokman and Martínez, 1997). The fact is that there are not enough inspectors, that they are not adequately trained, and do not have all the tools that are necessary for this task.

One of the recommendations of many analysts at this respect (Tokman and Martínez, 1997) has been that it is necessary for enforcement to take a “prevention” and “promotional” perspective (educating business and workers), with an active co-operation of labor and business associations, and not only a “labor police” perspective (that concentrates only in finding who is not complying to try to apply a sanction).

We are persuaded that, given the resources that most Caribbean countries will probably dedicate to this purpose, the “labor police” approach will never be strong enough to enforce legislation, in an adequate manner. A better solution requires the active cooperation of society, and the creation of “social norms” that favour the compliance with labor legislation.

This cooperation among labor and business associations, that we promote, could take the form of tri-partite sponsored public campaigns oriented towards the compliance with labor legislation. It is fairly obvious that business will be more willing to “listen” to this message when the leaders of business associations have an active role in the promotion of these practices<sup>60</sup>.

Fourth recommendation: develop a “prevention” and “promotional” approach to enforcement, seeking the co-operation of labor and business associations<sup>61</sup>.

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<sup>60</sup> Chile successfully applied a collaborative approach to the enforcement of labor legislation, not only at the national level, but also in specific sectors, such as forestry (Cortázar, 1996).

<sup>61</sup> There are other areas of reform to labor legislation, besides the ones we have mentioned, that are being considered by several of the countries of the Caribbean. Trinidad and Tobago has an advanced reform on occupational health and safety. This topic is also being discussed in Jamaica. The government of Barbados has initiated a process of consultation with respect to norms that would give more flexibility to the distribution of working hours during the week (The so-called 24/7. Leaders from the BWU do not want flexibility across the board. They want to bargain different conditions for different sectors). This is an issue that seems crucial for a service oriented economy. (The fact that the economy has moved from agriculture to services demands an adjustment of labor institutions). In Barbados there is also a debate with respect to the best way to reduce absenteeism.

## 3.2 Minimum wages

Of the countries that we are considering, Trinidad and Tobago, Jamaica and Bahamas have national minimum wages<sup>62</sup>. Guyana has different minimum wages for 14 sectors of activity, which cover most of the sectors<sup>63</sup>. These minimum wages are normally suggested to the government by tripartite committees<sup>64</sup>. Barbados has minimum wages only for shop assistants and domestic service, but there is some debate about the convenience of creating one<sup>65</sup>. The idea of establishing a minimum wage is also present in Suriname<sup>66</sup>.

The first question that one should try to answer is if the present level of minimum wages, in these countries, is high or low.

### 3.2.1 Minimum wage versus minimum income

A crucial distinction that needs to be made is that between minimum wage and minimum income. The “living” requirements of the worker and his (or her) family are relevant to the definition of the “minimum income”, which not only includes the wages of the family members that work, but also all transfers that a family may receive.

Sometimes people link the “living” requirements to the concept of minimum wage. But, even if we were to determine a minimum wage that would guarantee the “living” requirements of a worker, that objective would only be attained in the case of those workers that manage to find a job at that salary. If the “living” minimum wage is too high, from the point of view of job creation, many workers will be unemployed or underemployed, and the objective of guaranteeing a “living” minimum income for all workers will not be attained.

That is why it is convenient to distinguish between the concepts of minimum wage and minimum income. The minimum wage has to be used to guarantee access to employment and the minimum income to guarantee access to more adequate living standards. This distinction is especially important for economies like those of the Caribbean, that through

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<sup>62</sup> Jamaica has a special minimum wage for security workers, which is about 50% higher than the national minimum wage. The reason for this would be the higher risks they face, because of high crime.

<sup>63</sup> Many sectors that do not have minimum wages, supposedly pay more than that; such is the case of sugar, poultry and shrimps.

<sup>64</sup> They have different names. In Jamaica it is the Minimum Wages Advisory Commission; in Guyana it is the Minimum Wages Tripartite Committee; and in Trinidad and Tobago it is the Minimum Wage Board. Most of these committees act by consensus, even though some are dominated by persons appointed by the government, such as in the case of Trinidad and Tobago.

<sup>65</sup> Some people in Barbados perceive minimum wages as a mechanism to avoid the drastic fall of wages, as a consequence of international migration of labor, especially from Guyana.

<sup>66</sup> The MOL said it was designing a minimum wage policy (2005).

the surpluses of the modern sectors<sup>67</sup> can obtain the resources that are necessary to increase the minimum income of the poor, without necessarily increasing their minimum wage. As one of the persons we interviewed put it: “to have a living income is ok, we agree on that, the question is who is going to pay for it?”

### **3.2.2 Minimum wages and productivity**

We are analyzing labor institutions, and among them the minimum wage, from the point of view of their impact on employment and competitiveness. We have argued that in an open economy the evolution of wages has to be closely linked to the evolution of productivity<sup>68</sup>. If they grow faster than productivity firms lose competitiveness and there is job destruction. So, from this point of view, the relevant question is if the present levels of the minimum wage are compatible, or not, with labor productivity, at full employment.

There are several indicators that suggest that minimum wages in the Caribbean are higher than the ones that would guarantee full employment.

First, compute the minimum wage as a proportion of per capita income, using the latter as an indicator of average productivity<sup>69</sup>. The country with the lowest relative minimum wage, among the ones we are considering, is Trinidad and Tobago. Bahamas has a minimum wage, as compared to per-capita income, that is 50% higher than that of Trinidad and Tobago<sup>70</sup>, Jamaica has a minimum wage, relative to per-capita income, that is 75% higher; whereas Guyana’s minimum wage, relative to per-capita income, is almost three times that of Trinidad and Tobago.

But even though Trinidad and Tobago has by far the lowest minimum wage of the countries considered (as a proportion of per capita income), it is still fairly high, when compared with other countries that compete with the Caribbean. When compared to per capita income, minimum wages in Trinidad and Tobago are more or less the same than those of Brazil, but 15% higher than those of the United States and 80% higher than those of Mexico.

Second, there is also indirect evidence that points in the same direction. Take the case of Trinidad and Tobago, since it is the country with the lowest minimum wage, in comparison to its per-capita income. There is a study that shows that the potential costs of the minimum wage (when it was fixed at \$TT 7.00), in terms of employment, would have

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<sup>67</sup> Oil and gas, alumina and bauxite or tourism.

<sup>68</sup> In a closed economy employment is more dependent on the level of internal demand. Wage increases may contribute to employment, even if they grow faster than productivity, because of their contribution to spending. In an open economy that relation holds in a much weaker form.

<sup>69</sup> Per capita income is an indicator of total production per worker, and not strictly of labor productivity. The latter is measured by the coefficient that converts labor hours into effective labor in terms of production (Helpman, 2004). But still, we will use per capita income as a first approximation of labor productivity.

<sup>70</sup> The same is true of the minimum wages for shop assistants in Barbados.

been large, if there had been compliance (Strobl and Walsh, 2001)<sup>71</sup>. The lack of compliance reduced the potential costs of a minimum wage, but also the potential benefits aimed at by that policy.

Third, the employment surveys for Trinidad and Tobago indicate that in 2002, the employees working for the government and for state enterprises earned more than the minimum wage, but that one out of four paid workers in the private sector earned less than the minimum wage (a month) and 43% of own account workers were in the same situation (CSO, 2003)<sup>72</sup>.

Finally, minimum wages not only have an impact on employment. They also influence directly the lower wages of the public sector (especially daily paid workers) and may “push” upwards the wage structure of other public sector workers. Additionally, some studies for Trinidad and Tobago have indicated that minimum wages exert important effects on the rest of the labor market, by shifting the entire wage structure upwards, and negatively affecting formal sector employment (Rambarran, 1998)<sup>73</sup>.

From the arguments we have made someone could be tempted to conclude that it would be a good idea to reduce the minimum wage so as to guarantee full employment<sup>74</sup>. But, we believe that this is not feasible, from a political point of view. We recommend that minimum wages at least should not grow faster than the productivity of labor.

Taking the opposite point of view from ours, in some countries there has existed a discussion about the convenience of creating new minimum wages, much higher than the national one. This was the case of Trinidad and Tobago, in recent years, where there existed proposals to establish a higher minimum wage for workers in the heavy construction sector<sup>75</sup>; although it seems that this idea has been abandoned. This is also the case of Barbados where there exists a debate with respect to the convenience of establishing sector-specific minimum wages. Guyana has already established sector-specific minimum wages for most sectors. What is the conceptual basis for these proposals? Why should the law dictate a higher wage for one specific sector? Workers in that sector are more in need than the rest? The less productive workers of that sector (even though they would be more productive than in other sectors of the economy)

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<sup>71</sup> Today's minimum wage, in real terms, when compared with average productivity, is similar to the one considered in that study.

<sup>72</sup> Some of these workers may be part time, but still the conclusion holds.

<sup>73</sup> Some people could argue that having higher minimum wages that are not enforced is a sensible solution, from a political point of view. The fact that minimum wages are higher gives a political dividend, whereas the fact that they are not enforced avoids the costs of higher unemployment and underemployment. But there are various downsides to this strategy. Sooner or later, as Trinidad and Tobago, and the rest of the Caribbean countries, advance in the road to development, enforcement will improve. Secondly, it is very important to have, in the long run, a consensus that wages in an open economy should grow at the same rate than labor productivity. Thirdly, even if minimum wages are not enforced they do affect, in different proportions, the rate of growth of the rest of the wage structure.

<sup>74</sup> Even though the minimum income could continue to grow.

<sup>75</sup> Almost four times higher.

should not be permitted to continue to work there? On the other hand, it is evident that if a new minimum wage is applied to one particular sector, there would be a pressure from workers of other sectors to have their own minimum wage. So the issue at stake is, why would it be desirable to have sector specific minimum wages?

On the other hand, these sector specific minimum wages remove one of the most important incentives for collective bargaining and union affiliation. Therefore there exists, in this case, a trade-off between stronger government intervention in the labor market and the development of a stronger civil society.

### **3.2.3 Public sector wages and productivity**

Public sector employment and wages also influence wages, and hence competitiveness, in the private sector, although indirectly. First, there is the so-called “crowding out” of employment. The fact that public sector employment is high, leaves a smaller excess-supply of workers for private sector jobs<sup>76</sup>. This is certainly the case of several countries of the Caribbean. An extreme case is that of Suriname where, according to some estimates, public sector workers would represent over 45% of total employment<sup>77</sup>; but also Jamaica would have more than 35%, Trinidad and Tobago over 30%, and Barbados more than 20% of employment in public sector jobs (Downes, 2004). This compares with 12 % for Latin America and the Caribbean<sup>78</sup>. Bahamas is slightly above this average. The same effect is produced by government make-work programs that pay the minimum wage, such as the URP and the CEPEP programs in Trinidad and Tobago<sup>79</sup>.

Second, if wages, or more generally compensations and working conditions<sup>80</sup>, in the public sector are better than those in the private sector, the more effective workers will prefer public sector jobs, inducing an additional “wage push” for the private sector<sup>81</sup>. This seems to be the case in several Caribbean countries, especially in relation to wages of the lower echelons of the wage ladder<sup>82</sup>.

Third, the rate of growth of public sector wages is frequently used as a reference for the adjustment of wages of private sector workers, which are not covered by a collective

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<sup>76</sup> So the “equilibrium” wage ends up being higher and employment lower that would otherwise have been.

<sup>77</sup> This includes workers in public sector companies.

<sup>78</sup> In making these comparisons one has to consider that there are some economies of scale in government, so one would expect a higher proportion of public sector workers in the small Caribbean countries.

<sup>79</sup> The URP program, that is the more significant of the two, pays a minimum wage, for up to 12 weeks in the year.

<sup>80</sup> In the case of Suriname, for example, public sector workers have much better conditions in terms of pensions and health after they retire.

<sup>81</sup> If a private sector company wants to hire a good secretary, not only will there be a smaller number of candidates for the job, but it will have to compete with public sector wages.

<sup>82</sup> According to our interviews, this would seem to be the case in Barbados, Trinidad and Tobago (where the minimum wage of public sector workers doubles that of the private sector), Jamaica, Suriname and Guyana.

agreement<sup>83</sup>.

All of this leads us to our fifth recommendation:

Fifth recommendation: minimum wages and public sector wages, in real terms, should reflect the rate of growth of the productivity of labor<sup>84</sup>. Sector specific minimum wages should be avoided<sup>85</sup>. The government should redistribute incomes to the poor, through increases in the minimum income; through monetary subsidies, or through benefits in the form of education, training, health or housing. That is an effective way to advance in reducing inequality and exclusion.

### **3.3 Training<sup>86</sup>**

Vocational training has developed at a fast pace during the past years. Everybody agrees it could be an important contribution to the development of the Caribbean countries. Specially considering that, as we argued in the previous section, these are “high wage” economies, and therefore need to be “high productivity” ones. The need for training is strengthened by the fact that many of the better trained people emigrate, and leave domestic firms, as one minister said, “at the low end of the food chain”. There is the need to up-skill the existing workforce and to strengthen key skills in learning and technology related subject areas. There is a big number of training institutions and in some of the Caribbean countries, the government is spending increasing amounts of money in this area. But there are doubts if the process is efficient and effective in attaining its goals.

#### **3.3.1 Efficiency**

In Jamaica, vocational training is offered by the Heart Trust/ National Training Agency, a public institution that receives a training levy of 3% of all wages. That makes it a training institution with very abundant resources<sup>87</sup>. It develops programs in Institution Based Training, through its own Academies and Vocational Training Centers. Most of the training is offered in these public institutions, although some of the students have a month of practical experience at a firm, when possible. This program is the most

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<sup>83</sup> This is not to say that there are no problems in the collective bargaining of public sector workers. In many cases they are very constrained by the government budget restrictions. As one union leader put it in Guyana, “more than collective bargaining, we are really in the process of collective begging”. After an unsuccessful strike in 1999, they have not been able to bargain better conditions than those that the government has been willing to give. This same view was confirmed by a minister.

<sup>84</sup> To create a point of reference for the minimum wage policy it may suffice to have some basic statistics of GDP growth and employment growth. That will provide an order of magnitude of the wage readjustment that should not be surpassed.

<sup>85</sup> It is not the purpose of this document to analyse wage determination in the public sector. But there seems to be the need to introduce deep reforms in this area. There is the typical combination of too many workers, too badly paid (specially in the case of professionals), a lack of flexibility in job definitions, no good evaluation systems, seniority rules for promotions, and a lack of performance related pay.

<sup>86</sup> In this section we refer only to vocational training. There is no mention of secondary or vocational education.

<sup>87</sup> The 3% levy makes Heart an unique experience in this matter.

significant one of Heart, in terms of financial resources. There is also the Community Based Training, realized in partnership with community groups, and the Enterprise Based Training. The latter includes on the job training for high school graduates, apprenticeship and workforce development programmes. Part of the supply of training for this program is done by accredited private training organizations. In the board of Heart there is participation of labor and business associations. One distinctive element of the Heart case is the high degree of legitimacy that it seems to have both from business and labor<sup>88</sup>.

In Barbados vocational training is offered, basically, by the Barbados Vocational Training Board (TVET), a public institution<sup>89</sup>.

The same is true for Bahamas where vocational training is done by the Bahamas Technical and Vocational Institute (BTVI), that has a dependence from the Ministry of Education<sup>90</sup>.

In Suriname, vocational training is offered by the Vocational Training Institute, also a public institution, with a tripartite board.

In Guyana, training is overseen by the Board of Industrial Training, a public institution, with a tri-partite board. Training is offered by some public firms, especially Guysuco and Guyana Power and Light, as well as through programs that are financed by government. The main program, as of now, is one that has just started, on the basis of on the job training, that will benefit almost 1800 workers a year, for the next three years.

In Trinidad and Tobago there are many training institutions, both public and private. There are evaluations that argue (Werum, 2003) that in the public institutions there is a “public servant mentality”. And that this does not contribute to the dynamic and responsive behaviour that is required in this area. So there would be a problem of efficiency.

But, more generally, there doesn't seem to be a good reason why the supply of training should be provided by public training institutions. Once the subsidies and the rest of the incentives that will orient the training process are put in place, the supply of courses could well be provided by the private sector.

There is abundant evidence, both in Latin America (IDB, 2001) and elsewhere (Blanchflower and Lynch (1994) and Dolton et. al. (1994)), which indicates that the provision of training is more efficient when provided by private training institutions, than by the public sector institutions that are dominant in the Caribbean. To guarantee the quality of these private training institutions there is the need of an accreditation. We will comment this issue when making our ninth recommendation.

In the near future it is very probable that a great majority of the public institutions will remain as such. But, anyway, one could start as of now privileging the creation and

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<sup>88</sup> Whereas some business leaders told us that Heart should be “a benchmark for the world” union leaders said that “because we sit on the board we have a common understanding about where the institution is going”.

<sup>89</sup> Most of the students are in the skills training program, that has a duration of 5 to 9 months.

<sup>90</sup> There is some provision of vocational training by the Atlantis University.

expansion of private institutions. Also, one should try to create a more adequate structure of incentives for public institutions, for example linking the budget and pay to performance (IDB, 2001).

A recommendation in this area would be:

Sixth recommendation: promote the development of private training institutions (and improve on the structure of incentives of public training institutions).

### **3.3.2 Efficacy**

For the success of training, even more important than the issue of efficiency is that of efficacy. We refer to the relevance of training for the necessities of the labor market.

There is a rather widespread agreement, both in Latin America (IDB, 2001) and elsewhere (Elias et. al. (1994), Groot et. al. (1994)), that the best way to attain this objective is through “demand driven” training programs.

There are basically two forms to attempt to respond to demand, so as to develop those abilities that are going to be needed at the labor market.

The first one, is the traditional way of doing this, that was used in past decades in most of Latin America and the Caribbean, and is still applied in many countries. The State would project the demand for labor for different sectors and types of qualifications and, on the basis of those results, the State training institutions would develop their programs. But now, both globalization (the more intensive integration to the world economy) and the higher speed of technological change, make job requirements and job descriptions change very rapidly making it very difficult for a public institution, through the use of surveys, to grasp what the true needs of training are going to be<sup>91</sup>. Since 2000, in Trinidad and Tobago, surveys are provided by the National Training Agency (NTA, 2002)<sup>92</sup>, and some training institutions use this instrument to orient their courses. These surveys are also present in some of the other Caribbean countries.

The second way to learn about the abilities that are going to be needed in the labor market is through the so-called “dual approach”. Students obtain the theoretical contents at the training institutions and the practical experience at the firms that receive them as trainees<sup>93</sup>. Some programs of the Heart Trust/NTA agency follow this approach. The same is true in Trinidad and Tobago, specifically in the Metal Industries Company (MIC) and the Trinidad and Tobago Institute of Technology (TTIT). There are also some courses of the Barbados Vocational Training Board (TVET) and the Bahamas Technical and Vocational Institute (BTVI) that follow the apprenticeship system. But in all cases they are only a small fraction of the total supply.

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<sup>91</sup> The definitions used in those surveys are way too general to provide a clear orientation to training institutions.

<sup>92</sup> Before that year most institutions did not have this instrument.

<sup>93</sup> We use the term “dual approach” broadly, to identify those situations where students get theoretical contents at training institutions and participate as trainees at firms. We do not use the concept to refer to the specifics of the German training system.



If one is to pursue this second approach, when the government is going to spend money in training, besides being rigorous in the standards of quality for the different courses, it should require from institutions, public or private, that before opening the vacancies for a course, they obtain a commitment from those firms that are going to receive these students as trainees. The assumption behind this mechanism is that firms, in general, do not receive trainees in areas where they don't have the intention of hiring. So if firms are willing to receive students in certain areas, or with certain abilities, it would be an indication that the potential need for those workers in the labor market is there. Additionally, this creates a "feedback" process between firms and training institutions. When training institutions request from firms vacancies for their program of trainees, it is fairly common that they receive "demands" from those firms, in terms of the content and the orientation of courses. This "feed-back" is also useful for the relevance of training<sup>94</sup>.

There exist other mechanisms through which institutions can try to link the content of training with the needs of the labor market, such as the use of surveys to learn about the employment situation of former students, or through the creation of boards or advisory committees, in which business people participate. But we are persuaded that these alternative mechanisms are less effective than the so-called "dual approach". Therefore, they should be used as a complement but not as a substitute of it.

Additionally to the mechanism mentioned above, that attempts to obtain information about the needs of the labor market; it is also necessary to link budget and pay to performance, especially in the case of public training institutions<sup>95</sup>. We define performance as the quality of the response of training institutions to the requirements of the labor market.

When we talk about the needs of the labor market, we not only refer to technical skills but also to work attitudes and habits (IDB, 1998). In several of the Caribbean countries, among them Barbados, they are mentioned as a more crucial factor than the specific skills attached to each job.

Finally, the velocity of economic and technological change that we mentioned as characteristic of our epoch, requires that the tools and machines used in training have to be renewed more frequently. This is very costly for training institutions, and almost impossible for most of the public ones<sup>96</sup>. The so-called "dual-approach" (or apprenticeship system) is also at this respect a better solution. It makes it possible for students to have a practical experience with the tools and machines that they will actually find at the labor market, and not with the outdated ones that are still used in most training institutions.

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<sup>94</sup> Working in the opposite direction of causality, training institutions can also help firms identify their needs of training.

<sup>95</sup> This requires monitoring and evaluation.

<sup>96</sup> This situation was confirmed to us over and over again during our interviews with government authorities in the Caribbean.

This takes us to our seventh recommendation:

Seventh recommendation: promote the development of a “dual approach” training system.

### **3.3.3 Public goods in training**

But besides building more efficient and effective training institutions, it is necessary to create some “public goods” that are crucial for success.

The fact that firms are not sure to collect all the benefits from training, especially in the case of general training, as workers can move to other companies, makes them underinvest in their workers. They invest less than what would be the optimum, from the point of view of the whole industry<sup>97</sup>.

Countries use different strategies to solve this problem (Lynch, 1994). Germany follows a tripartite approach, with local chambers of commerce using moral persuasion to protect firms that train their workers from excessive poaching by other companies. Japan puts high costs on employees who quit a firm. Sweden uses government support. France and Australia use a tax subsidy for firms that train their workers, a system that is fairly common in Latin America (IDB, 2001).

We believe that a tax subsidy is the policy that would be most consistent with the tradition and corporatist structure of Caribbean countries<sup>98</sup>. Trinidad and Tobago has an arrangement of this sort. Firms can declare, for tax purposes, up to 50% more than what they actually spend in training. Given that the income tax for firms is of about 25%, they receive a subsidy of around 12% of what they spend. This seems a good policy, even though probably the magnitude of the subsidy is too low. Jamaica and Barbados tried a different solution. In the case of Jamaica there exists a training levy contribution, that cannot be spent directly by firms, but goes to the HeartTrust/VTA, that offers training to companies. A similar solution is that of Barbados. The training levy goes to the Barbados Vocational Training Board (TVET), a tripartite institution that allocates those resources to firms. The use of these resources in the form of a tax subsidy would make the training system more demand driven, and therefore probably more effective. At any rate, if no subsidy is considered, there will be underinvestment in training<sup>99</sup>.

This leads us to our eighth recommendation:

Eighth recommendation: create a tax break for firms that train their workers<sup>100</sup>.

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<sup>97</sup> This reflects the so-called “prisoners dilemma”.

<sup>98</sup> The Caribbean countries do not have the German corporatist structure and tradition; nor the fiscal resources of Sweden; nor the labor legislation and tradition that would make quitting very expensive for workers.

<sup>99</sup> As a leader of an employers association in Suriname put it, if there are no tax incentives, since trained workers are free to move to other firms, companies tend to train “only family and friends”.

<sup>100</sup> In the case of Bahamas, were there are no income taxes, the government could subsidize part of the cost of training. This would complement the effort that the hotel industry should develop through its employers

Another public good that is crucial for training is information. The existence of a “certification” and “accreditation” process would make it possible for potential employers to learn, at a reasonable cost, about the quality of the training that workers have received. Obviously, this is especially important when there is a multiplicity of training institutions.

Jamaica has already established an accreditation and certification system, through the Heart Trust/NTA, creating the National Vocational Qualification of Jamaica. It is being used widely to certify workers in Jamaica, and has contributed to the creation of the CARICOM Vocational Qualifications.

At present the governments of Trinidad and Tobago, Barbados and Guyana are in the process of creating accreditation and certification systems.

This takes us to our ninth recommendation:

Ninth recommendation: create an effective accreditation and certification system.

Next, consider the importance of loans and subsidies for training. The justification for a system of loans is the limitation of the access to the financial system, for most students, to finance education and training. The justification for subsidies lies in the desire of governments to favour training of the poorer segments of workers<sup>101</sup>.

For example, in Trinidad and Tobago, today there exist, in tertiary education, two funds for loans to students, that are in the process of integration. With respect to subsidies, we recognize their existence in the form of free (or subsidized) training as well as in the form of specific programs, such as the “dollar for dollar” program. The “dollar for dollar” program provides matching funds for students enrolling in tertiary education, primarily in public institutions (Werum, 2003). But this will change, since the government has decided to guarantee free access to tertiary education.

The same approach has been present in Barbados for quite a long time. In Barbados there is the conviction that the access to free education is a “right”, which helps integrate society. The fact that this is a very emotionally charged discussion, makes it is very difficult to argue about the advantages of a system that charges the cost of education to the higher income families; even though it is quite obvious that enrolment in tertiary education would have increased more rapidly if those students that had the means to pay would not have received the subsidy, and many students that did not enter tertiary education because they did not have the funds to maintain themselves, would have received a greater subsidy<sup>102</sup>.

A different approach is followed in Jamaica and Guyana, where the government charges for tertiary education and has a revolving student loan fund, for lower income families.

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association, since there exists a major challenge at this respect. Otherwise, the country will not reap all the benefits for its workers of the development strategy it is pursuing.

<sup>101</sup> As well as the recognition that training, as education, has positive external effects.

<sup>102</sup> This requires “means-testing” for the access to subsidies.

But still, independently of the trends in tertiary education, there is a lesson to be learnt about financing education and training, that constitutes our tenth recommendation.

Tenth recommendation: give “training-loans” to the upper and middle classes, and “training-subsidies” to the poor.

### **3.4 Industrial relations**

Some of the studies made for the Caribbean point out that there is a need to develop a better management culture<sup>103</sup>, as well as more cooperative behavior at the firm level (IDB, 1998). These better management culture and industrial relations cannot be imposed by law. They have to be the result of the conviction of persons and firms that this is the best way to go. There is no more effective instrument for this objective than the active promotion of best practices by organizations of civil society (business associations, universities, NGOs). It does not mean that there is no role for the government or for International Organizations. These instances, especially the latter, can play a very important “indirect” role, not promoting the best practices themselves, but inducing the organizations of civil society in this task.

This takes us to recommendations eleventh and twelfth:

Eleventh recommendation: disseminate best practices of management.

Twelfth recommendation: disseminate best practices of industrial relations.

A specific instrument that can induce better management and better industrial relations is performance based compensations. This is a crucial tool to expand competitiveness, as well as social protection<sup>104</sup>.

In the countries of the Caribbean that we are considering, there doesn't seem to exist legal restrictions to the expansion of performance based compensation systems. The most frequent obstacle is probably the lack of interest of workers and business in developing these type of labor institutions. There seems to exist a combination of lack of conviction that this is a crucial labor institution to attain compatibility of competitiveness and social protection (Figure 3), insufficient knowledge of how to measure performance<sup>105</sup>, plus the requirement to share information on the workings of the firm<sup>106</sup>, and the lack of “trust” in labor relations, behind the limited use of performance based compensations.

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<sup>103</sup> This was the view expressed by business leaders in Barbados and Guyana. There are more differences of opinion about this issue in the other countries.

<sup>104</sup> Performance based compensations seem to be present in Barbados, and more absent in Trinidad and Tobago, Bahamas, Jamaica, Suriname and Guyana.

<sup>105</sup> This is especially true for the public sector.

<sup>106</sup> Especially in the case of firms that do not have the legal obligation to give detailed financial information to the market, that is firms that do not participate in the stock exchange, which constitute the immense majority of them.

What to do about it? In practical terms, it doesn't seem to be necessary to create new legislation in this area. Probably, the best way to go is through the dissemination of best practices. This is recommendation thirteen:

Thirteenth recommendation: disseminate best practices of performance based compensations.

### **3.5 Social Dialogue:**

Most Caribbean countries have tri-partite arrangements that are used as instances of social dialogue. The benchmark in the region at this respect is Barbados, that had great success with a “social compact” signed in August of 1993, that included a wage reduction, so as to induce a real depreciation, without a devaluation of the nominal exchange rate. That first protocol has been followed by other four (Downes and Nurse, 2004). And the results are viewed by all social actors as being positive. Other tri-partite institutions in Barbados include the National Productivity Council, oriented at the implementation of measures so as to increase productivity in the economy. Besides their impact on specific objectives, these exercises on social dialogue, at the very least, permit information sharing and, as one high authority in Barbados put it, “keeps things relatively quiet at the labor front”<sup>107</sup>.

In Jamaica, there is the Labor Advisory Council where labor policies are discussed with business and labor. There is also the Minimum Wages Advisory Commission, that makes suggestions to the government about wage increases. In many ministries, for example in health and trade, there exist tripartite consulting boards. There is also a very fruitful experience of social dialogue at the level of different sectors, such as bauxite, the Jamaican Water Commission and ports. In the public sector, the signing of a MOU, in 2004, that agreed on a wage freeze and a job freeze, was very instrumental to avoiding a debt crisis that was very threatening for economic stability.

In the case of Trinidad and Tobago there exist several specific instances where social dialogue (or a “social compact”) takes place. This is the case, for example, of the Minimum Wage Board and of the Registration, Recognition and Certification Board. At a more general level, a few years ago social partners agreed on a declaration called “Compact 2000 and beyond”, that reflected their willingness to co-operate to attain several economic and social goals. But the agreement has not been implemented<sup>108</sup>.

In the case of Suriname there is, among others, the Conciliation Board<sup>109</sup>, the Dismissal Commission<sup>110</sup>, the board of the Vocational Training Institute, and the National

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<sup>107</sup> There are also costs associated to these type of exercises. For example, the agreements in Barbados have at some points included the commitment from the government of no firing from the public sector.

<sup>108</sup> Both labor and business leaders manifested, in the interviews we had with them, that the results of this process have been scarce.

<sup>109</sup> That participates in collective bargaining.

<sup>110</sup> That has to authorize dismissals.

Employment Advisory Commission<sup>111</sup>. In the nineties there was also an agreement of wage freeze, to overcome economic difficulties, among the government, and unions and business that identified themselves with the government.

In the case of Guyana there is the National Tripartite Committee<sup>112</sup>, the Board of Industrial Training<sup>113</sup>, the National Council for Technical and Vocational Education<sup>114</sup> and the Trade Union Recognition Board.

In the case of Bahamas there is a more informal social dialogue without the establishment of these numerous tripartite commissions. There are some interesting experiences of bi-partite social dialogue between unions and employers, especially in the hotel industry.

These social dialogue processes are not isolated from the political system. The interactions between the social organizations and the political system express themselves in many dimensions. Some are positive<sup>115</sup>. Some are negative. An example of the latter, is the interaction between the political system and the process of social dialogue in Guyana. The very confrontational relationship that exists in the political system (The Economist, 2005), translates itself to the social dialogue process. There is lack of trust. Many demands of the labor movement are interpreted by the government as political opposition, because of the links of unions to opposition parties, and many actions of the government are interpreted by unions as political actions. This is aggravated by the fact that the division between government and opposition reflects a racial divide. In this context, it is very difficult to discuss an economic and social agenda with objectivity. To overcome these difficulties there has to be more cooperation from the political system<sup>116117</sup>. A process to which international organizations could make a very significant contribution<sup>118</sup>.

In a lesser degree, the political and ethnic divide is also a difficulty in Trinidad and Tobago. Anyway there seems to exist a recent trend in the direction of de-politization that is present also in other countries, such as Jamaica. At any rate, the creation of instances

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<sup>111</sup> The MOL is considering the creation of a Social and Economic Council.

<sup>112</sup> That analyzes labor policies.

<sup>113</sup> That oversees the training process.

<sup>114</sup> This Council overviews all technical and vocational education, and is related to the Ministry of Education.

<sup>115</sup> For example, as an indication of the positive relationship of labor union leaders and the government, in Barbados, the president of the BWU is a senator, appointed by the government.

<sup>116</sup> This is another indication that the quality of the economy and the quality of the social process are closely linked to the quality of politics.

<sup>117</sup> Sometimes a change in the government coalition is enough to discontinue the social dialogue effort. It was the case of Trinidad and Tobago. At the end of the nineties there existed well advanced conversations to reach a social agreement. With the change of government these were interrupted to give rise to a new dialogue around Vision 20-20.

<sup>118</sup> This is an area where there can be a very significant impact of the IDB.

of social interaction, especially informal ones, can help create the basis of mutual trust, that is at the heart of the successful cases of social dialogue<sup>119</sup>.

It seems to be the case that the chances of success in social dialogue are the greatest when there is a big crisis, or a big opportunity. The 1993 agreement in Barbados and the 2004 agreement in Jamaica are examples of crisis-induced agreements. The excellent terms of trade of the economy of Trinidad and Tobago, could offer that big opportunity.

What recommendations can we make in this area? The first thing is to use all opportunities to stimulate a social dialogue both at the national level as well as in different sectors and regions. The government has a crucial role in leading this process. This creates the base for consensus building that is crucial to enhance the political resources available for the reform process (Figure 1), and that is also essential for the stability of development policies. Anyway, in following this strategy, one should avoid an ideological approach to the process of social dialogue. The most extreme neo-conservative views state that unions and, in general, organizations that represent corporatist interests, interfere with the adequate workings of markets, and have a cost in terms of social welfare. The most extreme neo-corporatist views, on the contrary, value social participation at every moment and place, and hence, favour it without second thoughts. We are persuaded that more effective than discussing “if” to have social dialogue or not, is discussing “what for”, “where” should it take place and “how”. The answer will vary according to the “agenda”.

Take the case of national agreements, like the ones of Barbados, or even like the Vision 2020 of Trinidad and Tobago. What for? To build a national consensus with respect to the development strategy. Where? Mainly at the national level, but also in different sectors and regions. How? Through a tripartite social dialogue. Consider the case of wage determination. What for? So that wages may grow with productivity. Where? It should be a process that takes place at the firm level. How? Through bi-partite bargaining.

In the case of minimum wage policy. What for? So that minimum wages may grow together with productivity. Where? Agreements should take place at the national level. How? Tripartite bargaining (you need the government at the table because you need a law). In the case of training policies. What for? So as to increase productivity and the capacity of workers to adapt to change. Where? At the national level or at the industry level. How? Through tripartite agreements (you need a law and subsidies for training low income workers).

These examples show that the election of national, industry or firm level for dialogue, as well as the election of bi-partite or tri-partite bargaining schemes, is not the result of ideology or some general proposition, but of the specific agenda that is at stake.

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<sup>119</sup> There are many specific ways to advance in this direction. For example, by inviting union leaders to the talks, that antecede the negotiations of free trade agreements. It need not be a very structured or bureaucratic process.

Governing by consensus?

As we argued above the pursuit of social agreements should not be transformed into a rigid ideology. Take the case of reforms to labor institutions. In some countries government authorities argue that the “organization of the labor sector” should be done in a tri-partite way. That seems a reasonable strategy, but only as step number one. What if there is no agreement among the three parties? Should that take the country to a dead lock? Not only would that seem questionable from the point of view of democratic theory, it would also be the most effective way to impede consensus building. We know that during the bargaining process all parties compare the costs and benefits of the potential agreement to the “best alternative to a negotiated agreement” (BATNA) (Fisher and Ury, 1981). When you assert that you are going to act only on the basis of consensus, if any one of the social partners prefers the status quo to the probable agreed upon solution, attained through bargaining, on any topic that is being considered, it will just veto any change, impeding the reform of labor institutions. The BATNA for both parties would normally be the status quo. Sometimes business will veto change, and on other occasions it will be labor. The final result will in all probability be dead lock. Whereas, if the government asserts the threat that if there is no agreement, it could act on its own, then both parties would have an incentive to try to conciliate their points of view, so as to diminish the uncertainties of the political process. The BATNA would not be the status quo, but the uncertain outcome of the political process. One could argue that, even though it may seem a paradox, the best way to attain a social consensus, would be for the government to indicate that it is willing to act without a social consensus.

Finally, this is a process that requires not only of a substantive dialogue, but also due respect for rhetoric. For example, in analyzing labor reform it may make a great difference to emphasize the need of modernizing labor legislation, than to identify the issue as one of increasing labor flexibility.

This more instrumental (as opposed to a more ideological) view should take us to accept that even though it is convenient to emphasise social dialogue whenever agreement is possible, in some other cases it is better not to get involved in a such process (when the expected costs of reaching an agreement exceed the benefits) and accept social conflict (or non-agreement) as the best solution. For example, and there are many cases of this sort, you may wish to implement a “performance related pay” for teachers, and it may be impossible to attain that result through a social dialogue, or social concertation, process with the teacher’s association.

Therefore, our proposition is not that of concertation, but of “concer-flict”. We should identify at each moment in time which are the areas where social agreements should predominate (like the national agreements of Barbados; and they must be significant if one wants to create and maintain a high degree of social cohesion) and which are the areas where there should be a greater presence of conflict.



This takes us to our fourteenth recommendation:

Fourteenth recommendation: create instances for social dialogue; and have agreements whenever possible and conflict whenever necessary<sup>120</sup>.

### **3.6 The role of the Ministry of Labor**

The role of the Ministry of Labor (MOL) has changed together with the shift in the development strategy. The “old development strategy” pursued by most of the countries in Latin America and the Caribbean, from the 1930s until the 1980s; emphasised import substitution and recognised the presence of a fordian technology, and a relatively homogeneous labor force (men head of households). In that scenario labor policy consisted of a “direct” intervention of the government in the labor market, to influence wages, employment and working conditions.

Governments intervened in collective bargaining through tripartite arrangements<sup>121</sup>, directly trained workers through public training institutions, and directly administered the social security and health systems. Frequently, governments also tried to solve employment problems through “make work” programs, or stimulating specific sectors, according to their “labor-intensity”.

When the development strategy was modified, as a result of the processes of globalization and technological change, governments started emphasising export promotion, and recognised the presence of the so-called flexible technologies, and the existence of a more heterogeneous labor force (including women and students). As a result of this, governments started intervening “indirectly” in the labor market to influence wages, employment and working conditions.

This does not mean that governments decided to avoid their responsibility in the design and enforcement of labor institutions. In most cases, they decided to act “indirectly” leaving a greater role to the market and civil society.

When we discussed labor legislation our recommendation was to maintain collective bargaining at the firm level, as a bi-partite affair. Therefore, the government would participate setting the rules of the game but not as a significant third "player" in labor relations. Another of our recommendations was to implement a “defined contribution” system for severance payments, administered by the private sector.

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<sup>120</sup> Specially in countries where there is a lack of trust among social partners, IOs (and specifically the IDB) could play a very constructive role, since they are accepted by all parties.

<sup>121</sup> In the "old" labor market (of a closed economy) wage policy was part of the keynesian tool kit. A means to affect aggregate demand. Many Latin American countries even had compulsory wage readjustments for those workers of the private sector that were not covered by collective agreements. Governments used wage policy, together with fiscal and monetary policy, as a way to regulate aggregate demand, and employment. It was recommended, for this purpose, that bargaining took place at an aggregate level, with a tripartite approach (to co-ordinate wage policy with monetary and fiscal policy).

In the case of enforcement we suggested a "prevention" and "promotional" perspective, with a significant role for labor and business associations. Additionally to an effective labor inspection, there would exist an indirect role for the government in promoting the action of the social actors.

When we discussed the case of minimum wages we objected the implantation of sector specific minimum wages, among other reasons, on the basis that they would weaken the role of direct bargaining between labor and business.

In the case of training we emphasised the private supply of training, in the framework of a "dual approach". It is not that the government should not have a role. It should have a crucial one: to provide the institutional framework, to create a tax break for firms that train their workers, to create an effective accreditation and certification system, and to incentive the development of "training-loans" for the upper and middle classes, and of "training- subsidies" for the poor.

The same situation occurs in relation to the pension reforms that have been applied in many countries of Latin America, with pension funds administered by the private sector. It is not the case that the government has abdicated of its obligations with respect to social security. It is intervening "indirectly" to guarantee protection for the old age.

With respect to social dialogue, the government has a crucial role in leading the process, but the main thrust of the challenge relates to civil society. This leads us to our fifteenth recommendation:

Fifteenth recommendation: the Ministry of Labor (MOL) should intervene "indirectly" to favour better employment, wages and working conditions.

Finally, there is the question of the place and contribution of the MOL within the government. For this issue to be adequately discussed, one needs to recognize that the main causes of the evolution of employment and wages are not the specific policies normally applied by the MOL, but growth and development.

Hence, the MOL should try to be part of all economic and social decisions that influence growth and development. It should try to put itself at the core of government decision making evaluating the impact on "labor" of the different policies<sup>122</sup>, and being a vehicle for the participation of "social actors" in the different economic and social decisions, through social dialogue. For example, in the discussion of free trade agreements.

This is a very different role than the one that the MOL normally plays in most countries of Latin America and the Caribbean. The most common case is that the MOL is an institution that only handles grievances (role that we have suggested should be reduced), or acts as an "ambulance", creating special employment programs when things go wrong

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<sup>122</sup> The MOL has to have the capacity to evaluate the impact of the different policies on "labor", especially in the case of labor policies and programs. In the case of the countries of the Caribbean, this capacity has to be enhanced.

(Cortázar, 1997).

To play this more significant role the MOL has to be perceived within government, and by the other political and social actors, as backing, in a consistent manner, the economic and social policies, as implemented by the economic and social teams (specifically the Ministry of Finance).

Frequently, in many countries of Latin America and the Caribbean, the MOL has preferred to remain as a “weak” government institution, with a “close” relationship with trade unions, a “distance” in relation to the “economic team”, and a certain irrelevance in decision making (Cortázar, 1997). A role that gives it very little power to influence political, social and economic events.

This leads us to our sixteenth recommendation:

Sixteenth recommendation: integrate the MOL as a significant member of the "economic team".

## **4. THE STRATEGY**

### **4.1 The two forces of change**

We have made a set of recommendations to reform the rules of the game, of the labor market. To analyze the strategy of reform we have to recognize that there are two forces that contribute to, or obstruct, the desired adaptation of these rules: feedback and lock-in. Feedback is the "process by which people perceive and react to the changes in the opportunity set" (North, 1990, p.7). Globalization and technological change would induce an adaptative (feedback) process with regards to institutions. We can perceive this trend all over the world. Countries, especially governments, try to adapt the "rules of the game" to the new reality. But, acting in the opposite direction, lock-in "comes from the symbiotic relationship between institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions.... The increasing returns characteristics of an institutional matrix that produces lock-in come from the dependence of the resultant organizations on that institutional framework and the consequent network externalities that arise" (North, 1990, p.7). Many of the organizations that were born in the old labor market, and under the old rules of the game, resist change. For example, typically a nation-wide teachers union, that was born under the old rules of the game, will resist the decentralization process in education, that would lead to a reduction in its organizational power. Feedback is OK. Our task is to cope with lock-in.

## 4.2 The recommendations: impact and difficulties

To comment on the strategy of reform, we present a summary of our sixteen recommendations, together with a subjective assessment of the magnitude of the impact (high (H), medium (M), low (L)) that they would have on variables such as labor productivity growth and competitiveness, and employment creation (Table 1). We also include a subjective assessment of the degree of difficulty associated to the implementation of each one of these recommendations (high (H), medium (M), low (L)). Most of these difficulties arise from the lock-in and inertia that obstructs reforms. Also, some of them come from a lack of resources or of the institutions required for the new policies.

It is the relation between the potential impact and the degree of difficulty that indicates the “bang for the buck” of different policies.

These evaluations are for the region as a whole. Below we make some comments for specific countries.

**TABLE 1. POTENTIAL IMPACT AND DEGREE OF POLITICAL DIFFICULTY OF RECOMMENDATIONS**

Recommendation	Potential Impact	Degree of Difficulty
<b>I. LABOR LEGISLATION:</b>		
First: - maintain, as much as possible, collective bargaining at the firm level; or	H	L
- induce collective agreements at the firm level, when they are industry wide	H	M
Second: - strengthen the bi-partite aspects of collective Bargaining	H	L
Third: - reduce uncertainty about payments associated to retrenchment;	H	M
- substitute partly severance payments for benefits to workers when they quit or retire;	M	M
- create a “defined contribution” system, for those payments that are received by the worker when he is made redundant, quits or retires; administered by the private sector;	M	M
- change rules of severance pay only for future years	M	M
Fourth: - develop a “prevention” and “promotional” approach to enforcement, seeking the co-operation of labor and business associations.	M	L
<b>II. WAGE POLICY:</b>		

Fifth: - minimum wages and public sector wages, in real terms, should follow the rate of growth of the productivity of labor. Sector specific minimum wages should be avoided;	H	M
III. TRAINING:		
Sixth: - promote the development of private training institutions (and improve on the structure of incentives of public training institutions).	H	M
Seventh: - promote the development of a “dual approach” training system.	H	M
Eighth: - create a tax break for firms that train their workers;	H	M
Ninth: - create an effective accreditation and certification system.	M	L
Tenth: - give “training-loans” to the upper and middle classes, and “training-subsidies” to the poor.	H	M
IV. INDUSTRIAL RELATIONS:		
Eleventh: - disseminate best practices of management	M	L
Twelfth: - disseminate best practices of industrial relations	M	L
Thirteenth: - disseminate best practices of performance based compensations	M	L
V. SOCIAL DIALOGUE:		
Fourteenth:- create instances of social dialogue; - have agreements whenever possible and conflict whenever necessary;	M H	L M
VI. MINISTRY OF LABOR:		
Fifteenth: the Ministry of Labor (MOL) should intervene “indirectly” to favour better employment, wages and working conditions.	H	M
Sixteenth: integrate de MOL as a significant member of the “economic team”.	H	M

Needless to say that there is a high degree of subjectivity in these evaluations. And we are not in the position to “prove” that our classification is the “correct” one. But there is no alternative to these “educated guesses”. Policymakers need to make them to govern, and IO need to make them to provide policy prescriptions. Still, the propositions are not arbitrary.

For example, with respect to the recommendation to maintain collective bargaining at the firm level we assert that the potential impact is high, because otherwise wages would probably grow at a different pace than productivity, inducing unemployment. And we suggest that the degree of difficulty is low because, as we have argued above, the

organizations that resist change, and create inertia, are normally the ones that were born under the “old rules of the game”. But in this case, since these countries have bargaining mostly at the firm level<sup>123</sup>, the organizations that exist are adapted to this institution. In other words, inertia is on our side<sup>124</sup>. The opposite occurs with the second part of the first proposition, that recommends to induce collective bargaining at the firm level when it is industry wide. The impact is high, for the same reasons that we have just given. But the difficulty is not low but medium, because probably organizations have adapted to industry wide collective bargaining, and therefore inertia is now a restriction to change.

When we recommend to strengthen the bi-partite aspects of collective bargaining, inertia is also mostly on our side. It is true that in all countries there is some third party participation, especially in the case of Trinidad and Tobago (with the arbitration of the Industrial Court) and Jamaica (with the arbitration of the Industrial Disputes Tribunal)<sup>125</sup>. But most of bargaining is a bi-partite affair.

The fact that these first two recommendations have a “high” impact and a “low” difficulty, indicates that the rules of the game related to collective bargaining are an asset for the Caribbean countries. But, still they should not be forgotten as part of our policy prescriptions, since there are social and political forces that aim at their modification. If that were to occur, significant binding constraints for employment and development would emerge.

With respect to the termination of contracts we suggest to reduce the uncertainty about payments associated to retrenchment. This is especially urgent in the case of Suriname since, as we have mentioned, there exists a very significant administrative restriction that makes this institution very costly in terms of employment creation and competitiveness. We consider that, in general, the impact of reducing this uncertainty would be high. But, obviously, the magnitude of the impact would depend on the magnitude of the distortion. The biggest impact would occur in the case of Suriname. On the other hand we have said (Table 1), that this reform would have a medium degree of difficulty. Again, this would vary from country to country. Our view is that the reform would be most resisted in the case of Suriname, since these norms have become the source of a very passionate debate.

We also recommend to partly substitute severance payments for benefits when workers quit or retire, and to create a “defined contribution” system. We assert that there would be, in general, a “medium” impact and a “medium” degree of difficulty. There would be a “medium” impact since, on average, severance payments are not very high in these countries. Anyway, one would expect, *prima facie*, that the bigger the distortion, the

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<sup>123</sup> We recommend to maintain the “old rules of the game”.

<sup>124</sup> To maintain an institution that is working properly is a valid policy prescription, since if it is changed it could become a binding constraint for development. The constraints and incentives that need to be analyzed are not only the ones that are inexistent but also those that could be modified or suppressed.

<sup>125</sup> As we mentioned above there would be some advantages of transforming this arbitration procedure into “final offer” arbitration, which has the ability of helping induce bi-partite agreements.

bigger the impact<sup>126</sup>. If that is so, the country that would most benefit from this recommendation would be Trinidad and Tobago, then Barbados, and after them Jamaica and Guyana. Bahamas would be the less affected. We also indicated that this would have a “medium” degree of difficulty. Even though a reform of this type would reduce the uncertainty with respect to the benefits that the workers would receive and give them benefits, that at present they lack, when they quit or retire<sup>127</sup> (and this would be valued by unions), it would also reduce “job security” and the relative power of “insiders” (something unions probably would resist).

Our fourth recommendation is to develop a “prevention” and “promotional” approach to enforcement, seeking the co-operation of labor and business associations. We suggest that this would have a “medium” potential impact and a “low” degree of difficulty. After all, why would there be significant resistance to cooperate in a promotional task like the one described? This could be, in general, true for the countries of the region, but in those countries where there is a greater lack of trust between business and labor, as is the case of Guyana, probably there would be at least a “medium” degree of difficulty in the application of this policy.

In the case of minimum wages, our recommendation is to let them grow with the productivity of labor. That would have a high impact, as compared with the alternative to make them grow at a faster pace. We suggest a medium degree of difficulty. The degree of difficulty of letting minimum wages grow with productivity is not low because there is still the tendency to compare the minimum wage, and not the minimum income, with living requirements; and in most of these countries minimum wages are not able, by themselves, to cover the “living income” required by a family<sup>128</sup>.

Then comes training. To promote the development of private training institutions and a dual approach would have, according to our view, a high impact on the quality of training, competitiveness and employment. On the other hand, it would have a medium degree of difficulty. Probably a lower degree of difficulty in the more developed countries of the region that have a greater economic capability of developing these kinds of institutions. But restrictions are not only economic. There will be political resistance to expand the private supply of training, especially among the most traditional segments of society. One should also count on the resistance to a reform of this type from at least some of the people that today labor in the public training institutions.

To create a tax break for firms that train their workers should have the least resistance in Trinidad and Tobago, that already has an institution of this type but that needs to be strengthened. But it is a policy that should be expanded to other countries. The most

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<sup>126</sup> Even though this is not necessarily true, because in these countries there are other second best institutions that create other distortions, and we don't not how they interact with this one.

<sup>127</sup> Or in cases of bankruptcy in which workers lose their benefits.

<sup>128</sup> We have argued above that countries should aim at a “living income” through the summing up of the wages of the different people of the household that work, plus the transfers and subsidies that they perceive from the government.

important restrictions and difficulties are fiscal.

To give training loans to the upper classes and training subsidies to the poor, and therefore to charge for training, except in the case of the poor, is a “non-starter” in certain countries like Barbados and since recent times in Trinidad and Tobago. For those countries it would probably be more realistic to catalogue the degree of difficulty as “high”. But one can give this proposition a try in the other countries of the Region. That is why, on average, we assume a “medium” degree of difficulty.

To create an accreditation and certification system for training, and to disseminate best practices are safe propositions, with a medium impact and a very low degree of difficulty. The same is true with respect to the creation of instances of social dialogue<sup>129</sup>.

More complex, and with a higher impact over the results is the policy of having agreements whenever possible and conflict whenever necessary. This requires being able to identify some areas where reform will necessarily be accompanied with social conflict.

Finally, there is the task of changing the role of the Ministry of Labor. It would have a “high” impact, and a “medium” degree of difficulty, because reform in this area normally takes quite a bit of bureaucratic infighting. This analysis, that compares the impact and difficulty of different reforms helps us identify the “binding constraints” that are faced by the different countries, and also makes it possible to identify different possible strategies.

#### **4.2.1 The binding constraints:**

The binding constraints are identified by the policies where you get the biggest “bang for the buck”. Some of them are policies that we could name as “pro-active” and some of them are policies that we could call “reactive”. Among the latter are the two first recommendations. There is no bigger “bang for the buck” than to resist the pressures to move collective bargaining beyond the firm, or to make the government participate in collective bargaining. Just resisting those pressures may be deemed the most effective contribution of a Minister of Labor. And, of course, there are many pro-active policies that also matter. And they differ from country to country, because even though these countries have many similarities, they do not face exactly the same constraints. For example, to make minimum wages grow no faster than the productivity of labor is crucial for several countries, especially for Guyana. To reform rules for the termination of contracts is useful for most of the countries, but a crucial binding constraint in the case of Suriname. Social dialogue is also important for most of the countries, but very especially in the case of Guyana.

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<sup>129</sup> At this respect, the contribution of the IDB could be very important. The IDB is an institution that is perceived with great trust by many social and political actors of the region. Therefore it can provide a trustworthy “third party”, an “honest broker”, that may be very important for the success of these policies.



#### **4.2.2 The different strategies:**

Given the scarcity of political resources, and the difficulties imposed by lock in, governments may choose different ways of inducing reform:

The low risk and low return (at least in the short run) strategy:

If you are lucky enough to have collective bargaining at the firm level, and a bipartite bargaining process, as is basically the case for the countries that we have considered, you maintain them (that will have a high impact<sup>130</sup> and a low degree of political difficulty, because inertia is on your side). Then you have to choose all those policies with a low degree of difficulty. In the case of labor legislation, the development of a “prevention” and “promotional” approach to enforcement (fourth); in the case of training, the creation of a certification and accreditation system (ninth); with respect to industrial relations, you should contribute to disseminate best practices, in general management, in industrial relations, and with respect to performance based compensations (eleventh, twelfth and thirteenth); as for social dialogue, you should create a few instances to induce this process (fourteenth). You can also choose one or two of the recommendations with a medium degree of difficulty, and a high potential impact.

The medium risk and medium return strategy:

Besides pursuing the low risk and low return policies, also identify the “bottlenecks” relevant for your country and pick two or three of the six areas of intervention. It may be that in your country the “bottleneck” for competitiveness and job creation is labor legislation, or wage policy, or lack of training, or a very adversarial system of industrial relations, or a lack of social dialogue, or a very outdated Ministry of Labor. Once you have selected the relevant areas pick one or two policies in each area, with a medium degree of political difficulty. You can exchange two or three of these policies for one with a high degree of difficulty. This is not a precise exercise, but it tries to illustrate that there is a relatively fixed amount of political resources that you may “spend” on labor reforms. And, therefore, you have to choose.

#### **4.3 The high risk and high return strategy:**

Finally, there is the high risk and high return package. You can choose policies from all six areas of intervention. This “window of opportunity” seldom occurs. But you have to look for those opportunities that are also necessary for the medium risk and medium return package.

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<sup>130</sup> When compared with the alternative of modifying these rules of the game.

#### **4.4 Adapting the rules: shock therapy versus gradualism**

We have presented three types of strategies. The obvious question is: when to apply each one of them? There are two general scenarios in which change takes place: shock therapy and gradualism.

##### **4.4.1 Shock therapy**

In the case of shock therapy you can apply the “high risk and high return” strategy. Is only possible under very special circumstances. A revolution, a military dictatorship, a hyperinflation, very high unemployment rates, or some other deep crisis. In these very special situations it is at times possible for governments to impose a fairly coherent set of rules (for good or for bad) in a fairly short period of time. The "restrictions" that policy-makers normally face are suddenly, and transitorily, reduced. For every other day there is gradualism<sup>131</sup>.

##### **4.4.2 Gradualism**

In this case you have to settle for the “medium risk and medium return” strategy or the “low risk and low return” one. Is the most common of the alternatives. In this situation you normally need to be more subtle than under shock therapy. You have to consider that the new rules of the game cannot be transferred mechanically from the drawing board to reality. There are balances of power, unions and business associations, there are vested interests of all kinds and sorts. These are the real world circumstances under which the policy maker has to try to succeed.

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<sup>131</sup> The fact that you pursue a gradualist strategy does not mean that you refrain from advocating more ambitious reforms. You can always pursue a “two handed approach”: while you attempt to build a consensus around deeper reforms you advance in the gradualist policies that are viable, as of today.

## INTRODUCTION

The objectives of improving competitiveness and reducing unemployment, especially among the youth, are a part of the economic and the political agenda of most Caribbean countries.

To attain these objectives, labor institutions play a crucial role. They are fundamental for the working of labor markets (North, 1990), and affect, among other aspects, employment creation, labor productivity growth and competitiveness (Heckman and Pagés, 2000; OECD, 1994); the variables that will be at the centre of our discussion<sup>1</sup>.

We will analyse six types of labor institutions: labor legislation, minimum wages, training, industrial relations, social dialogue<sup>2</sup> and the role of the Ministry of Labor. In each case we will make policy recommendations.

We will conclude that the Caribbean countries have, with respect to labor institutions, many assets and also some liabilities. Among the assets one could mention the fact that collective bargaining takes place mostly at the firm level, and as a bi-partite affair. Also, with the exception of Suriname, severance payments are rather moderate. Social dialogue is well developed in several of the Caribbean countries, providing an instrument for consensus building. Among the liabilities one could mention the fact that these are “high wage” economies, when compared with labor productivity; in all of the countries with respect to minimum wages, and in some of the countries with respect to public sector wages. If these “high wage” economies want to be also “high employment” economies, they have to be “high productivity” ones. At this respect, the basic institutions do not seem to be the most adequate ones. For example, there are not enough incentives for training at the firm level, most of the training is provided by public institutions and there are insufficient linkages between the content of training and the needs of the labor market. Also, with respect to industrial relations, in several countries there is a deficit of best practices in management, industrial relations and the use of performance based compensations. But before we move on, let’s discuss the approach we will use in this work.

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<sup>1</sup> One could also discuss labor institutions from the point of view of labor standards, or of the degree of social participation; but the emphasis in this document is on the impact of labor market institutions on employment, competitiveness and growth. It is not that social participation is not important. As a matter of fact we dedicate a whole section to social concertation. But in this work we consider social participation as an instrument and not as an objective in itself.

<sup>2</sup> We will use the terms “social dialogue” and “social concertation” as synonymous.



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