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STATUTORY WAGES AND EMPLOYMENT STABILIZATION IN DEVELOPING COUNTRIES: SOME OBSERVATIONS ON LATIN AMERICA

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I. Introduction

Although the humanitarian ideals embodied in modern social welfare legislation rarely engender controversy, the actual achievements of this same legislation often do. Rather than helping those groups in a society who are exploited by substandard wages, unsafe or unhealthy working conditions, or are vulnerable to job loss by one means or another, it is frequently argued that the legislation has the opposite effect. Child labor laws lead to high unemployment rates for younger workers; statutory wages cause the discharge of low-skilled workers (both young and old) as their employment becomes uneconomical; social security costs induce employers to substitute capital for labor and thus reduce employment costs of this kind; and so on.

That social legislation does have an impact on employment is undenied. Instead the argument is joined first over the magnitude of the employment impact on the one hand and secondly on the value of the benefits received by those employed on the other. Existing empirical data, unfortunately, shed little light on these two questions. Moreover, most of the research carried out has been limited to the developed nations and that particularly to the United States.[1] This is a significant omission when one considers that social welfare programs are quite extensive in most

The author wishes to acknowledge his indebtedness to Mr. Juan Viudez for his valuable suggestions in formulating the research problem.

1. The major exceptions to this generalization, at least as far as Latin America is concerned, appear to be: Tom E. Davis, "Dualism, Stagnation, and Inequality: The Impact of Pension Legislation in the Chilean Labor Market," Industrial and Labor Relations Review: Vol. 17, April 1964, pp. 380-398; and Lloyd G. Reynolds, "Wages and Employment in a Labor Surplus Economy," American Economic Review, March 1965, pp. 19-39.

developing countries while concomitantly, employment problems bulk large as major economic and political issues.

It is the premise of this paper that in particular two classes of social legislation, statutory minimum wages and employment stabilization policies, are in good part responsible for explaining several observable labor market phenomena in Latin America: (1) stagnation of industrial sector employment; (2) very large wage differentials between agricultural and industrial sectors; and (3) relative uniformity of wage rates within the industrial sector. One is also tempted as well to add to this high rates of urbanization of Latin American population since this also seems in part traceable to the dysfunctional consequences of wage and employment legislation.

The discussion in Part II of the paper will identify certain characteristics predominating in Latin American labor markets as well as relate these characteristics to several generally accepted explanations of labor market structure and functioning in developing countries.

In Part III the statutory wage and job stabilization legislation will be analyzed for their potential employment and wage impact. Here resort will be made primarily to marginal analysis from economics in order to identify causal relationships.

The final section will consider the implications derived from the analysis, indicating briefly the direction evolving manpower policy might be channeled toward alleviating the dysfunctions associated with wage and employment legislation in developing countries.

II. Discussion

In recent years economic science increasingly, albeit grudgingly, has come to accept the premise that economic growth is a function of human resource development as well as capital accumulation and levels of investment. No longer is it heresy to suggest that "/t/he building of modern nations depends upon the development of people and the organization of human activity. Capital, natural resources, foreign aid, and international trade, of course play important roles in economic growth, but none is more important than manpower."[2] The work of Harbison and Myers,[3] Schultz,[4] Hagen,[5] McClelland,[6] Weber[7] and others has long since taken its toll.

The recognition accorded to human resource development and manpower planning has in turn generated concomitant theoretical and empirical attempts directed at describing, explaining and predicting the precise causal nexus between economic growth and the quality and quantity of an area's human resources. On the basis of the "models" as well as data now accumulated, one can generalize Latin American societies to be characterized as: (1) dual economies in which small modern industrial sectors exist as

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2. Frederick Harbison and Charles A. Myers, Education, Manpower, and Economic Growth, New York: McGraw-Hill, 1964, p.v.

3. Ibid.

4. T. W. Schultz. "Investment in Human Capital," American Economic Review, Vol. 51, No. 1, March 1961.

5. Everett Hagen, On the Theory of Social Change, Homewood: Dorsey Press, 1962.

6. David C. McClelland, The Achieving Society, Princeton, N.J.: Van Nostrand, 1961.

7. Max Weber, The Protestant Ethic and the Spirit of Capitalism, New York: Charles Scribner's Sons, 1958.

enclaves within much larger undeveloped agricultural sectors;[8] (2) rapidly urbanizing populations in which mass migration from rural to urban areas prevail;[9] and surplus labor markets in which visible and disguised unemployment are rampant in both rural and urban areas.[10]

More particularly, derivable generalizations regarding the process of structural change in Latin American labor markets would also indicate that: the sectoral expansion of employment should be one in which a decline in agricultural employment occurs with a rise in manufacturing or industrial employment which then declines in the face of an expansion of employment in the service or tertiary sector;[11] average wages paid to workers in the modern or capitalist sector should exceed those paid to subsistence sector workers only by a small amount (that necessary to cover costs of transfer

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8. Various authors have dichotimized developing countries in terms of capitalist vs. subsistence; traditional vs. modern and so on. Cf. W. A. Lewis, "Economic Development with Unlimited Supplies of Labour," The Manchester School of Economic and Social Studies, Vol. XXII, No. 2, May 1954, pp. 139-191.

9. A plethora of materials exists for the issue of urbanization in Latin America but for two recent efforts see: Glenn H. Beyer, The Urban Explosion in Latin America, Ithaca: Cornell University Press, 1967; and Gerald Breese, Urbanization in Newly Developing Countries, Prentice-Hall, 1966.

10. Economically speaking, surplus labor will be defined as those workers whose marginal product is negligible or zero. See Stanislaw Wellisz, "Dual Economies, Disguised Unemployment and the Unlimited Supply of Labour," Economica, February 1968, p. 35.

11. Colin Clark, The Conditions of Economic Progress, 3rd edition, London: MacMillan and Co., 1957, pp. 492-494. According to Clark "...as time goes on and communities become more economically advanced, the numbers engaged in agriculture tend to decline relative to the numbers in manufacture, which in their turn decline relative to the numbers engaged in services." (p. 492)

from one sector to the other in addition to higher urban cost of living);[12] and, finally within the industrial or capitalist sector, as economic development advances wages of skilled workers should increase at a proportionately faster rate than those for unskilled workers.[13]

The growth, structure, and pricing of labor factor inputs in response to the course of Latin American economic development thus can be hypothesized in some detail. Moreover, an impressive amount of evidence is being accumulated in support of the first three sets of generalizations considered above; that is, that Latin American societies are dual economies marked by rapid urbanization and surplus labor.

Support, based admittedly on fragmentary data, for the second set of three hypotheses, however, is much less evident.

<u>The sectoral expansion of employment</u>: Contrary to Clark as agricultural employment has declined, manufacturing or industrial employment has not expanded. Rather as Table I shows, employment growth has been limited to the services sector.

Individual countries showing a marked decline in the proportion of manufacturing employment in the period 1947-1960, are Chile, Ecuador,

12. With an unlimited supply of labor from the subsistence sector, employers can hire any quantity of units of labor desired at a constant wage. The labor supply curve thus approximates perfect elasticity with changes in capitalist sector wage levels dependent upon changes in the subsistence sector. Lewis, pp. 145-151.

13. The logic of this generalization is that while there are unlimited supplies of unskilled workers available at a constant wage, the same can not be said for skilled workers. The supply of the latter is much less elastic, hence with upward shifts in the demand for skilled labor, the price must necessarily rise, widening the gap between skilled and unskilled wages in the capitalist sector.

TABLE I

DISTRIBUTION OF EMPLOYMENT BY ECONOMIC SECTORS
LATIN AMERICA 1925-1960

	Percent of Economically Active Population		
	Agriculture and Mining	Manufacturing	Services(a)
1925	62.3	13.7	24.0
1950	52.2	14.5	31.4
1955	51.1	14.3	34.6
1960	48.3	13.4	37.4

(a) Includes construction to maintain comparability with Clark

Source: "Structural Change in Employment Within the Context of Latin American Economic Development," Economic Bulletin for Latin America, Vol. X, No. 2, October 1965, p. 167.

Haiti, Panama, Paraguay, and Peru while most of the remainder experienced a stationary or minimal change.[14] Mexico shows the very interesting result of employing relatively fewer in its manufacturing sector in 1960 than it did at the advent of its revolution in 1910.[15] While some

14. International Labour Organization, Manpower Planning and Employment Policy in Economic Development, Report II, Eighth Conference of American States Members of the International Labour Organization, Ottawa 1966, pp. 43-45.

15. Statistics presented in Nacional Financiera, Statistics on the Mexican Economy, Mexico, D.F., 1966, p. 26 give a sectoral division of employment to be:

	Agriculture and Extraction	Mfg.	Service and Construction
1910	64.4	15.4	18.7
1960	51.8	13.1	30.5

authors[16] contend that we are merely witnessing "an employment multiplier effect" in which one new manufacturing job creates the need for three or four jobs in the service sector, the more conventional explanation is one in which rural migrants to urban areas, unable to secure factory employment, are forced into service employment of a predominantly petty nature. In Lewis' terms they come to occupy urban subsistence employment.[17] Thus, in contrast to the United States and Europe, where better than one-half of urban employment is accounted for by industrial work, Latin American urban centers provide one-third or less of their job seekers with industrial work.[18]

Finally of major significance, given continuing mass migration to urban areas, is the conclusion that these same urban areas, the center for most industrial activity, are diminishing in ability to absorb the expanding urban labor force.[19] A basic explanation for this phenomenon is to be found in ". . . the prevailing tendency in major enterprises to reduce manpower input-output ratios as far as possible in order to diminish heavy social security payments involved and to simplify labour problems."[20]

16. See Walter Galenson. "Economic Development and the Sectoral Expansion of Employment," International Labour Review, Vol. 87, June 1963. Galenson argues that "Under conditions of modern technology, however, /the manufacturing sector's/ role is not likely to be that of a major source of new employment. Rather it will tend to generate the effective demand leading to employment expansion in other sectors." This explanation of the growth of urban service employment is rejected here for reasons which will be outlined below.

17. See Lewis on this point, p. 141.

18. "Structural Change in Employment Within the Context of Latin American Economic Development," Economic Bulletin for Latin America, Vol. X, No. 2, October 1965, p. 182.

19. Ibid., pp. 170-171.

20. Ibid., p. 166.

<u>The subsistence v. capitalist sector wage differential:</u> It was stated above that W. Arthur Lewis, in what has become a classical work, argued persuasively that so long as productivity was low and the supply of labor unlimited in the subsistence sectors the gap between this sector and wages in the industrial or capitalistic sector would be on the order of 30 percent.[21] It is not of little interest to find that recent research indicates this differential to be far greater than that assumed by Lewis. For example, the Economic Commission for Latin America concludes that for Brazil industrial wages average 70 percent greater than those in agriculture while in Mexico the capitalist-subsistence differential is 75 percent.[22] It is further estimated that the wage disparity is even larger in such countries as Colombia, Costa Rica, Peru, and Chile.[23]

<u>Skilled v. unskilled capitalist sector wage differentials:</u> At a recent conference on manpower planning and economic development the ILO pointed out:

> Shortages of trained manpower available to meet current and foreseeable needs in a wide range of occupations are reported from almost all Latin American countries.... The general situation is well known: there is a mass of actual and potential workers lacking partly or wholly the most elementary technical qualifications; as to the more qualified manpower already in employment, the basic training received is often so inadequate

21. Lewis, p. 150.

22. Comision Economica para America Latina, <u>Estudios Sobre La Distribusión del Ingreso en America Latina</u>, E/CN. 12/770/ Add. 1, 21 Abril 1967, p. 9.

23. International Labour Organization, <u>The Role of Social Security and Improved Living and Working Standards in Social and Economic Development</u>, Report III "Remuneration and Conditions of Work," Eighth Conference of American States Members of the ILO, Ottawa, September 1966, p. 3.

that upgrading and retraining are very costly if at all possible. Such shortages of trained manpower have been a serious bottleneck for economic development, particularly for industrialization schemes.[24]

Well known also is the non-technical orientation of the bulk of Latin American systems. Thus it is not illogical to conceive of the labor market for skilled workers to be one in which progressive industrialization generates a growing demand for these workers which can not be met. The predicted result would be a growing disparity in wages between skilled workers and the unskilled whose wage remains set by conditions in the subsistence sector.[25]

Evidence, which can be considered as fragmentary at best, seems to indicate that the logic of the situation is not borne out. For those countries for which wage structure data are available, the differential between skilled and unskilled in the industrial sector, has narrowed very greatly, if not disappeared all together. Argentina, for example, has experienced a situation in which a differential in favor of skilled factory workers of 71 percent in 1935-1939 was successively reduced to 26 percent in 1950-1954 and by 1965 stood at a mere 13 percent.[26]

Although evidence is not presented, Fischlowitz indicates that Brazil parallels in Argentina, concluding that the former country possesses

24. I.L.O., p. 80.

25. See Estanislaw Fischlowitz, "Manpower Problems in Brazil, International Labour Review, Vol. 79, April 1959, pp. 398-417, on this point. He cites the case of the expansion of the Brazilian auto industry in the early 1960's in which the level of employment jumped from 35,000 to 120,000 necessitating a crash program to upgrade semi-skilled workers.

26. U.S. Department of Labor. Labor Developments Abroad, June 1967, pp. 21-22. Cf. also Morris Horowitz, "High-level Manpower in the Economic Development of Argentina." in Frederick Harbison and Charles A. Myers, (eds), Manpower and Education, McGraw-Hill, 1965, pp. 24-25.

"an extreme uniformity of wage rates which certainly discourages any great effort to acquire higher vocational skills, with the investment of time, money, and other immediate sacrifices which such an effort would involve."[27]

The third of the ABC countries, Chile, follows the pattern of the first two. A trend toward narrowing of the skill differential is apparent here as well.[28] Moreover, the gap between skilled-unskilled wages is now so small that "it would virtually disappear if total remuneration /fringe benefits/ were considered."[29] Consequently, the Chilean wage structure is much more like that of the most highly developed countries than its actual counterparts in development elsewhere in the world.[30]

The final country for which pertinent wage data were available was that of Mexico. And here the data are even more restricted in scope, pertaining unfortunately, only to the steel industry. As can be observed from Table II, however, a narrowing of the differential clearly has occurred over the period 1936-1963 on the order of 18 percent.

From the foregoing, a picture of Latin American labor markets begins to take shape in which the industrial sector holds little potential for absorbing a rapidly expanding urban labor force; that despite an unlimited supply of labor at constant wages the industrial wage has risen far beyond

27. Fischlowitz, p. 407.

28. H. Günter, "Changes in Occupational Wage Differentials," International Labour Review, Vol. 89, February 1964, p. 143.

29. Peter Gregory, Industrial Wages in Chile, Ithaca, N.Y.: New York State School of Industrial and Labor Relations, 1967, p. 88.

30. Ibid., p. 90. Gregory lays the blame for wage narrowing at the door of inflation. The effect of statutory wages, social security costs and the like is rather one of reduced employment through encouraging employers to substitute capital for labor.

TABLE II

RATIO OF SKILLED TO UNSKILLED WAGES
MEXICAN STEEL INDUSTRY
1936 - 1963

1936	1:65
1948	1:57
1955	1:41
1959	1:35
1963	1:35

Source: Computed by the author from the wage schedule of labor grades negotiated by the Industrial Union of Miners and Metal Workers and La Fundidora Steel Company

that of the subsistence sector; and finally, again, in the face of "irrevocable" laws of supply and demand, the internal wage has become quite narrow and uniform.

In the following section, the question of the relationship of statutory wages and employment stabilization to those characteristics of the labor markets enumerated above will be considered analytically through a conventional tool of economics, marginal analysis. It is hoped that by so doing the variables in the relationship can be more precisely identified, their dependency specified, and the nature of their relationship more clearly understood.

III. The Impact of Statutory Wages and Employment Stabilization Policies

Figure 1 below depicts a firm functioning under surplus labor conditions.[31] Given a constant wage the supply curve for labor is horizontal, i.e. perfectly elastic. The firm can hire as many additional units

31. For purposes of simplification the model also assumes that the firmfaces perfect competition in its product market.

Figure 1

S_L - Supply Curve for Labor

MPL - Employer's Demand Curve For Labor

ON - Number of Units of Labor Hired

OS - Subsistence Sector Wage

OW - Capitalist Sector Wage

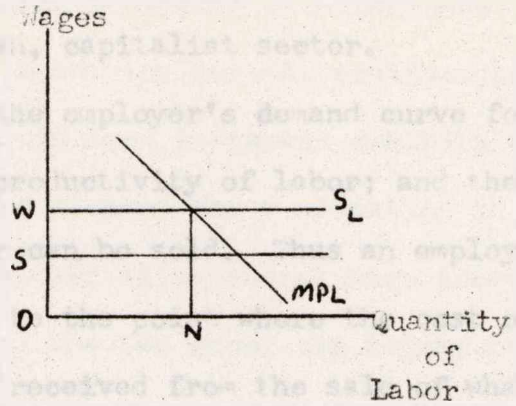


Figure 2

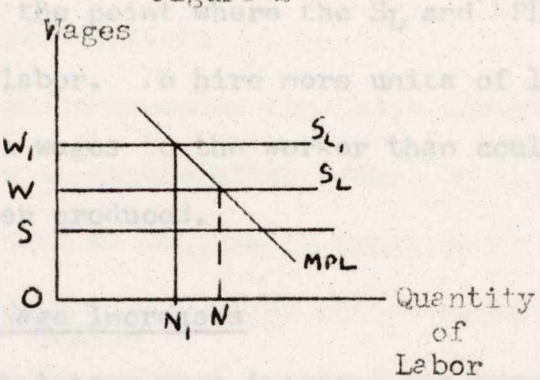
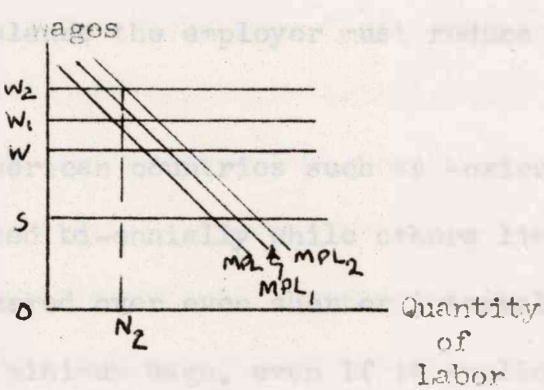


Figure 3



of labor as it desires without having to pay any more for these additional units. The wage, OW, is determined by the cost to the worker, both real and psychological, of moving from the agricultural or subsistence sector to the industrial, urban, capitalist sector.

The MPL curve, the employer's demand curve for labor, is derived from two factors: the productivity of labor; and the price for which the goods produced by labor can be sold. Thus an employer will hire additional units of labor only up to the point where the cost of the last worker equals the value to be received from the sale of what he produces. In Figure 1 this would be the point where the S_L and MPL curves intersect, an amount of ON units of labor. To hire more units of labor would require the employer to pay more in wages to the worker than could be obtained from selling what this worker produced.

Analysis of Statutory Wage Increases

In Figure 2 a statutory wage increase has been decreed raising the wage from OW to OW_1. Under the circumstances to keep his marginal labor costs and revenue in balance the employer must reduce his employment back to ON_1 units of labor.

In many Latin American countries such as Mexico statutory minimum wages have been increased bi-ennially while others like Argentina, Brazil and Chile this has occurred over even shorter intervals.[32] In addition, the legal minimum wage, even if it applies beyond the industrial sector, which frequently it doesn't, is enforced most effectively and

32. Pan American Union, Inter-American Economic and Social Council, Summary of National Reports on the Labor Situation in the Hemisphere, OEA/Ser H/XIII, CIES/Com. VII/53, October 2, 1964, pp. 12-17.

energetically upon the more conspicuous manufacturing firms. These are often the larger, foreign owned companies for whom avoidance is difficult if not dangerous. Finally it should be noted that the agricultural sector of most Latin American countries has not achieved significant increases in productivity but rather in some instances exhibits declining productivity. Thus the ingredients are at hand for a situation in which the subsistence wage remains fixed, the capitalist sector wage increases periodically, and the differential between the two grows far beyond the 30 percent prophesized by Lewis. "Islands" of high wages occur in which the industrial workers become the elite of the proletariat.

Further, it could be expected that high industrial or capitalist sector wage levels have an acceleration effect on the urbanization of the population on the one hand as well as to urban unemployment on the other. One could argue that workers are pulled out of rural areas by the high wages of the capitalist sector in contrast to the conventional thesis that unemployment or under-employment in rural areas pushes workers out to urban areas in search of employment. And once there, these rural migrants lacking skills which would offset their "artificially" high cost the employer would have to bear in hiring them, drift into service jobs or become unemployed.[33] Thus urban unemployment or underemployment would exist independent of the existence of unemployment in the countryside.

33. See Stanislaw Wellisz. "Dual Economies, Disguised Unemployment and the Unlimited Supply of Labour," Economica, February 1968, p. 43.

It was indicated diagramatically that the employer responded to the wage increase with a reduction in employment. Were he to do this he would have to raise the productivity of his remaining workers in order to prevent the firm's total output of goods from falling. For this reason the employer is provided with an incentive to increase the amount of capital he is using; that is, to substitute capital for labor.

As Figure 3 illustrates, we have portrayed the likely situation in which over time demand for the firm's product increases, shown by successive movements of the MPL curve to the right, but simultaneous increases in the statutory wage have also occurred (OW_1, OW_2, OW_3). Therefore despite greatly expanded industrial production, industrial employment remains stationary, or perhaps even declines, relative to other sectors such as service employment. This phonemenon was noted in the discussion section as characteristic of most Latin American labor markets.

Next is the question of the uniformity of the industrial wage structure. Narrowing of skilled-unskilled wage differentials has occurred in a number of countries contrary to what labor market conditions would have led us to predict. Again, at least in part, this occurrence seems traceable to statutory minimum wages through the following mechanism. As the minimum wage is raised, workers below the minimum (likely to be the unskilled or semi-skilled) are brought up to it but workers already at or above minimum are not given corresponding increases.[34] Although only one

34. The U.S. Department of Labor studying the effects of the 1956 $1.00 minimum wage on seven low wage industries, found this to be a major result of the statutory increase. Norman Samuels, "Effects of the $1.00 Minimum Wage on Seven Industries," Monthly Labor Review, March 1957, pp. 323-328.

observer points directly at minimum wage legislation as the major culprit in observed industrial wage uniformity,[35] it never-the-less seems inescapable that a strong relationship exists.

In addition to general employment and wage effects, statutory wage changes also have been observed as related to the special problems of particular segments of the economically active population. Thus, for example, a rapid increase in population has lowered the age structure, producing in many Latin American countries a population averaging under twenty years of age. This coupled with a school dropout rate reaching 90 percent before a six grade level of education is attained, means that nearly all of this young population is soon in the labor market seeking work.[36] Having few skills and little productivity to offer, industrial employers find young workers uneconomical to hire in view of their legally stipulated cost. Even in those instances where the wage law permits a reduction in the statutory wage for youthful workers[37] there are dysfunctional employment consequences. Illustrative of this fact, a recent report concluded:

> . . . when there is an official period of probation during which a wage below the minimum (or even no wage at all) is paid, it often appears that the employer dismisses the young worker as soon as the period is up and brings in another who will suffer the same fate.[38]

35. Fischlowitz, p. 407.

36. "Youth and Work in Latin America," Part I, International Labour Review, Vol. 90, No. 1, p. 20.

37. In Argentina, for example, a minus differential is permitted as follows: Age 17, 10 percent; Age 16, 20 percent; Age 15, 30 percent; and Age 14, 40 percent. Amaldo R. Campaño, "The Minimum Wage Act in Argentina," International Labour Review, Vol. 94, Sept. 1966, pp. 237-254.

38. "Youth and Work in Latin America," Part II, International Labour Review, Vol. 90, No. 2,p. 160.

Under the circumstances many workers find themselves shuttling around to different employers and different jobs without an opportunity to acquire necessary skills or job security.

Analysis of Employment Stabilization Legislation[39]

A pervasive concern for affording workers maximum job security is manifested throughout the nations of Latin America in legislation aimed at restricting the employer's power of dismissal. Specifically job security has come to signify "the idea that an employee has a right to keep his job during his whole working life and that he cannot be deprived of it unless there is cause justifying dismissal."[40] In much of the legislation "just cause" is synonymous with serious misconduct on the employee's part, thus excluding reasons not connected with the worker's behavior including economic problems of the firm. Recourse is provided through either civil or labor court systems which may either order reinstatement or require the payment of compensation of varying amounts to the individual declared unjustifiably dismissed.[41]

39. Except where noted, the information for this section of the paper is drawn from International Labour Organization, Some Aspects of Labour-Management Relations in the American Region, Geneva: International Labour Office, 1962, pp. 64-94.

40. Ibid., p. 68.

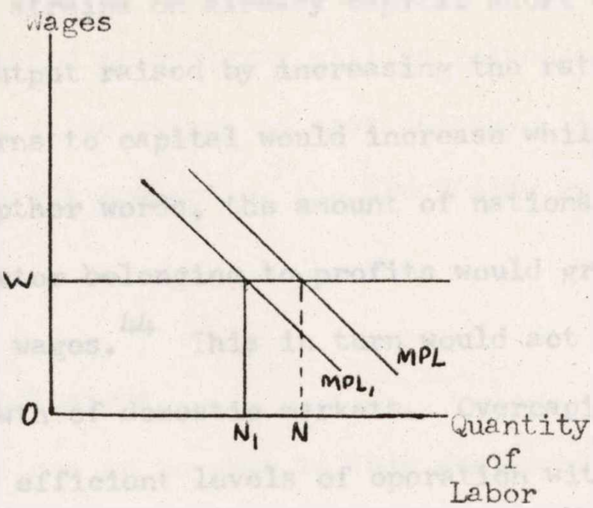
41. In Argentina, Boliva, Brazil, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Peru, Uruguay, and Venezuela, one month's wages per year of service is the norm. For Mexico, the compensation required is three months wages plus twenty days additional indemnity for each year of service. Brazil also requires double indemnity for workers with ten years or more employment.

For many countries the law is quite restrictive as well for those situations in which technological change, market conditions, and related factors necessitate a reduction in force. For example, Ecuador stipulates that the approval of a governmental labor inspector be obtained prior to dismissal and that it is unlawful to dismiss simultaneously two or more workers in a firm of twenty or less employees or to dismiss five or more workers in a firm larger than twenty employees. In other countries such as Mexico and Chile suspension or dismissal of personnel for economic reasons also requires prior governmental permission. A final illustration is that drawn from Argentina which requires that seniority govern any lay-off of employees occasioned by economic circumstances.

Hence, although employment stability legislation does not preclude completely dismissals for either disciplinary or economic reasons it does introduce elements of uncertainty, expense, and delay if this course of action is attempted. As a consequence, it is likely that incompetent or inefficient workers may be retained as well as numbers of employees beyond those optimally required for given levels of production.

The increased inefficiency of the workforce will be reflected in lower physical productivity per worker. This is shown in Figure 4 where MPL is the employer's demand curve without employment stability legislation and MPL_1 is the demand curve with the legislation.

Figure 4



In contrast to minimum wage legislation which affects the supply side of the labor market, job security or employment stabilization legislation affects the demand for labor. Under stabilization legislation the MPL curve is to the left of what it would otherwise be. Under these circumstances the employer will hire fewer units of labor (ON_1) instead of ON units. Thus, while they work in different ways, the employment impact of both types of social legislation is the same: fewer jobs available to employment seekers.

Unfortunately the dysfunctional consequences do not end with reduced levels of employment. To compensate for the inefficiencies and additional costs employment stabilization imposes the employer will be forced to substitute capital for labor.[42] Capital is thereby diverted from other uses placing further strains on already capital short economies.[43]

Further, with output raised by increasing the ratio of capital to labor the total returns to capital would increase while those to labor would diminish. In other words, the amount of national income generated by the industrial sector belonging to profits would grow proportionately larger than that for wages.[44] This in turn would act to dampen consumption and restrict the growth of domestic markets. Overcapitalized firms are thus producing below efficient levels of operation with attendant high costs and prices.

Upward biases on price levels also can be traced to employment stabilization legislation in another way. Since the employer can not reduce his workforce with any ease in a downturn in the economy in which a falling volume of sales in turn requires a concomitant lowering of output, a static level of employment will raise unit labor costs. This will

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42. With productivity reduced the employer would have to employ more units of labor to reach "normal" levels of output but in doing so the marginal cost of these additional labor inputs would exceed the value of the product obtained from them. Rather than do this he would raise the productivity of the smaller number of workers by providing them with more capital and raise output to the desired level this way.

43. It might be suggested that the labor of the remaining units might be used more intensively as through working employees longer hours and raise its output this way. Given restrictions on the number of hours which can be worked in most Latin American countries as well as the existence of high premiums for overtime this would offer only a temporary solution at best.

44. It should also be noted that with productivity raised those units of labor employed in the industrial sector could, and through not only minimum wage legislation but trade union action, probably would be paid higher wages. This would permit the gap between the subsistence and industrial wage to grow even more.

act as a floor preventing prices from being adjusted downward to compensate for falling sales. On the other hand, under conditions of increasing volume of product demand an employer will be reluctant to add the additional workers necessary to raise output to meet demand. herefore, with supply to the market relatively inelastic, the inevitable result will be increased prices.

IV. Summary and Conclusions

The generalizations to be made in this section are intended to be only tentative. In the first place, a great many more data are required before the full nature of the relationship of wages and employment to social legislation is understood and predictable. Secondly, the analysis has been limited purposely to only two categories of legislation, statutory wages and employment stabilization. We have omitted any discussion of other categories including pension, family allowance, maternity benefits, and trade union legislation. It is likely that each of these as well has an identifiable and perhaps measurable impact.

In the foregoing sections it was concluded that:

1. Observed lack of growth of secondary or industrial employment, widening of the wage gap between subsistence and capitalist sectors, as well as narrowing of differentials between skilled and unskilled workers within the industrial sector appear strongly related to governmental minimum wage activity. The high capitalist wage probably speeds urbanization of rural workers who, unable to find industrial employment,

are forced into unemployment or urban subsistence employment. Moreover, as the industrial wage narrows, the incentive for acquiring work skills diminishes reducing further the availability of already scarce higher level manpower.

2. Employment stabilization legislation also gives evidence of contributing to a decline in employment opportunities in the secondary sector. To combat the ridigity in labor use accompanying this legislation employers were observed also to substitute capital for labor. The resulting increased ratio of capital to labor raises total profits and lowers the amount going to the waged sector of the laborforce thus dampening the growth of domestic markets. Paradoxically, it was noted that the increased capital raised productivity of the remaining industrial workers permitting their average wages to go up. This contributed to widening further the subsistence-capitalist sector gap. Also identified through governmentally stabilized employment was an upward bias on prices.

It seems obvious from the foregoing that developing countries must integrate investment, employment, and social welfare programs. To neglect this may result in the creation of unforseen obstacles which cause the programs to cancel each other out. Thus economic planning must consider simultaneously the setting of employment and investment goals together with those dealing with social welfare in order to allocate scarce resources optimally. As it stands now planning is limited to capital investment, employment assumed to flow automatically out of investment, and social welfare programs operated without regard for either employment or investment. The pitfalls of governing a society in this fashion are clearly evident.