"The Origins of Dualism"

David Rueda
Oxford University
david.rueda@politics.ox.ac.uk

Erik Wibbels
Duke University
e.wibbels@duke.edu

Melina Altamirano
Duke University
melina.altamirano@duke.edu

From Spain and Greece to Brazil and South Africa, dualized labor markets are a worldwide phenomenon. In many countries, workers are divided between those with permanent contracts that come with valuable benefits and extensive labor market protections and those who work under contingent contracts or no contracts at all. This latter group receives few or no labor market protections and lower levels of social benefits. They are the world's labor market outsiders, and recent research has suggested that this pool of outsiders has important implications for the nature of democratic politics in the 21st century.[1]

Yet the extent of dualization varies hugely across countries. Figure 1 provides a sense of how large the pool of outsiders is across the globe. Clearly, there is a negative association between the wealth of societies and the extent of dualization, but there is huge variation both within and across rich and developing nations. In the OECD context, the process of dualization has been linked to a number of political and economic processes: the changing nature of international markets, increasing competition in manufacturing, the rise of the service sector, the decline of unionization and centralized collective bargaining, political choices by Left governments, etc. Echoes of these arguments are present in work on developing countries, where dualization is closely linked to the informal sector and has received a lot of attention from economists and sociologists (if not political scientists). Indeed, a long tradition of models in development economics emphasize the stark income and productivity gaps inherent in "dual economies" and uneven growth that characterize broad swaths of the developing world (Rosenstein-Rodan 1943; Nurkse 1953; Norris 1954; Ray 2010). Yet while all of these arguments emphasize important features of dualization, they often focus on the consequences rather than the causes of labor market dualism. Most existing analyses understand dualization as an exogenous factor (some countries have more of it, some countries have less of it) and explore its political and economic implications. They

[1] See, for example, Mares (2006), Martin and Thelen (2007), Rueda (2007), Iversen and Stephens (2008), Palier and Thelen (2010), and the contributions to Emmenegger *et al* (2011).

therefore provide very little leverage for explaining why dualization varies so much among rich and middle-income countries.

Figure 1

We seek to explain the political origins of dualization. We argue and show that there are affinities between decisions about economic policy in the aftermath of World War II, the emergence of labor market regulations, and the extent of labor market dualism across the world today. Industrialization produces a demand for protection and insurance. As recognized by authors like Katzenstein (1985), industrialization in an open economy is consistent with either very modest protection/compensation, as in the US, or very significant compensation, as in the small states of Northern Europe. While this last benign combination, openness and social compensation (and its resulting flexibility and competitiveness), has received a lot of attention in the literature, we argue in this paper that the combination of internally-oriented industrialization and insider protection is a much more common one. Both in the OECD and in developing countries, protection of insiders and dualization of labor markets have been more substantial, and it is this outcome that interests us most. Indeed, the inflexible economies of southern Europe represent a much more general dynamic than the rather unique flexicurity arrangements in northern Europe.

More specifically, we argue below that policies developed with an eye toward internally-oriented industrialization left a powerful imprint on labor market regulations aimed at protecting labor market insiders. Those labor market policies have survived the last several decades of economic liberalization thanks to a series of advantages that insiders have in electoral and interest group politics. Yet by increasing employment protection legislation and protecting workers in some of the least productive sectors, those labor market policies then become a significant determinant of labor market dualization today. Ours is a story of continuity within countries and tremendous diversity across them. We argue that this variation helps explain why some economies have generated a huge number of good jobs and produced more equitable societies, while others have produced large pools of labor market outsiders.

The organization of the paper is as follows: In the following section we provide a more detailed explanation of our main argument and explore the implications for alternative and complementary views in the existing literature. We present two claims: one connecting the process of industrialization to employment protection and the second connecting employment protection to labor market dualization. In the second section, we provide some suggestive evidence showing the link between autarkic industrialization and insider employment protection around the world. We show how resilient insider protection levels have been even in a context of general financial and economic liberalization. And we explore the relationship between insider employment protection and labor market dualization. We show that high levels of insider protection are an impressive predictor of subsequent dualization; once insiderness emerges, outsiderness follows. The final section includes our conclusion and a discussion of the implications of our argument for insider-outsider politics around the world.

1. Protectionism, Insiders and Dualism

Our argument proceeds in two steps. First we develop the link between the process of industrialization and insider employment protection; then we discuss the connection between insider employment protection and labor market dualization. A few preliminary observations are needed to justify our approach.

There are several ways of thinking about dualization. They represent different emphases on factors like employment status, access to benefits and protection, political representation, citizenship, etc.[2] For the purpose of this paper, we follow Rueda (2005, 2006 and 2007) in understanding the division between insiders and outsiders to be essentially related to the unemployment vulnerability of different actors in the labor market. We understand insiders to be workers with highly protected jobs. They are sufficiently protected by the level of security in their jobs not to feel significantly threatened by increases in unemployment. Outsiders, on the other hand, are either unemployed, working in the informal sector, or

[2] For a more detailed analysis of these distinctions in industrialized democracies, see Davidsson and Naczyk (2009).

hold formal jobs characterized by low levels of protection and employment rights, lower salaries, and precarious levels of benefits and social security regulations.

Because low vulnerability to unemployment is the key distinction between insiders and outsiders, the emergence of insider employment protection is the first outcome we need to explain. Below, we argue that labor market regulations have their roots in processes of industrialization and we relate this claim to alternative explanations in the existing literature. We then explain what happens subsequently in countries with highly protected insiders and provide an argument for the relationship between insider employment protection and the emergence of dualized labor markets.

1.1 Protectionism and the Origins of Labor Market Regulations Around the World

Insider employment protection emerges as a consequence of protectionist industrialization. From the present point of view, when the decades-long intellectual swing in favor of free markets has barely stalled in the face of a global financial crisis, it is hard to remember how deeply embedded state-led industrialization was to post-Depression conceptions of growth. A number of considerations drove this consensus, including the collapse of commodity markets during the Great Depression, the prevalence of Keynesian state-led intervention in the economic "core", the decades-long closure of international markets, and the association of industrialization with economic growth.

Industrialization exposes large numbers of market participants to a dizzying array of risks: physical injury, unemployment and business failure as a result of downturns in the business cycle or technological innovation, and aging in a social context marked by the decline of traditional family networks. Some of these are the direct result of industrial production while others are the result of the economic specialization that is the hallmark of industrialization. In the face of these dislocations, citizens often demand social solutions, and history shows that the widespread demand for social policy is closely associated with labor market specialization, wage labor markets, and urbanization that are inherent to the process of industrialization. Those solutions involve the use of the fiscal and regulatory power of the state to reallocate risks and the costs of mischance. Whether through spending programs for the displaced,

diseased or otherwise debilitated or regulations that make displacement less likely, social policy serves to ease the risk of participating in an industrial economy.

Key to our argument is a recognition that policy can *compensate* workers after they have suffered mischance or it can *protect* them from mischance in the first place. While compensatory measures protect workers from ill health, aging, and unemployment *ex post*, labor market regulations are designed to protect them from the business cycle *ex ante*. The former set of policies can facilitate adjustments to market forces, while the latter are aimed at resisting them. This distinction is important because different experiences with industrialization have resulted in quite different weights on compensatory and protective social approaches to risk, and as we discuss in the next section, the two have starkly different implications for the extent of dualization in today's globalized markets.

History shows that there is more than one path to industrialization. While some countries developed industry in the context of open markets, others pursued import substitution industrialization (ISI)—the development of heavy industry to service domestic demand. In the open economy cases, which range from Sweden to South Korea, economic policies emphasized external competitiveness as the key for economic dynamism and sought to generate foreign exchange by exporting manufactures. Complementary policies typically included export incentives, low trade barriers (with some exceptions for imports), and weak exchange rates. The flip side of the open market model was import substitution industrialization, with its concerted attempt to foster domestically-oriented heavy industry. In most such cases, there was a common policy mix: trade protection, the creation and subsidization of infant industries, overvalued exchange rates to promote the importation of capital goods, and the extraction of surplus from commodity exports in order to finance the industrialization project.

While the focus of this paper is the consequences of internally-oriented industrialization, a prominent literature in political economy has emphasized the relationship between openness and compensation. In economies dependent on international markets, the costs of industrialization can be met with social compensation. As a long line of work suggests, this compensatory approach to market risks plays a prominent role in work on the development of the welfare state in Northern Europe. Whether the

welfare state is seen an efficient compromise in the face of open markets (Cameron 1978; Katzenstein 1985; Garrett 1998; Rodrik 1998; Adserá and Boix 2002) or a reflection of varieties of capitalism (Iversen 2005; Iversen and Soskice 2010), social policy compensation, we are told, provides the linchpin between democratic politics and open markets. In the former set of arguments, there is an affinity between democracy, open markets and insurance from labor market risks. Adserá and Boix summarize the dynamic well: "In closed economies, politicians have few incentives to engage in substantial public spending. In open economies, a large public sector emerges as the price that the tradable part of the economy has to pay to ensure the acquiescence and cooperation of both the sheltered economy and declining tradable industries."[3] The larger the tradables sector and the greater the international economic competition, the greater the compensation. In the VoC version, high minimum wages and social insurance transfers compress the income distribution.[4] By constraining wages in those sectors where the marginal product of labor is highest, labor market insurance serves as a subsidy to investment in the most competitive sectors of the economy (even as it increases wages in non-tradeable sectors). These are benign accounts that emphasize how compensation, competition and democracy can go together.

Yet *ex post* compensation is only ones means of insuring against the risks of an industrial economy. By comparative standards, *ex ante* protective measures are much more common, and as we show below it is the most internally-oriented economies that generated the most extensive protections for labor market insiders. Consistent with the need to respond to dynamic market signals, the most externally-oriented economies promoted low levels of employment protection. They combined these with high levels of social compensation in the Scandinavian cases and low levels of compensation in the non-OECD export-led industrializers. The most extensive labor market protections did not develop in the smallest, most open economies; its chief constituents were not in the most trade-exposed or competitive sectors of the economy; and it has not facilitated productive dynamic labor markets in today's globalized economy.

[3] Adsera and Boix 2002: p.246.
[4] One might reasonably ask why some workers are willing to forego higher wages for social insurance. The answer, as discussed in Moene and Wallerstein (2001) and Iversen and Soskice (2001), is that given some level of risk aversion, workers are willing to forego higher income now for greater income security in the future.

Quite the contrary, labor markets were most protective in the most closed economies, and its chief supporters were in the most internally-oriented portions of the economy. In these countries, employment protections were explicitly designed to benefit industrial workers who benefited from trade restrictions. Why?

While industrialization in an open economy made market actors sensitive to the costs of insuring against the risks of industrialization, protectionism provided an easy means to pass them on. Import-substituting economies allocated risks in a very particular way that produced a shared interest among capital and labor in trade and labor market protections.[5] In ISI countries, capital and labor shared a preference for limiting competition, and they coordinated to capture the rents associated with protection.[6] Capital benefited from these economic rents directly through subsidies, trade protection, and anti-competitive regulations on the domestic market; labor benefited through high wages and employment protection, which were the cost of labor peace in the protected industrial sectors.[7]

The greatest threat to labor in an industrializing economy is unemployment, and its interest vis-à-vis any prospective social policy is to protect jobs and increase wages. One can imagine workers as maximizing their expected wage income, i.e., the probability of finding an industrial sector job times the industrial wage plus one minus that probability times the reservation wage (e.g., farm labor income). Risk is the *ex ante* probability that the worker will not be employed in the industrial labor force. This *ex ante* preferred level of insurance holds for *all* workers, not just those who end up holding well-paying industrial jobs. A worker's preferred level of insurance will be increasing not just in the risk of not holding an industrial job, but also in the difference between industrial and non-industrial wages and the

[5] The argument does not necessarily imply that development strategy choices preceded social policy implementation. They can be chosen jointly, e.g., Perón's promise of substantial benefits to workers while also promoting ISI policies, or they can be chosen sequentially, as what appears to have happened in Mexico and Korea.
[6] Economic rents occur in uncompetitive product markets, and arise due to the market power of producers vis-à-vis consumers. Such power allows producers to charge a price for their products in excess of the price that would pertain in competitive market conditions.
[7] A link between the competitiveness of product markets and the employment conditions of employees is strongly supported by the labor economics literature. For example, a well-established empirical finding in the OECD is that employees in economies or sectors with relatively low levels of competition enjoy higher wages than those employed in companies operating in more competitive markets (Jean and Nicoletti 2002: 4). There also exists a strong cross-country association between levels of product market competition and levels of employment protection (Conway et al 2005: 31).

worker's aversion to risk (Moene and Wallerstein 2001). *Ex post*, well-paid industrial workers will still want insurance to the extent the probability that they continue in that job is uncertain, and their demand for insurance will *increase* with income (Moene and Wallerstein 2001).

The severity of labor's *ex ante* and *ex post* risks were shaped by the nature of industrialization. Particularly at early stages of Fordist industrialization, manufacturing utilizes unskilled workers whose counterfactual wage in agriculture is very low. This was particularly true in import-substituting countries, which typically industrialized faster and later than their open-economy counterparts. In such settings the wage gap between industrial and traditional employment tended to be very high. The high levels of inequality between manufacturing wages and farm incomes and government policies that limited the arbitrage of urban and rural wages imply that the actuarial value of a good industrial job is higher in inward-looking industrializers; in the event of job loss, injury, sickness, etc., workers in such settings have further to fall.[8]

If labor's primary interest is job stability, the interests of capital in industrializing societies center on labor peace. Since Marx, work on the sociology of industrialization has noted that urbanization and the industrial workplace serve to harmonize the interests of workers, facilitate collective action and promote unionization (Silver 2003). Generous labor market protections, steep seniority pay and severance payments are potential means to appease the working class and reduce the risk of labor unrest.[9] These labor market regulations had the obvious effect of insulating workers from being laid off, increasing barriers to entry into the formal industrial labor market, and increasing industrial wages. The problem, of course, is that such policies increase costs for business. They do so by increasing the barriers to firing urban blue and white-collar workers while reducing the incentives to hire additional workers from the traditional sectors. Once in place, they increase labor turnover costs and provide substantial obstacles for

[8] One can imagine labor as maximizing its expected return from current wages and its alternatives in the labor market. Where the alternatives are sufficiently poor (conditions of high inequality), it prefers spending on insurance at the expense of human capital. When the alternatives are sufficiently good (conditions of low inequality), it prefers spending on human capital that will permit increased wages in a context of an open development strategy.
[9] Indemnities are a more common policy tool than unemployment insurance in the developing world.

rural workers seeking to break into the modern sector, thereby constraining the supply of skilled workers and limited the arbitrage between urban and rural incomes.

These costs are easier to address in a closed economy than an open one. In ISI countries, product markets were both highly protected and concentrated. Protectionism ensured that producers did not have to compete with foreign companies, and concentrated markets (a typical byproduct of protection, monopolistic state-owned enterprises, and economies of scale), ensured that capital did not face domestic price competition. With captured product markets, capital was free to raise prices, which served to externalize the costs of labor market regulations onto all of society. No such option was available to firms in open economy industrializers as they faced prices set on global markets.

Our argument implies a specific historical development of employment protection as a consequence of World War II era economic development. Empirically, this is clearer in OECD countries (where the data are more easily available). First, starting in the late 1960s, firms accepted highly restrictive tenure and severance pay arrangements—see Blanchard *et al* (1986) and Bentolila and Bertola (1990). In many respects, the creation of a significant degree of "insiderness" (defined as protection for those in standard employment) starts at this point in most OECD countries. Most employment protection legislation was enacted during the late 1960s and in many cases it was strengthened during the early 1970s. This explanation of the development of employment protection in the OECD is consistent with that emerging from the work of Allard (2005). Allard has created a historical series based on the OECD's employment protection legislation indicator (OECD 1999, chapter 2). Her indicator provides a picture of "fairly unregulated labor markets in the OECD overall during the 1950s and early 1960s, with sharp increases in regulation clustered in the 1964-1978 period" (p. 8). We will show below that these highly diverse cross-national levels of employment protection are, in fact, strongly correlated with the nature of industrialization.[10]

[10] Our argument is not that the nature of industrialization is the only factor that matters. Blanchard *et al* (1986) argue that this process was influenced by a pattern of stability and growth which allowed firms to consider employment protection as relatively costless. Bentolila and Bertola point out that the post-Oil Shock crises contributed to a further reinforcement of legislation in France and the UK, among other countries, around 1975 (1990: 394). And

1.2 Employment Protection and Labor Market Dualization

By the end of the 1970s a substantial share of labor in many countries around the world had become significantly insulated from unemployment by restrictive legislation. Our second claim is that, where the advantages of insiders dominate, labor market policies built for an era of protectionism have persisted and served to block the labor market adjustments needed in a world of increasingly open markets. In these cases, pro-insider labor market policies have become a source of social exclusion and segmented labor markets even as they prove to be a robust political equilibrium.

In our historical account, just as insiderness established itself in those countries that had experienced protectionistic industrialization, a new set of challenges was developing. A large body of work has described the economic shocks associated with the liberalization of the global economy beginning in the1980s. A common result across all of these cases—developed and developing, open market and import-substituting industrializers alike—was a pronounced process of deindustrialization. A fairly extensive literature in economics has examined the extent of deindustrialization across the world (Pieper 2000; Palma 2006; Rowthorn and Coutts 2004). Explanations range from the technological bias of contemporary manufacturing to the diminishing marginal returns to the consumption of manufactured goods as incomes increase to the growth of trade and the accompanying breaking down of value chains. More important, however, for the focus of this paper is the challenge that deindustrialization represents for insider protection.

While deindustrialization is a common force affecting all countries, in the OECD other challenges were also present. The increase in unemployment experienced by many OECD countries during the post-Oil Shock crises is very significant. But, simultaneously, in a number of countries labor supply shocks caused by larger numbers of women entering the labor force applied further pressure on the labor market. A number of authors have argued that since the mid-1970s there has also been a production change in certain sectors of the economy caused by "firms using 'working time' variations as an instrument of gaining flexibility and higher productivity" (Maier 1994: 151). As Dore explains, until the 1970s,

---

many analysts agree that these later developments were influenced by social unrest and union activism. We look forward to addressing these alternatives more systematically in future work.

"growing oligopoly" had "made it possible for more and more managers to 'afford the luxury of a contented and loyal workforce'" but the "intensification of international competition" and the "change in the nature of work" altered this (1994: 21-2).

Since many of the factors emphasized by the arguments above are common across countries, however, they provided limited leverage to explain cross-country variation in the extent of labor market dualization. The fact that industry had shrunk and production changes demanding flexibility were more common did not imply that outsiderness had to grow. Indeed, the proponents of market reforms argued that while the reallocation of labor and capital inherent in liberalizing policy would certainly destroy some jobs, they would produce new ones in more efficient sectors. Yet, while the transition from an industrial to a post-industrial economy went relatively smoothly in some countries, it did not in others. In the former cases, relatively flexible labor markets facilitated the transition; in the latter cases, labor market protections complicated the transition by protecting insiders and promoting the growth of a large pool of labor market outsiders.

We argue that even where they are large in number, labor market outsiders face stark disadvantages in the democratic process when compared with their insider counterparts. While labor market insiders benefit from concentrated interests and impressive powers of collective action, outsiders have heterogeneous preferences and face stark limitations on collective action. Thus, outsiders tend not to share a programmatic orientation that would them to serve as a key constituency for political parties. Unlike traditional classes or even coherent interest groups, the pool of outsiders is composed of a large number of individuals with few shared interests and even fewer incentives and capabilities to organize around them.

In economies where insiders are well-protected, therefore, the logic of policy change becomes a profoundly dualizing one. When insiders are sufficiently powerful, the need for flexibility to achieve international competitiveness will not result in lower employment protection. Rather, insiders can promote the emergence of outsiderness as a buffer to protect them from economic downturns. The relationship between insider-outsider differences and employment protection can therefore be best

understood as a reinforcing loop playing itself out since the late 1970s. Once insider employment protection is high, it allows insiders to direct adjustment strategies by facilitating the emergence of an outsider sector, which allows for the continuation of high levels of insider protection.

As a consequence of this, labor market regulations protecting insiders have proven surprisingly sticky even in a world of liberalizing markets. We will show below that, while there has been extensive liberalization in everything from macroeconomic to trade and capital account policies, insider protection has persisted. We argue that this stability emerges as a result of the ideological coherence and mobilizational capacity of labor market insiders relative to outsiders. This dynamic presents parties, particularly those on the left, with stark and difficult choices as they must choose between mobilizational strategies aimed at a shrinking (but politically potent) pool of labor market insiders and a large (but often politically inchoate) pool of outsiders. Where the advantages of insiders dominate, labor market policies built for an era of protectionism have persisted and served to slow economic adjustments to a world of open markets.

In developing countries, instead of a boom in new employment opportunities afforded by liberalized markets, millions of workers and small businessmen had to fend for themselves in a burgeoning informal sector. Though there are important debates about what exactly constitutes the informal sector, the crucial characteristic for our purpose is that it is defined by work that occurs outside of the legal system of taxing, spending, and regulation. Informal work spans a broad range of activity ranging from small manufacturing firms, pirates of music, movies and other intellectual property, house cleaners, and everything in between. Informal sectors have become a permanent feature of many developing economies, and a huge body of work has emerged in response (Turnham et al. 1990; Portes 2003; de Soto 1989; Garxhani 2004; Tokman 1992; Maloney 1999; Levy 2008). Generally speaking, informal sectors grow as a result of coping strategies on the part of workers without alternative employment opportunities and the desire of firms to avoid regulations.[11]

[11] The World Bank defines coping strategies in terms of casual jobs, temporary jobs, unpaid jobs, subsistence agriculture, multiple job holding. It defines illegal business activity in terms of tax evasion, avoidance of labor

In a similar way, the need for flexibility did not result in lower employment protection in many OECD countries. Instead, the flexibilization of labor market legislation that took place in the 1980s affected entry into (not exit from) the labor market (see, for example, Bentolila and Bertola 1990). One of the consequences of this process was a dramatic increase in part-time work and temporary contracts to the point that, Maier argues, "whole sectors of national economies have reorganized their employment/working-time patterns around various forms of part-time work" (1994: 152). The great majority of part-time work and temporary contracts, however, pay poorly, are concentrated in low-skilled activities, and offer a precarious level of benefits, social security regulations, and employment rights.[12] Moreover, the precariously employed and the unemployed are the main, if not only, group to suffer the consequences of economic fluctuations (being hired in good times and fired in downturns).[13]

2. Evidence on the Link between Industrialization, Labor Market Protections and Dualization

Unfortunately, all of the key concepts discussed above—internally orientated industrialization, labor market protections, and dualization—are difficult to measure across a broad cross-section of countries, and there is almost no means of measuring them in a common way as one goes farther back in history. That being the case, we present three waves of highly preliminary evidence bearing on our argument. With each wave, we present evidence for as large a sample of countries as possible, albeit using data that only partially captures the key concepts, and then present results for the OECD sample for which we have better data. First, we show the cross-country association between trade distortions in the 1960s-1970s and subsequent labor market regulations; we have to rely on more modern labor market regulatory data because there is very little data for the developing world that dates to even the 1980s. Second, we show that labor market regulations are extremely stable through time. In light of the time-series constraints discussed above, we provide results only for Latin America and the OECD, the two

---

regulation and other government regulations, and failure to register companies. See: http://lnweb90.worldbank.org/eca/eca.nsf/0/2e4ede543787a0c085256a940073f4e4?OpenDocument

[12] See, for example, Maier (1994) for an analysis of part-time legislation and Mosley (1994) for a description of temporary employment in Europe. See also the contributions in Gregory *et al* (2000).

[13] Immigration also plays an important role in buffering insiders. In fact, it could easily be argued that immigrants are the ultimate outsiders. Immigrant labor is not emphasized in this paper, but see King and Rueda (2008) for a more detailed analysis of this issue taking the insider-outsider model as its starting point.

regions where we have a reasonably long time-series that is comparable. Third, we show labor market regulations are associated with larger pools of outsiders. We do so with a measure of the size of the informal workforce for a large cross-section of countries and then show more refined results for the OECD. The results are only suggestive, but they are broadly consistent with our argument.

2.1 Industrialization and Labor Market Protections

To test our argument on the link between internally-oriented industrialization and labor market protections, we would like to have measure of internal-orientation circa the 1960s and for the initial decades when labor market reforms are passed. It is not obvious how to measure internal orientation during industrialization (Gibson and Ward 1992; Nomi 1997; Balassa 1981; Aitken 1992). In this section, we understand industrialization to take place during the 1960s and 1970s and we measure outward-looking orientations as trade openness. As a proxy that covers as many cases as possible, we rely on Hiscox and Kastner's (2006) data on trade distortions. They use fixed country-year effects in a gravity model to produce an index of trade distortions. This measure has the important advantage over traditional trade ratios of internalizing the impact of country size and distance from markets on trade patterns. To maximize country coverage, we take the average for all countries over the course of the 1970s.

Cross-national data on labor market regulations is very hard to come by, particularly for the years before 2000. That being the case, we rely on more recent data that come reasonably close to approximating our desire to measure obstacles to hiring and firing workers on fixed contracts. The first is a summary measure of "labor freedom" produced by the Heritage Foundation on the basis of the World Bank's *Doing Business* report. The measure equally weights data on six dimensions: Hindrance to hiring additional workers, rigidity of regulations on working hours, the ratio of minimum wage to the average value added per worker, difficulty of firing redundant employees, the legally mandated notice period for firing an employee, and mandatory severance pay. The measure is scaled from zero to 100, with labor regulations falling across the scale. The second, more focused measure is on the cost of firing a worker. Botero et al (2004) collect data on the cost of firing a worker by calculating the sum of the notice period, severance pay, and any mandatory penalties established by law or mandatory collective agreements for a

worker with three years of tenure with the firm. Figure 2 plots each of these measures against the trade distortions measure discussed above. Though there is obviously considerable noise, there is clearly a negative relationship between labor "freedom" and a history of import substitution (as proxied by trade distortions). Likewise, the costs of firing workers are climbing with such a history. Obviously, one would like to see if these relationships hold in the face of multivariate analysis and alternative measures of labor protections, but the initial picture is broadly consistent with our hypothesis.

Figure 2

For the OECD cases, we can use a better measure of insider employment protection. We analyze an indicator summarizing the main aspects of dismissal protection for workers with regular contracts. The OECD indicator used in this paper incorporates three aspects of dismissal protection: "*(i)* procedural inconveniences that employers face when starting the dismissal process, such as notification and consultation requirements; *(ii)* notice periods and severance pay, which typically vary by tenure of the employee; and *(iii)* difficulty of dismissal, as determined by the circumstances in which it is possible to dismiss workers, as well as the repercussions for the employer if a dismissal is found to be unfair (such as compensation and reinstatement)" (Venn 2009: 6). While it is clear that insider employment protection in the OECD did not start exactly in 1980, this is the earliest time at which we can make a distinction between the levels of employment protection enjoyed by insiders in regular employment and those for outsiders with non-standard employment.

Figure 3

The picture emerging from Figure 3 is quite similar to that in Figure 2. Countries where trade distortions were high in the 1960s (like Portugal, Spain, Finland and Austria) have high levels of insider employment protection in the 1980s. Countries where trade distortions were low in the 1960s (like the UK, the USA, Belgium or Switzerland) have low levels of insider employment protection in the 1980s. While the relationship is not perfect (the Netherlands, Sweden and Germany have comparatively low trade distortions in the 1960s but comparatively high levels of employment protection in the 1980s and

Ireland, Australia and Canada have comparatively high trade distortions in the 1960s but comparatively low levels of employment protection in the 1980s), it is broadly supportive of our claims.

It is also the case that the historical record is replete with examples of protectionist coalitions promoting industrial development and using labor market regulations to insulate key coalition members from economic risks. Though less work has noted that those economic policies had important implications for the creation, regulation and sustenance of labor markets, labor histories and work on social policy consistently show that in countries with a history of ISI, social benefits were inextricably tied to labor status, and labor status was profoundly shaped by labor market regulations that established stark barriers to entry and exit to formal jobs.

2.2 The Stability of Labor Market Regulations through Time

We argue that ISI is linked to contemporary rates of dualization via labor market regulations, which we hypothesize have proven highly resilient in the face of the political power of labor market insiders. As noted above, beginning in the late 1970s and running through the following decades, politicians and the private sector in many countries, including many former import-substituters, fundamentally reorientated their economies, and the era of "state-led development" came to a halt. Trade liberalization, macroeconomic discipline, capital account liberalization, privatization of state-owned enterprises and the like swept across the globe. Given that labor markets in import-substituters had been built around a dated vision of economic policy, one might have expected labor market policies to follow the common, liberalizing trend. As explained above, we expect otherwise—the power of insiders should produce tremendous persistence in labor market policies, despite the sea change in other policy spheres.

Again, it is woefully difficult to find comparable time-series data on labor market regulations across countries. That said, Figure 4 provides some initial, suggestive evidence. The figure displays Heritage Foundation data on trade, fiscal, monetary, and labor market policies from 1995 to 2011 for both the OECD and developing worlds. Though the data on labor markets is available for only half of this period, it evinces a very different trend than those bearing on trade, fiscal and monetary policies. While

the macroeconomic policy tools have undergone a steady process of liberalization, labor market policies have barely moved at all.

Figure 4

Moving beyond comparable measures for OECD and non-OECD countries, the two exceptions to the paucity of cross-sectional, time-series data on labor market regulations come from Lora et al. (n.d.), who report annual data on various reform indices for 19 Latin American countries from 1984 through 2010 and the OECD measure on insider employment protection already used in Figure 2.[14] Latin America is interesting because many of its countries pursued a particularly aggressive version of market liberalization; it is also a region with a high concentration of countries that have a history of import substitution. The OECD data is interesting because it is the region where there has been the most research on insider-outsider labor markets and politics.

Figure 5 (5a & 5b)

Figure 5 shows that the picture that emerges in the Heritage data above is not the result of averaging across countries. Figure 5a shows that most of the countries in Latin America pursued basically the same labor market policies in 2010 as they did in 1985. The red 45 degree line in the figure denotes no change at all, and most cases fall quite close to (if not on) the line. Though the changes are tiny, it is worth noting that the former import substituters, including Mexico, Argentina, and Brazil have, if anything, made policy more restrictive rather than more liberal over the 15-year period. At least in the Latin American sample, it seems that labor markets have seen much less reform than other areas of public policy. Figure 5b presents a very similar picture for the countries in the OECD. Cases are again concentrated along the 45 degree line. Only in Spain and Portugal have extremely high levels of insider employment protection in the 1980s become less high ones in the 2000s (but these two countries still remain within the group characterized by the highest levels of insider employment protection).

[14] The OECD data is available as yearly observations from 1980 until 2008. Lora et al…

Given the historical link between ISI and pro-insider labor market regulations, it seems reasonable to expect that restrictive labor market policies would have gone the way of other policies that characterized the internally-oriented development model. Yet while differential exchange rates, high tariffs, state-owned enterprises, industrial subsidies, and the like have disappeared, pro-insider labor market policies have persisted. The power of insiders has been borne of their continued organizational strength in the nontradable service and state sectors, where for various reasons, employers can pass on high costs to the entire domestic market of consumers. These groups are the political legacy of the era of import substitution. Their privileged economic and organizational position stands in stark contrast to the heterogeneous interests and weak capacity for action among the outsiders. In many cases, the economic and organizational strength of insiders makes them privileged constituents for political parties and provides them influence when governments considered social policy reforms. Given the centrality of labor market regulations for the very survival of insiders, they have spent considerable resources blocking microeconomic reforms, even as they passed on various macroeconomic ones that, while painful, did not strike at their very survival (Murillo and Schrank 2009).

2.3 Labor Market Regulations and Dualization

Finally, we turn to our last explanandum: labor market dualization. The extent to which specific *labor market regulations* matters for the performance of labor markets and the economy writ large is a matter of real disagreement. One line of thinking builds on the notion that anytime governments redistribute resources, they distort incentives, a sin compounded by the deadweight loss inevitably associated with any government activity. More specifically, Lazear (1990), Saint-Paul (1996), Siebert (1997) and others suggest that under very general conditions, job security provisions, including severance pay and unemployment insurance decrease the level of employment by raising the costs of hiring and firing. The empirical evidence on these points is mixed (Botero et al 2005; Agell 1999; Blanchard and Wolfers 2000), but it does seem clear that the negative employment effects climb if regulations, taxes and labor standards are very costly and are written without productivity in mind (as in laws that require high severance pay) (Heckman and Pages 2003). Such is the case in countries that developed systems of labor

market regulation under extensive protectionism. Though some regulations, such as those governing minimum wages, impact labor costs directly, most social insurance policies (including those governing seniority pay and indemnities for dismissals) impact nonwage labor costs.[15] Evidence collected by Heckman and Pagés (2004), Pagés (2010), and others clearly indicates that countries with a history of ISI have particularly high nonwage labor costs. Argentina, Brazil, Turkey, Mexico, Spain, Greece, and Portugal for instance, have non-wage labor costs that on average add an additional 50 percent to wage costs. These costs are up to sixty percent higher than they are in a country like Sweden. Obviously, labor costs of this magnitude serve as a powerful disincentive to hire workers on permanent contracts. That being the case, we expect them to be associated with larger pools of labor market outsiders.

An ideal measure of dualization would include the unemployed, the involuntarily under-employed, those on contingent contracts, and those in the shadow economy. But, again, there is no such data for a large cross-section of countries (indeed, there is not even comparably unemployment data). As a first cut we rely on an indicator of the size of the informal labor market. Measuring the size of this pool of labor market outsiders is a daunting task complicated by the fact that much of the work and production takes place outside of the purview of tax authorities, regulators and many survey firms (La Porta and Shleifer 2008). Neither workers nor firms declare earnings to the government, and both firm and income surveys have a hard time reaching individuals in the informal sector. We therefore use a measure provided by the World Competitiveness Report (2007), based on a survey of business leaders in which they were asked to estimate the amount of business activity that is unregulated.

For the OECD and non-OECD sample, our key independent variables are assorted measures of labor market regulations that proxy for pro-insiderness. We rely on the measure of labor market freedom from the Heritage foundation described above and three measures provided by the Frasier Institute. The

[15] The OECD defines nonwage labor costs as "social insurance expenditure and other labour taxes and include: (a) employers expenditure for legally required insurance programmes and contractual and private benefit plans (retirement and disability pensions, health insurance, income guarantee insurance and sick leave, life and accident insurance, occupational injury and illness compensation, unemployment insurance and family allowances) and, for some economies; (b) labour taxes, that is, taxes on payrolls or employment or reductions to reflect subsidies - even if they do not finance programmes that benefit workers directly." See: http://stats.oecd.org/glossary/detail.asp?ID=4837

first is a product of the World Competitiveness surveys, which ask respondents whether the hiring and firing of workers is impeded by regulations or flexibly determined by employers; it is scaled from 1-8, with regulations declining across the scale. The second measure is of the cost of dismissing workers and is calculated by the Frasier Institute on the basis of the World Bank's *Doing Business* data. The measure includes information on the advance notice, cost and penalties for firing a worker, with regulations again falling across the scale. Finally, we also rely on the Fraser Institute's data on collective bargaining, with the expectation that peak level bargaining will produce pro-insider policies. The Frasier Institute produces an index scaled from 1-7 designed to capture the extent to which wages are set at the firm-level (=7) or by a collective bargaining process (=1).

Probably the only standard finding in the small cross-national quantitative literature on informality is that there is an inverse relationship between societal wealth and informality. Because of this, we run a series of simple models that control for logged per capita income.[16] The key dependent variable in each model is one of the indicators of labor market regulations discussed above.

Figure 6 presents component-plus-residual plots for each of the four models described above. In each of the models, protective labor regulations are associated with a larger informal sector. As the figure shows, while there is a lot of noise in the relationship, informal employment is climbing in the restrictiveness of labor regulations.

Figure 6

Our OECD sample allows us once more to use a measure for the dualization of labor markets that better addresses our theoretical claims. In Figure 7 we use once again the OECD index of insider protection as country averages for the 1980s. We then use a measure of labor market dualization in the 2000s that includes individuals who are unemployed, in fixed-term employment and in involuntary part-time employment as a percentage of the civilian labor force.

[16] The main other factor hypothesized to impact informality is the difficulty of a firm registering with the authorities. As the time and cost of registering increases, informal firms are expected to proliferate; as they do so, employment in the informal sector also should grow. Our results are robust to the inclusion of a control for the cost of registering a business, which measure using the (log) number of procedures required to legally start a business from Djankov et al. (2002).

Given the importance of secure employment to the definition of insiders, including the unemployed within the category of outsiders is not controversial. The classification of fixed-term and part-time employment is perhaps not as straightforward. There are two aspects to employed "outsiderness." The first has to do with the precarious nature of employment. Fixed-term and part-time jobs are not simply insider contracts with added flexibility. They are in fact characterized by low wages, protection and rights (see, for example, OECD 1998). The second has to do with the involuntary nature of outsider employment. Most outsiders would like to have insider jobs. This is particularly the case when looking at fixed-term employment (most workers holding fixed-term contracts in the OECD do so involuntarily) but it is also the reason why we focus on involuntary part-timers.[17]

Figure 7

Figure 7 again presents some evidence in support of this paper's arguments. In the OECD, countries with high levels of insider employment protection in the 1980s developed high levels of labor market dualization in the 2000s. It is, in fact, the case that this relationship would be also present if we used labor market dualization data from the 1990s. Notoriously dualized countries like Spain and Portugal are an example of this combination of high insider employment protection and high labor market dualization, but so are Finland, Sweden, or the Netherlands. Countries like the US, the UK, Australia, Switzerland, Ireland and Denmark are examples or very limited insider employment protection in the 1980s which then promoted low levels of labor market dualization in the 2000s.

3. Conclusions

While protections from labor market risks might have facilitated skill investments, helped overcome labor market failures, and increased overall productivity in a small handful of European countries, they have led to bifurcated, unproductive labor markets across many other OECD countries and most of the developing world. Built as they were for the demands of autarkic economic policies, systems

[17] Temporary employment data are not available for Australia. Labor market dualization is measured only as unemployment and involuntary part-time employment in this country. Both temporary and involuntary part-time employment data are not available for the USA. Labor market dualization is measured only as unemployment in this country.

of social protection have proven poorly adapted for a world of open economies. Such systems limit the capacity of workers to enter the formal economy, reduce their incentives to gather human capital (the returns of which are low in the informal sector), encourage capital to invest in low-productivity sectors, and discourage capital from making human capital-intensive investments. As a result, labor regulations that date to protectionist processes of industrialization have contributed to the growth of informal sectors, weak labor productivity, income inequality, and slow economic growth.

Above and beyond the economic costs associated with bifurcated labor markets, our account of their origins and effects has implications for three literatures. First, it provides a framework for unifying the study of the welfare state and labor markets in developed and developing countries. A host of recent contributions have provided rich insight into the link between global markets and changes in social priorities, innovations in targeted poverty relief, and social policy reform in the developing world. In the OECD, an equally significant literature has emphasized the changing nature of the welfare state (and the role of conditionality and workfare). But most of these literatures are focused on *changes* in social policy, even if researchers draw on different theoretical traditions, develop distinct causal claims, and use diverse empirical methods. Clearly, by emphasizing insider employment protection and uniting OECD and non-OECD cases, we tend to see continuity where others see considerable change.

Second, we place a specific set of actors, policies and institutions—those relating to and governing labor markets—at the center of the analysis and link them to the emergence and extent of bifurcated labor markets. This approach is not entirely new but our findings do call into question the generality of an influential claim in research on advanced industrial democracies. In some European countries, extensive systems of social insurance that broadly share risks coexist with highly productive economies. In some accounts, social policy, labor market regulations, educational systems, etc. are an equilibrium political outcome that is fundamental ingredient of economic competitiveness; this is a virtuous story in which many good things go together. We diverge from such accounts by describing an equilibrium in which social insurance persists despite huge negative effects on economic efficiency. In a related way, one dominant account suggests that social policy emerges as a means to compensate various

labor market participants for the risks they face and that global economic exposure and social insurance reinforce one another. Clearly, the argument and findings here emphasize a very different combination. Both in some OECD countries and in most developing countries, we have argued, *ex post* compensation is much less common than the *ex ante* protection promoted by inward-looking industrializers.

Third and finally, our account speaks to the sustainability of markets and democracy in a globalized world. An enormous body of work on the OECD suggests that social policies have served a key role in mediating the relationship between capitalism and democracy. Absent the security provided by social insurance, citizens would reject the creative destruction inherent in the market and fail to make productivity enhancing investments that only generate returns over the long run. Fueled by the democratic power to vote and organize, citizens have demanded insurance as compensation for the costs of open economies. If *ex post* social compensation and *ex ante* employment protection in the OECD has played a key role in smoothing citizen participation in markets, employment protection as social insurance across much of the developing world would seem ill-equipped to fulfill such a role. It benefits too few citizens located in the least propitious portions of the economy and does so while generating distortionary economic incentives and limiting opportunities for many entrepreneurs and workers. The political consequences for the failure of social insurance to be the glue binding democratic politics and market participation can be quite damaging. Wibbels (2012) shows that it is those developing countries with higher employment protection and extensive that citizens hold the most skeptical attitudes toward markets. More importantly, while these attitudes are not associated with decreased support for democracy as a system of governance, they are associated with decreased support for specific democratic institutions.

Partial List of References

Adserá, Alicia, and Carles Boix. 2002. "Trade, Democracy, and the Size of the Public Sector: The Political Underpinnings of Openness." *International Organization* 56:229-62.

Agell, Jonas. 1999. "On the Benefits from Rigid Labour Markets: Norms, Market Failures, and Social Insurance." *The Economic Journal* 109 (453):143-64.

———. 2002. "On the Determinants of Labour Market Institutions: Rent Seeking vs. Social Insurance." *German Economic Review* 3 (2):107-35.

Aitken, Brian J. 1992. "Measuring Trade Policy Intervention: A Cross-Country Index of Relative Price Dispersion." In *Policy Research Working Papers*. Washington, D.C.: World Bank.

Alt, James E., Jeffry A. Frieden, Michael Gilligan, Dani Rodrik, and Ronald Rogowski. 1996. "The Political Economy of International Trade: Enduring Puzzles and an Agenda for Inquiry." *Comparative Political Studies* 29 (6):689-717.

Ansell, Benjamin. 2007. "Traders, Teachers, and Tyrants: Democracy, Globalization, and Public Investment in Education." *International Organization* 62 (2):289-322.

Aukrust, Odd. 1977. "Inflation in the Open Economy: a Norwegian Model." In *Worldwide Inflation: Theory and Recent Evidence*, ed. L. B. Krause and W. S. Salant. Washington, D.C.: Brookings Institution.

Avelino, George, David Brown, and Wendy Hunter. 2005. "The Effects of Capital Mobility, Trade Openness, and Democracy on Social Spending in Latin America, 1980-99." *American Journal of Political Science* 49 (3):625-42.

Baer, Werner. 1972. "Import Substitution in Latin America: Experiences and Interpretations." *Latin American Research Review* 7:95-122.

Balassa, B. 1981. *The Newly Industrializing Countries in the World Economy*. New York: Pergamon Press.

Barro, Robert J. 1997. *The Determinants of Economic Growth*. Cambridge: MIT Press.

Bates, Robert H. 1981. *States and Markets in Tropical Africa*.

———. 1997. *Open Economy Politics: The Political Economics of the International Coffee Market*. Princeton: Princeton University Press.

Bentolila, Samuel and Giuseppe Bertola. 1990. "Firing Costs and Labour Demand: How Bad is Eurosclerosis?" *Review of Economic Studies*, 57: 381-402.

Bergquist, Charles. 1986. *Labor in Latin America*. Stanford: Stanford University Press.

Blanchard, Olivier and Lawrence Summers. 1986. "Hysteresis and the European Unemployment Problem." In *NBER Macroeconomic Annual*. Cambridge, Massachusetts: MIT Press.

Boix, Carles. 2001. "Democracy, Development, and the Public Sector." *American Journal of Political Science* 45:1-17.

Brooks, Sarah. 2002. "Social Protection and Economic Integration: The Politics of Pension Reform in an Era of Capital Mobility." *Comparative Political Studies* 35:491-523.

Brown, David, and Wendy Hunter. 1999. "Democracy and Social Spending in Latin America, 1980-92." *American Political Science Review* 93:977-90.

Cameron, David R. 1978. "The Expansion of the Public Economy." *American Political Science Review* 72:1243-61.

Cardoso, F., and E. Faleto. 1979. *Dependency and Development in Latin America*. Berkeley: University of California Press.

CEPAL. n.d. "Base de Datos de Gasto Social (Actualizada hasta fines de 1999)." CEPAL.

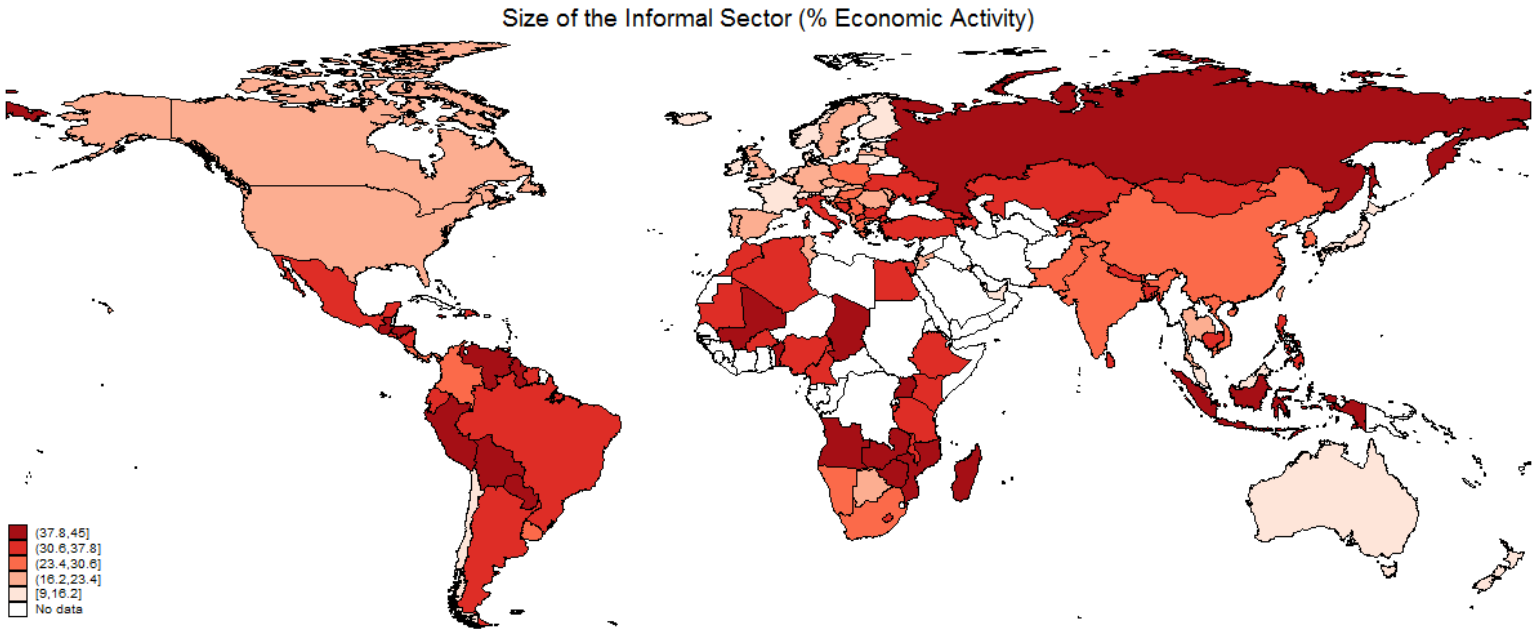
Collier, Ruth Berins, and David Collier. 1991. *Shaping the political arena : critical junctures, the labor movement, and regime dynamics in Latin America*. Princeton, N.J.: Princeton University Press.

Conway, Paul, Véronique Janod, and Giuseppe Nicoletti. 2005. "Product Market Regulation in OECD Countries: 1998 to 2003." *OECD Economics Department Working Paper* (419).
Davidsson, Johan Bo and Marek Naczyk. 2009. "The Ins and Outs of Dualisation: A Literature Review" *Barnett Papers in Social Research* 2009:2, University of Oxford.
Deyo, Frederic. 1990. "Economic Policy and the Popular Sector." In *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, ed. G. Gereffi and D. Wyman. Princeton: Princeton University Press.
Diaz Alejandro, Carlos F. 1984. "Latin America in the 1930s." In *The Role of the Periphery in the World Crisis*, ed. R. Thorp. London: MacMillan.
Dore, Ronald. 1994. "Incomes Policy: Why Now?" In Ronald Dore, Robert Boyer and Zoë Mars (eds.), *The Return to Incomes Policy*. London: Pinter Publishers.
Dornbusch, Rudiger, and S Edwards, eds. 1991. *The Macroeconmics of Populism in Latin America*. Cambridge: MIT Press.
Dutt, Pushan, and Devashish Mitra. 2002. "Endogenous Trade Policy through Majority Voting: An empirical investigation." *Journal of International Economics* 58 (1):107-33.
Emmenegger, Patrick, Silja Häusermann, Bruno Palier, and Martin Seeleib-Kaiser (eds). 2012. *The Age of Dualization.* Oxford: Oxford University Press.
Fishlow, A., C. Gwin, Stephen Haggard, Dani Rodrik, and Robert Wade, eds. 1994. *Miracle or Design: Lessons from the East Asian Experience*. Washington, D.C.: Overseas Development Council.
Garrett, Geoffrey. 1998. *Partisan Politics in the Global Economy*. New York: Cambridge University Press.
Gereffi, Gary, and Donald Wyman, eds. 1990. *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*. Princeton: Princeton University Press.
Gershenkron, Alexander. 1967. *Economic Backwardness in Historical Perspective*.
Gibson, Martha Liebler, and Michael D. Ward. 1992. "Export Orientation: Pathway or Artifact?" *International Studies Quarterly* 36:331-44.
Gleditsch, Kristan S., and Michael D. Ward. 2001. "Measuring Space: a minimum distance database." *Journal of Peace Research* 38 (749-68).
Goldberg, Ellis. 2004. *Trade, Reputation, and Child Labor in Twentieth-century Egypt*. New York: Palgrave Macmillan.
Gregory, Mary, Wiemer Salverda and Stephen Bazen (eds.). 2000. *Labour Market Inequalities*. Oxford, UK: Oxford University Press.
Haggard, Stephan. 1990. *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries*. Ithaca: Cornell University Press.
Hall, Peter A., and David Soskice, eds. 2001. *Varieties of Capitalism*. New York: Oxford University Press.
Heston, Alan , Robert Summers, and Bettina Aten. 2006. "Penn World Tables Version 6.2." Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania.
Hirschman, Albert O. 1958. *The Strategy of Economic Development*. New Haven: Yale University Press.
———. 1968. "The Political Economy of Import-Substituting Industrialization in Latin America." *Quarterly Journal of Economics* 82:1-32.
Hiscox, Michael J. 2002. *International Trade and Political Conflict*. Princeton: Princeton University Press.
Hiscox, Michael J., and Scott Kastner. 2006. "A General Measure of Trade Policy Orientations." Harvard University.
Huber, Evelyne, Thomas Mustillo, and John D. Stephens. 2008. "Politics and Social Spending in Latin America." *Journal of Politics* 70 (2):420-36.
International Monetary Fund. *Government Finance Statistics* [CD-ROM] 2005 [cited 1/15/06.
Iversen, T., and D. Soskice. 2001. "An asset theory of social policy preferences." *American Political Science Review* 95 (4):875-93.
Iversen, Torben. 2005. *Capitalism, Democracy, and Welfare*. Cambridge: Cambridge University Press.

Iversen, Torben, and Thomas R. Cusak. 2000. "The Causes of Welfare State Expansion: Deindustrialization or Globalization?" *World Politics* 52.
Iversen, Torben, and David Soskice. 2009. "Distribution and Redistribution: The Shadow of the Nineteenth Century." *World Politics*.
Iversen, Torben, and John Stephens. 2008. "Partisan Politics, the Welfare State and Three Worlds of Human Capital Formation." *Comparative Political Studies* 41:600–37.
James, Daniel. 1988. *Resistance and integration : Peronism and the Argentine working class, 1946-1976*. Cambridge [Cambridgeshire] ; New York: Cambridge University Press.
Jean, S. and G. Nicoletti. 2002. "Product Market Regulation and Wage Premia in Europe and North America: An Empirical Investigation", *OECD Economics Department Working Paper* (318).
Katzenstein, Peter J. 1985. *Small States in World Markets: Industrial Policy in Europe*. Ithaca: Cornell University Press.
Kaufman, Robert, and Alex Segura-Ubiergo. 2001. "Globalization, Domestic Politics, and Social Spending in Latin America: A Time-Series Cross-Section Analysis 1973-1997." *World Politics* July:553-87.
Kim, Dae-Il, and Robert H. Topel. 1995. "Labor Markets and Economic Growth: Lessons from Korea's Industrialization 1970-1990." In *Differences and Changes in Wage Structures*, ed. R. B. Freeman and L. F. Katz. Chicago: University of Chicago Press.
King, Desmond, and David Rueda. 2008. "Cheap Labor: The New Politics of 'Bread and Roses' in Industrial Democracies." *Perspectives on Politics*, 6 (June): 279-97.
Korpi, Walter. 1983. *The Democratic Class Struggle*. London: Routledge.
Leamer, Edward. 1984. *Sources of International Comparative Advantage: Theory and Evidence*. Cambridge: MIT Press.
Linbeck, Assar, and Dennis Snower. 2002. "The Insider-Outside Theory: A Survey." In *IZA Discussion Paper Series*. Bonn: IZA.
Lindert, Peter H. 2004. *Growing Public: Social Spending and Economic Growth Since the Eighteenth Century*. Vol. One. Cambridge: Cambridge University Press.
Lund, Frances. 1993. "State Social Benefits in South Africa." *International Social Security Review* 46 (1):5-25.
Mahon, James. 1992. "Was Latin America Too Rich to Prosper? Structural and Political Obstacles to Export-Led Industrial Growth." *Journal of Development Studies* 28 (241-63).
Maier, Friederike. 1994. "Institutional Regimes of Part-Time Working." In Günther Schmid (ed.), *Labor Market Institutions in Europe: A Socioeconomic Evaluation of Performance*. New York: M. E. Sharpe.
Mallet, Alfredo. 1970. "Diversification and Standardization: Two Trends in Latin American Social Security." *International Labour Review* 101 (49-83).
Malloy, James. 1979. *The Politics of Social Security in Brazil*. Pittsburgh: University of Pittsburgh Press.
Mares, Isabela. 2003. *The Politics of Social Risk*. New York: Cambridge University Press.
———. 2005. "Social Protection Around the World: External Insecurity, State Capacity, and Domestic Political Cleavages." *Comparative Political Studies* 38 (6):623-51.
———. 2006. *Taxation, Wage Bargaining, and Unemployment*. New York: Cambridge University Press.
Mares, Isabela, and Matthew E. Carnes. 2009. "Social Policy in Developing Countries." *Annual Review of Political Science* 12:93-113.
Martin, Cathie Jo, and Kathleen Thelen. 2007. "The State and Coordinated Capitalism." *World Politics* 60:1–36.
Marshall, Monty G, Keith Jaggers, and Ted Robert Gurr. 2004. "Polity IV." College Park, Maryland: University of Maryland.
Mesa-Lago, Carmelo. 1978. *Social Security in Latin America: Pressure Groups, Stratification, and Inequality*. Pittsburgh: University of Pittsburgh Press.
Midford, Paul. 1993. "International Trade and Domestic Politics: improving on Rogowski's model of political alignments." *International Organization* 47 (4):535-64.

Milner, Helen V., and Keiko Kubota. 2005. "Why the Move to Free Trade? Democracy and Trade Policy in Developing Countries." *International Organization* 59 (1):107-43.
Moene, Karl O., and Michael Wallerstein. 2001. "Inequality, Social Insurance, and Redistribution." *American Political Science Review* 95 (4):859-74.
———. 2003. "Earnings Inequality and Welfare Spending." *World Politics* 55:485-516.
Mosley, Hugh. 1994. "Employment Protection and Labor Force Adjustment in EC Countries." In Günther Schmid (ed.), *Labor Market Institutions in Europe: A Socioeconomic Evaluation of Performance*. New York: M. E. Sharpe.
Mulligan, Casey B., and Xavier Sala-i-Martin. 2004. "Internationally Common Features of Public Old-Age Pensions, and Their Implications for Models of the Public Sector." *Advances in Economic Policy and Analysis* 4 (1).
Nomi, Tomoaki. 1997. "Determinants of Trade Orientation in Less Developed Economies." *Policy Studies Journal* 25 (1):27-38.
O'Rourke, Kevin H., and Alan M. Taylor. 2006. "Democracy and Protectionism." In *NBER working papers*.
Palier, Bruno, and Kathleen Thelen. 2010. "Institutionalizing Dualism." *Politics & Society*, 38:119–48.
Rogowski, Ronald. 1987. "Political Cleavages and Changing Exposure to Trade." *American Political Science Review* 81 (4):1121-37.
———. 1989. Commerce and Coalitions: how trade affects domestic political arrangements. Princeton: Princeton University Press.
Rudra, Nita. 2002. "Globalization and the Decline of the Welfare State in Less-Developed Countries." International Organization 56 (2):411-45.
Rueda, David. 2005. "Insider-Outsider Politics in Industrialized Democracies: The Challenge to Social Democratic Parties." American Political Science Review 99 (1):61-74.
———. 2006. "Social Democracy and Active Labour Market Policies: Insiders, Outsiders, and the Politics of Employment Promotion." *British Journal of Political Science*, 36: 385-406.
———. 2007. *Social Democracy Inside Out*. Oxford: Oxford University Press.
Ruggie, John Gerard. 1982. "International Regimes, transactions, and change: embedded liberalism in the postwar economic order." International Organization 36 (2):379-415.
———. 2003. "Taking Embedded Liberalism Global: The Corporate Connection." In Taming Globalization: Frontiers of Governance, ed. D. Held and M. Koenig-Archibugi. Cambridge: Polity Press.
Sachs, Jeffrey D. 1985. "External Debt and Macroeconomic Performance in Latin America and East Asia." Brookings Papers on Economic Activity 2:523-64.
Sachs, Jeffrey D., and Andrew Warner. 1995. "Economic Reform and the Process of Global Integration." Brookings Papers on Economic Activity 1 (1-118).
Stadler, Alfred. 1997. The Political Economy of Modern South Africa. London: Croom Helm.
Tamarin, David. 1985. The Argentine Labor Movement, 1930-1945. Albuquerque, NM: University of New Mexico Press.
Thelen, Kathleen. 2004. How Insitutions Evolve: The Political Economy of Skills in Comparative-Historical Perspective. New York: Cambridge University Press.
van Ginneken, Wouter. 2003. "Extending Social Security: policies for developing countries." International Labour Review 142 (3):277-94.
Vanhanen, Tatu. Democratization and Power Resources, 1850-2000. Finnish Social Science Data Archive 2003 [cited.
Venn, Danielle. 2009. "Legislation, Collective Bargaining and Enforcement: Updaging the Oecd Employment Protection Indicators," *OECD Social Employment and Migration Working Paper* 89.
Wade, Robert. 1990. Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization. Princeton: Princeton University Press.
Waterbury, John. 1993. Exposed to Innumerable Delusions. New York: Cambridge University Press.

Figure 1: The Size of the Informal Sector around the World, 2006



Note: Data from Schneider and Bruhn (2010).

Weber, Max. 1958. The Protestant Ethic and the Spirit of Capitalism. Translated by T. Parsons. New York: Scribner's.
Wibbels, Erik. 2006. "Dependency Revisited: International Markets, Business Cycles, and Social Spending in the Developing World." International Organization 60:433-68.
Williamson, Jeffry G. 2002. "Land, Labor, and Globalization in the Third World, 1870-1940." Journal of Economic History 62 (1):55-85.
World Bank. 2006. World Development Indicators [website]. World Bank 2006 [cited 1/15/06 2006].

Figure 2: Early Trade Distortions against Labor Market Regulations

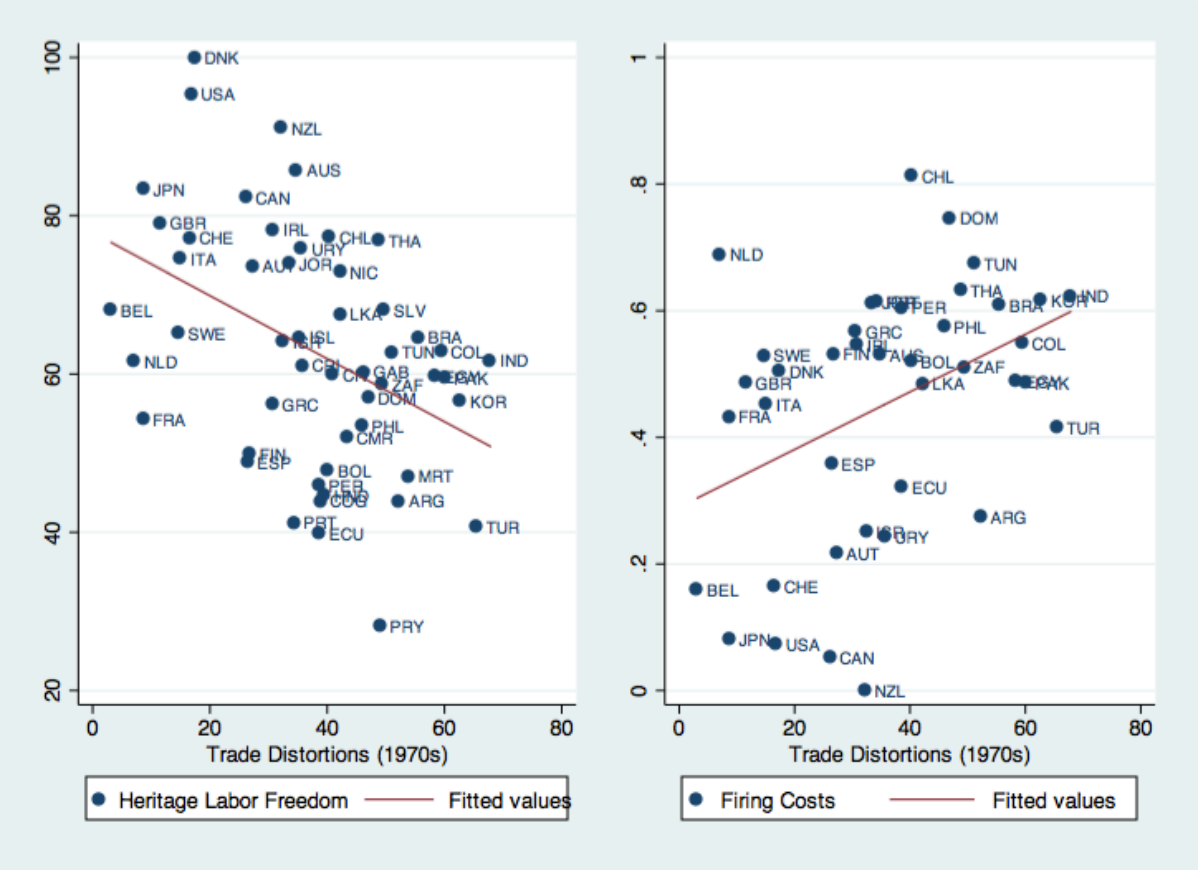


Figure 3**: Early Trade Distortions against Labor Market Regulations**, OECD

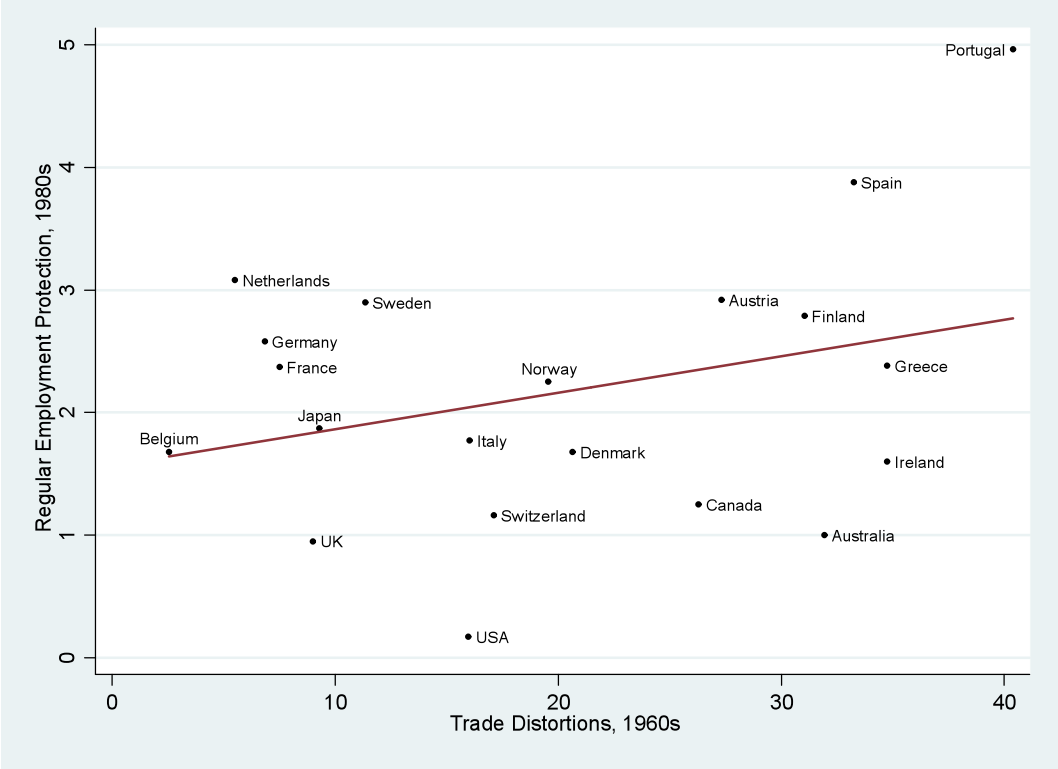


Figure 4: Economic Policy Through Time in Developing and OECD Countries

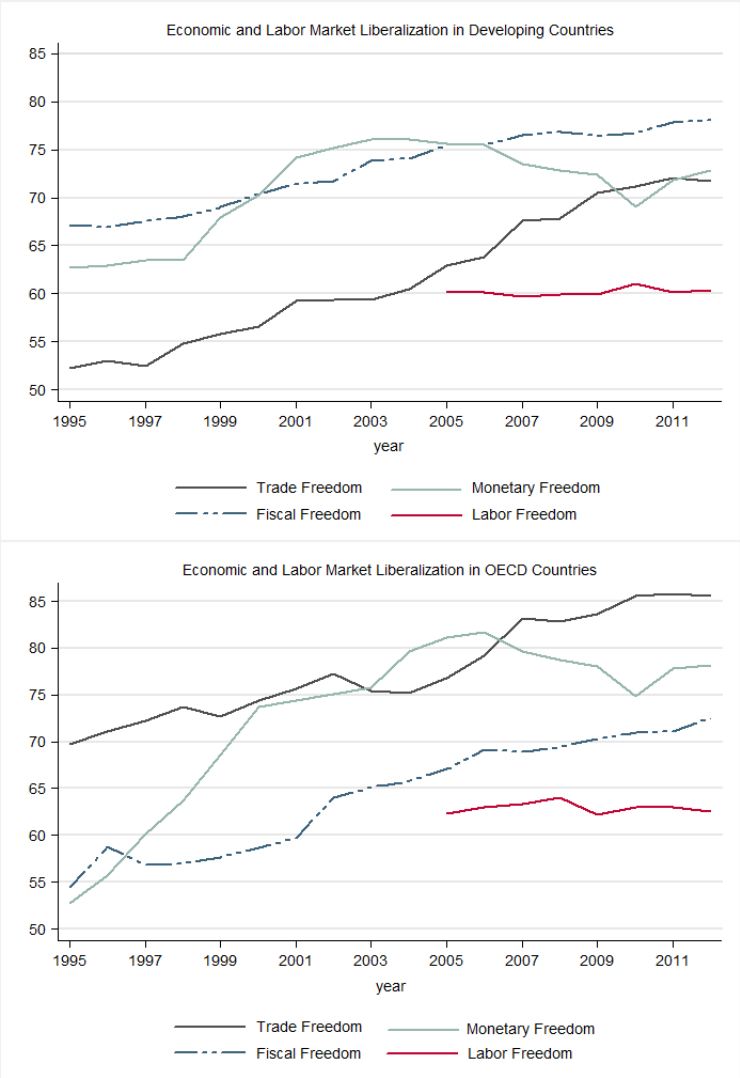


Figure 5: Labor Market Policies Across the Decades in Latin America and the OECD

Figure 5a: Labor market reform index in 1984 and 2010 in 19 Latin American countries

Figure 5b: Labor market policies in 1980s and 2000s in OECD countries

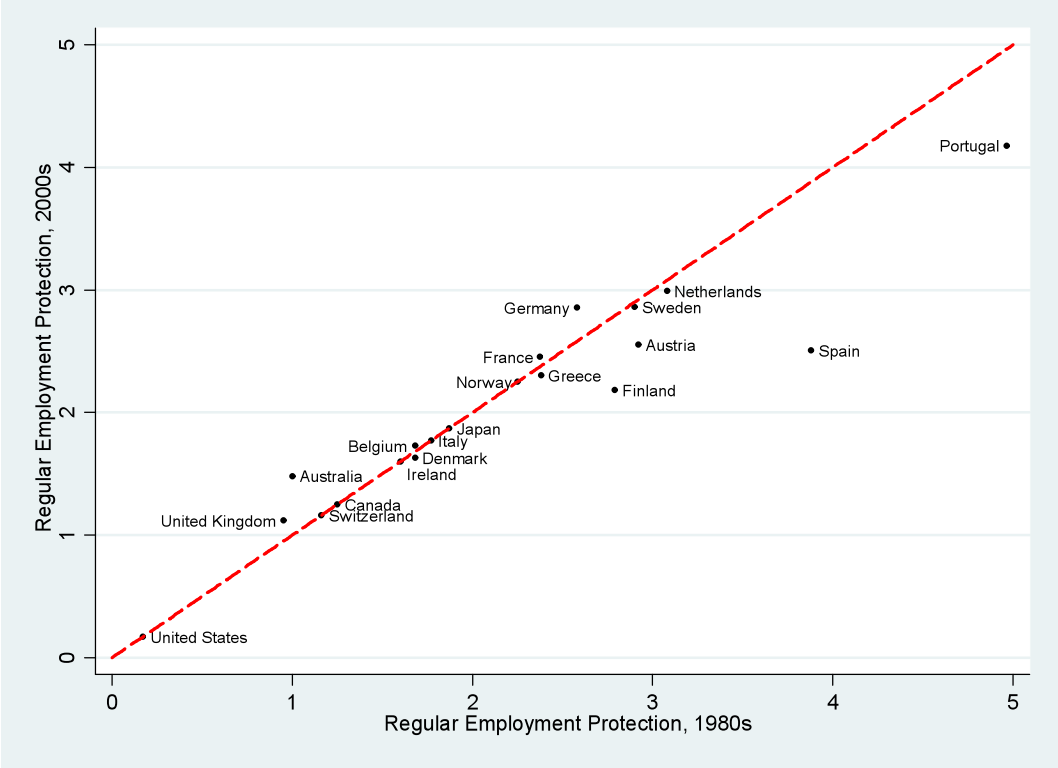


Figure 6: The Relationship between Labor Market Regulations and the Size of the Informal Sector

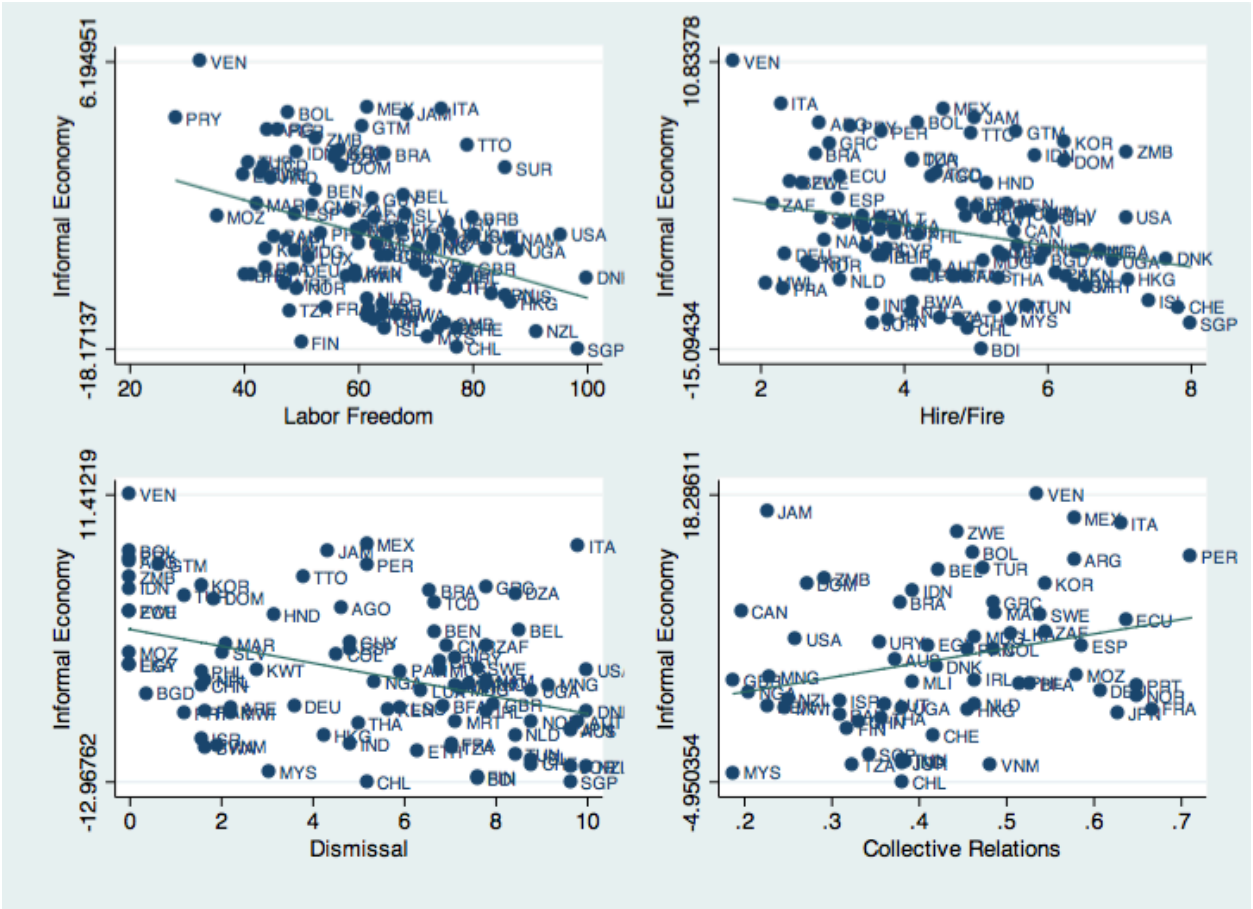


Figure 7: The Relationship between Insider Employment Protection and Labor Market Dualization in the OECD