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Why Social Policy is Condemned to a Residual Category of Safety Nets and What to Do about It

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Abstract

There are several stubborn causes of the problem alluded to in the title, but I choose to dwell on four that are less obvious and also lend themselves to suggestions for a research agenda of use to policymakers and program designers and executors in developing countries. The *first* is a tendency in the international donor community to conceive of social policy in a way that allows them to “projectize” and “micro-ize” it—a tendency that, remarkably, shows little variation from left to right across the donor spectrum. The *second* relates to the demise of the now-discredited models of import-substituting-industrialization and industrial policy—in many ways representing an advance in our understanding of development, but at the same time losing the strategic focus of this period on supporting the growth of local industry, and on including employment concerns centrally in economic-development policy, rather than marginalizing them. The *third* relates to the politics of the informal sector within developing countries, and how this—together with the preoccupation of the donor poverty agenda with the informal sector and small firms—renders more difficult the pursuit of certain aspects of a proper social-policy agenda within countries. The *fourth* points to the importance of managing the generic conflict of interest between workers and owners of capital through institutions of conflict mediation within countries, and the way in which this agenda is undermined, unintentionally, by certain aspects of the poverty-reducing agenda of the donor community. The paper includes a set of suggestions for comparative case-study research—based on the type of lessons that can be learned from a handful of illustrative cases presented in the paper—which could prove to be of benefit to policymakers and program designers and executors, as well as elevating certain aspects of social policy to more than a residual category with respect to economic development.

Introduction

I would like to start by congratulating Thandika Mkandawire for leading a badly needed initiative to re-think social policy in a way that does not condemn it to the residual category of “safety nets.” There are several stubborn causes of this problem, including the ideological one, but I choose to dwell on four that are less obvious and also lend themselves to suggestions for a UNRISD research agenda.

The *first* is a tendency in the international donor community to conceive of social policy in a way that allows them to “projectize” and “micro-ize” it—a tendency that, remarkably, shows little variation from left to right across the donor spectrum. The *second* relates to the demise of the now-

discredited models of import-substituting-industrialization and industrial policy, and the loss of their strategic focus on supporting the growth of local industry; this focus explicitly included employment concerns rather than marginalizing them. The *third* relates to the politics of the informal sector within developing countries, and how this—together with the preoccupation of the donor poverty agenda with the informal sector and small firms—renders more difficult the pursuit of certain aspects of a proper social-policy agenda within countries. The *fourth* points to the importance of managing the generic conflict of interest between workers and owners of capital through institutions of conflict mediation within countries, and the way in which this agenda is undermined, unintentionally, by certain aspects of the poverty-reducing agenda of the donor community.

Projectizing and Micro-izing

For all the talk of policy reforms, most donors—as funding organizations—have to organize their work around designing and funding projects. It is their *modus operandi*, their bread and butter. This “project imperative,” in turn, influences the way they define the poverty-reduction agenda, or any other for that matter. Historically, however, many of the needed social policy commitments and reforms that have had the largest proven impact on poverty—such as social-security and other social-insurance mechanisms—evolved on a much broader canvas in terms of administration, policy and politics, and demand-making by organized groups. They did not emerge from the humble beginnings of the microized or projectized approach, though the latter might fit comfortably within such a broader initiative.

Social Investment Funds (SIFs) are but one recent and major example of the project approach to poverty reduction, as supported by many donors large and small.¹ In such programs, a central-government agency or unit disburses grant funding to myriad communities, sometimes through local governments, for small projects like road paving or rural electrification, the building of schools or clinics, microcredit, and so on. Typically, the projects are said to be decided on by the community in a participatory fashion. Since the late 1980s, the World Bank, the Inter-American Development Bank, and the European donors together have committed more than US\$3.5 billion to the creation and perpetuation of SIFs in more than 40 countries. The funds are routinely described as a “safety net” for the poor against the adversities of macro programs of adjustment and, more generally of economic growth in a globalized world.

¹There are several names used for the last decade’s crop of social funds—including Social Funds (perhaps the most general category), and Social Emergency Funds (applying to temporary emergencies caused by natural or man-made disasters). I use the acronym SIFs (Social Investment Funds), rather than the looser category SIFs (Social Funds), partly because SIFs have become much more prominent in the current portfolio of social-fund projects, and partly so as to avoid confusion with the acronym commonly used for small firms (SIFs), including in a later section of this chapter.

Some attribute the large commitment of the major donors to SIFs as a poverty-reducing instrument to Washington-consensus views about reducing the role of government, and of central government in particular. This does not explain, however, the equal enthusiasm for SIFs or SIF-type projects by other donors that often oppose the so-called Washington-consensus or “neoliberal” views—such as NGOs and some of the of the smaller, more socially-oriented Northern European donors. In fact, the interest of these smaller donors can be better explained by their small size in comparison to the development banks, their provision of grant rather than loan funding, and the mandate of some of them to work through non-government organizations rather than governments. All this conspires toward an organizational imperative to produce a stream of bite-sized and discrete projects and, hence, to think in these terms.

The project-level view of the poverty problem, in turn, is highly compatible with other “micro-ized” views of poverty reduction that are now widely held—briefly, that decentralization together with community participation produces better services for the poor, and that NGOs are important actors in the carrying out of this agenda. I am not saying that these views are necessarily wrong, but rather that this noisy celebration of “the local” and nongovernmental tends to distract attention—even of those seriously committed to the poor—from broader social policy reforms.

The more micro views of how to approach poverty reduction have gained such strength that they seem to have become impregnable to contrary findings from evaluation research. For example, the findings of evaluations by the donors themselves on Social Funds—let alone of others—have been quite mixed. In particular, impacts on poverty and unemployment have often been found to be *insignificant*, sometimes even when compared to more traditional and longer-lived employment-generating schemes.² This set of mixed findings does not mean that such decentralized schemes cannot serve other important purposes, like the execution of myriad small works projects. It does suggest, however, that SIFs and similar projects may be a rather dull instrument for the purposes of reducing poverty and unemployment. To offer them to national leaders as a “safety net” to catch those hurt by economic crisis can also provide these leaders, in certain ways, with a way *out* of facing the poverty challenge more seriously.

There is by now an extensive literature on the SIF experience, including a vigorous debate on their pros and cons.³ My purpose in bringing them up here is not to add to the debates or review them,

²With respect to insignificant impacts with respect to reducing poverty and unemployment, see that chapter in IDB (Goodman et al. 1997); with respect to comparisons to longstanding employment schemes, see Cornia (1999; 2001; 2001) and Stewart (1995).

³In addition to the works cited in the previous note, see the following for clearly pro or con arguments and evidence. For the pro view, the best source and the most extensive set of studies can be found on the World Bank’s web site and the publications listed therein. For a concise pro and con set of arguments from *within* the World Bank, see van Domelen (pro) and Dellerman (con) at: www1.worldbank.org/publicsector/civilservice/acrex/vol1page1.htm. For the con view, see Cornia (1999; 2001; 2001),

but to point to the broader current of thinking they reflect and to how it contributes to the conundrum posed by Thandika Mkandawire as to why social policy is condemned to a residual category of safety nets.

For almost a decade, in sum, the “projectizing” and “micro-izing” mode of the operations of development organizations have captured and monopolized the imagination of the international development community, despite mixed evaluation findings. They have lulled many into believing that SIFs and other SIF-type projectizable initiatives will make significant contributions to resolving the twin problems of poverty and unemployment. The challenge to a research-supporting agency like UNRISD is to bring the attention of the development community back to more powerful instruments.⁴ The following three sections provide some examples of how this might be done.

Employment, Economic Development, and Implicit Industrial Policy.

In the donor world, a kind of post-Cold-War “take” has emerged on the policies, programs, and lessons learned from the prior period of import-substituting industrialization (ISI) and strategic subsidization of investment in certain sectors to promote industrial growth. Whereas policies involving state subsidy and direction used to be denounced by those who did not like them as “communist,” today they elicit a response that is even more withering—namely, that this kind of thinking is “old.” This has resulted in a kind of “cultural revolution” with respect to the texts and the thinking of this prior period. No one is “allowed” to praise anything that happened then, and students are not assigned the literature of that period, let alone the substantial research on that experience, which negative *and* positive results.

Whatever judgments might be made today about the policies of the ISI period, and however less appropriate they might be in a trade-liberalized 21st-century world, policy concerns about employment creation in that period were wedded to those about economic development rather than, as today, mainly to social policy. Independently of whether the outcomes turned out to be good or bad or mixed, employment concerns had an explicit place *within* the policy thinking about economic development itself and shaped the various forms of public-sector support. Today, concerns about employment have no such home. No longer considered “serious economic development,” they are now relegated to the realm of social policy, safety nets, and small-enterprise and informal-sector specific programs—a realm that has become marginal to the central project of economic growth. (The following section picks up on certain implications of this last development.)

Stewart(1995), and Tendler (2000b; 1999). For clearly mixed reviews, see IDB (1997), and a recent evaluation of the SIFs by the World Bank’s Operations Evaluation Department (2002).

⁴Such as those discussed in Andrea Cornia’s contribution to this volume and other works cited in the previous footnote (see References).

The marginality is reinforced by the new functional home for these concerns—in social-action, welfare, and labor agencies—and outside the public sector in NGOs—all of which have always had less power and prestige than agencies dealing with “economic development.” The placement of these activities among such “social” agencies, and the “distributive” or divisible nature of programs that provide project funding for communities, also makes them highly suitable for patronage purposes. This, needless to say, compromises the employment-creating and poverty-reducing criteria that are supposed to guide allocation of these funds.

To be sure, much of the industrial policy of the ISI period itself rode roughshod over existing local economies, and sometimes ignored the development potential of local-firm clusters that today have become the object of so much interest. Though the ISI policies of tariff protection were meant to support the development of local firms, then, they did not necessarily perform well in terms of enhancing the potential of existing concentrations of small and medium firms. Also, we have by now learned that some of the most effective assists for employment-creating growth are carried out by subnational governments—states or provinces, and municipalities. Many such assists, in turn, were “lite”, in contrast to the heaviness of the credit and other subsidies associated with the ISI period. Examples are the brokering of the connection to export markets, providing customized training to small-firm owners and their workers, or breaking particular efficiency-hampering infrastructure bottlenecks.

At the same time, however, the explicit and public articulation of industrial policy of the ISI period contributed to making the development of local industry and firms the subject of extensive examination and debate—in government, in development banks, in universities, and in the press. One important subject of policy attention was the attempt to forge customer-supplier linkages between foreign customer firms and local supplier firms, within the larger supportive policy context of laws requiring local content by foreign firms.

Today, in many countries, the debates about economic growth suffer from the lack of such attention to matters that directly and indirectly affect employment. It is not so much that industrial policy and its association with excessive subsidies and intervention is discredited, but that nothing as prestigious *and* inclusive of employment concerns has come to replace it in the current discourse about serious economic development. Hence many governments, including subnational, are at a loss as to how to deal with various challenges of the post-trade-liberalization era. A typical example relates to the decisions of many large global buyers to encourage or require their developing-country suppliers to procure their equipment outside the country rather than locally, even in cases where there is substantial local supply; or of outsider companies, newly located in a country, that prefer buying from the foreign

suppliers to which they are accustomed rather than from local suppliers; or of outsider firms buying local state enterprises, and switching their procurement from local supplier clusters to abroad.⁵ These developments often result in unemployment problems that, under the benign neglect of today's implicit industrial policy, become the burden of social policy.

Perhaps even more significantly, anyone who has done field research in developing countries finds governments—despite the strong current anti-subsidy discourse—to be subsidizing industries in a variety of ways. One of the most conspicuous forms of this—though the details are not always made public—involves the subsidies provided to attract large transnational firms to locate in a particular country or state; in addition to the well-known tax exemptions and infrastructure investment, this includes significant credit at highly favorable terms and substantial discounts on public services such as telecommunications, electric power, and water supplies.

Though the degree of today's subsidization of industry is probably not as great as that of the previous ISI period—no one to my knowledge has actually made such a comparison—the more important difference between the two periods is the *ad hoc* nature of the subsidization of the current period. The current subsidies, that is, are more the outcome of individual deals between a single government and a large firm—foreign *or* local—rather than of a strategic development vision, let alone a vision that embraces goals of sustainable employment.

I refer to this state of affairs as “implicit” industrial policy. “Industrial policy,” on the one hand, because it does add up to something like that—even though the whole may be less than the sum of its parts when outside firms do not have the developmental impact that was expected, or when the “market-destroying” effect of their arrival is greater than the market-creating effect. “Implicit,” on the other hand, because the rhetoric of the current policies of economic development is just the opposite of the old “industrial policy” and, indeed, explicitly eschews it. Namely, it is a discourse about *eliminating* subsidies, supporting private-sector growth and, more specifically, about the large outsider firm as the “new” engine of development, the “transformational” agent—with its cutting-edge technologies, best-practice organizational cultures, contacts with export markets, and tough-love relationships with its local suppliers.⁶

⁵An example of the former can be found in Schmitz (1998), with respect to the Sinos Valley shoe-exporting cluster in southern Brazil; an example of the latter can be found in Barnes (2000), with respect to the autoparts industry in South Africa; and in Dohnert (forthcoming), with respect to the privatized Venezuelan steel producer and its initial rejection of the local metal-mechanic sector.

⁶The portrayal of the outsider firm as an engine of development and as transformational, actually, is old rather than new. It appeared clearly in the “old” industrial policy of the ISI period. There is, however, a major difference. In the ISI period, a set of complementary policies obligated outsider firms to procure a certain percentage (often increasing through time) of their inputs from local firms, particularly machinery (e.g., Mexico's local-content laws and Brazil's Law of Similar). Public institutions often brokered the forging of these customer-supplier relationships, while providing technical assistance to the local firms in upgrading

At the same time, government officials in economic-development roles fear that the outside firms will be “frightened” away if the host governments ask for certain concessions in exchange for the subsidies, locating instead in a neighboring state or country that offers subsidies without strings. Requested concessions might relate to supporting the forging of linkages between the outside firms and existing local supplier firms, or in other ways enhancing the outsider firm’s role in spilling development to the economy around it. The fear by governments of losing potential investments by outside firms is particularly disabling with respect to these governments’ ability to be intelligently proactive with respect to supporting local economic development.⁷

Given these circumstances and this larger context, government officials see themselves as having no other choice than to relegate employment concerns to other realms—the safety nets, informal-sector programs, small-firm programs, microcredit. It is not that these measures are not important, though they often suffer from the aforementioned twin problems of “projectization” and “micro-ization.” By abandoning the realm of serious economic development, rather, they give up on important opportunities to reduce unemployment and also inadvertently render more difficult the unemployment-combating burdens of the social policy agenda itself. This takes me to the next two points, before which I conclude by pointing to the obvious role to be played by UNRISD—by supporting research that would chronicle and call attention to cases in which “implicit” industrial policy actually *did* lead to greater employment through linkages with local firms, in which governments actually were successful in negotiating development-enhancing concessions from large outsider firms, and in which governments provided strategic support to local firms that actually were effective—an industrial policy that was neither explicit à la ISI, nor implicit, à la the post-ISI period. Opening up such a policy space in the thinking about economic development would seem to be facilitated by the current interest in small firms and the informal sector, to which I now turn.

their product. Also, outside firms in the ISI period often chose to produce in certain developing countries because it was the only way to breach its high tariff walls in order to sell their product. This contrasts with today’s decisions by multinationals to move production to a particular developing country, which are often impelled instead by the desire to *export*. In making decisions about where to produce during the ISI period, then, multinational firms were at least as interested in getting access to a particular large consumer market as they were in finding the best production conditions and costs. This made the outside firms more amenable to development conditions imposed on them by host-country governments—such as local-content requirements—than they are in the current period.

⁷I have written about these fears at greater length, explored some of the reasons that outsider firms are actually willing to grant such concessions, and explored other aspects of implicit industrial policy and the conditions under which some outside firms tend to have more positive spillover effects than others—based on findings from a research project on local economic development in Northeast Brazil (Tendler 2000a; 2001)

Small Firms, the Informal Sector, and the Devil's Deal.

Over the last decade or so, myriad programs, projects, and policy reforms have focused attention on informal-sector (IS) firms and small firms (SFs) in general, as part of a broader social-policy agenda of reducing poverty and unemployment.⁸ Despite this welcome attention, many planners in developing countries nevertheless continue to view SF/IS programs as “only” welfare, rather than the stuff of “serious” economic development. The particular form taken by SF/IS support in many countries reinforces this view, as explained below, as does the way SF/IS support is often embedded in politics. This jeopardizes certain benefits, ironically, that we hold crucial to the current agenda of reducing poverty and unemployment: greater observance by firms of environmental and labor regulations, sustained increases in efficiency and productivity in local economies and, as a result, improvement in the quantity and quality of jobs.

I was first struck with the darker side of small-firm and informal-sector support when interviewing economic-development officials in the Brazilian state of Pernambuco. I was curious to know why they had not included, in a new program of support to a handful of small-firm clusters in the state, a particularly vibrant and longstanding garment cluster about a two hours' drive from the capital city. They explained that it would be quite awkward to elevate a cluster of firms to “growth-pole” status that was notorious for not paying taxes and not observing other government regulations.⁹ At the same time, however, they did not see themselves as having the option to enforce these regulations, even as a *quid pro quo* for providing public support, because the cluster was concentrated in two municipalities that contained more than 30,000 electors.

After visiting some other places and reading about cases in other countries, I came to interpret what I was observing as a kind of unspoken deal between politicians and their constituents—myriad small-firm owners, many in the informal sector. If you vote for me, according to this exchange, I won't collect taxes from you; I won't make you comply with other tax, environmental, or labor regulations; and I will keep the police and inspectors from harassing you. I call this tacit understanding “the devil's deal” because it causes informality to become *more* attractive, and formalization *less* attractive, than

⁸By specifying the subject to be firms that are small and/or informal, I am not excluding from the universe of firms discussed herein some small firms that are partly or fully formal, and even some firms that are producing in the same sector and in the same locality as the small firms, but tending toward medium size. Though this fuzzy definition ignores important distinctions, it is necessary to reflect the fact that SF demands often emerge from a set of firms defined by the space they occupy together and the same product or value-chain in which they produce. Just as important, the loose definition serves the purpose of brevity, and is also consistent with the language used by the international development community in describing and justifying the kinds of policy objectives and programs discussed in this chapter.

⁹The non-payment of taxes in this region has been no secret in Brazil. A national news magazine reported—in an article on the dynamism of the cluster entitled, “Taxes not paid here”—that “this (cluster) wouldn't even exist if firm owners had to pay taxes.” The chief of the state's Treasury Department, in turn, said that the taxes collected there did “not even represent 1% of what could be collected” (Furtado 2001).

they otherwise might be. Once the deal is made, it is difficult for either side to get out of it, as the above-mentioned comments of the Brazilian officials reveal.

In certain ways, then, the devil's deal can pose just as significant a barrier to formalization and upgrading of small-firm clusters¹⁰ as the actual costs themselves of formalization and regulation. Much of the policy advice on this subject, however, focuses on the "burdens" themselves as the source of the problem—particularly, the costs of formalizing and observing tax, environmental, and labor codes. It advocates reforms, in turn, that grant special relief from these burdens to small firms in the form of exemptions from or reductions of taxes and other costs associated with environmental and labor regulation. In addition, the SF literature is strangely silent on the politics in which SF support is so firmly embedded.¹¹

The dynamic of the devil's deal also reinforces the distinctly dismissive attitudes held by many economic-development planners and by development-bank managers toward smaller and informal-sector firms. To the extent that these managers and civil servants acknowledge the importance of SF/IS assistance, they often view it as a "welfare" measure that belongs in "social" rather than economic-development agencies—in ministries or departments of labor or social welfare, or special small-firm agencies. In their eyes, SF support will help mop up the unemployment resulting from the necessary reforms and initiatives meant to restructure the economy and institutions of government for a trade-liberalized world.

In these terms, the SF sector becomes mainly an instrument for preserving and even creating *jobs*—albeit often poor-quality jobs in poor-quality firms—rather than as an opportunity to stimulate economic development. This frees policymakers to dedicate their economic-development attention

¹⁰With apologies to today's cluster specialists, I will use the word "cluster" throughout more loosely than it is sometimes defined, partly for lack of a better single word and to avoid the more ponderous "agglomeration." In its more carefully-defined form, a small-firm "cluster" usually means a set of small firms located close together geographically with significant inter-firm relations among them, with an at-least evolving associational dynamic, and usually some history of success in growing, and in improving efficiency and productivity; in more recent definitions, other parts of the supply chain to which those firms belong also have to be present to qualify as a "cluster." My less demanding use of the term requires only that a particular region has a significant number of small firms producing the same product or in the same value chain, which may also include an admixture of medium and even large firms. Again, my sloppier definition is in some ways more consistent with the way the term is used in the world of policy and practice.

¹¹There are some exceptions, though they tend to come from outside the small-firm literature, involving country studies by political scientists; some take place in the now-industrialized countries. For example, Cross (1998). Actually narrates an analogous deal between government and informal firms; he documents how continued informality, in this case, was central to the government's willingness to support the vendors' organizing efforts, and to negotiate a series of their demands. In a study of taxation in Zambia, Rakner (2001) notes that the government "may have refrained from broadening its tax base to include the emerging informal business sector in order not to jeopardise its support among the Owambo-speaking majority. Italian political scientists studying Italy's postwar period have pointed explicitly to the importance of "(c)lientelist generosity—in the form of regulation to protect small business, a lax approach to tax collection for the self-employed, and so on—was systematically directed at these groups" (Hopkin and Mastropaolo 2001). Suzanne Berger's work on this same subject in Italy and France is cited in the following note. For an interpretation of small-firm politics in the U.S. economy as affecting viewpoints and policies, see Brown (1990).

elsewhere, by reducing for them the political cost of the job losses that ensue from the modernization of industry and economic-policy reforms. From this perspective, and more generally, SF-assistance programs do the important work of helping to maintain the “social peace,” rather than necessarily to modernize the local economy.¹² Contributing to this same perspective, many international donors and non-government organizations couch their current support for IS/SF assistance, such as micro-credit and other programs, in terms of “safety-net” measures for poverty reduction.

The devil’s deal offers more to IS/SF clusters than just looking the other way from their violation of regulations. Governments often grant small firms a particular kind of support in which there is something for everyone—special lines of cheap credit, blanket credit amnesties when times are bad, and blanket exemptions for small firms from certain taxes and regulations. The exemptions are “burden-relieving” in that they reduce the costs of small firms (or keep them from increasing) in a way that requires no effort on their part. They are also “universalist” or “distributive” in that they benefit *all* small firms—whether they want to grow or not, whether they are seeking to improve their efficiency or not, and regardless of sector.¹³

In maximizing the number of satisfied constituents, this kind of support to small firms is ideal for maintaining and increasing electoral loyalty. It is less than ideal, however, for stimulating local economic development that is sustained and employment-enhancing. Today, that is, the most widely agreed-upon forms of public support for local economic development do not have this universalist and burden-relieving character. In some ways, in fact, they are just the *opposite*. They strategically identify and try to remove bottlenecks to improved efficiency, productivity, and marketing for the sector as a whole. Before any significant support is rendered, they often require or elicit broad involvement of the sector in a process of discovering exactly what the problem is and what to do about it. And they may

¹²Using the small-firm sector to maintain employment and the social peace is not unique to the current period, or to less-developed countries. In work on the political economy of industrial policy in France and Italy, published more than 20 years ago, the political scientist Berger (1980; 1981) explicitly linked the pro-SF programs and regulations that developed in France and Italy during the 1970s to the simultaneous pursuit of a *large-firm* industrialization strategy by those very same governments. She had posed the question of why two countries that had so explicitly pursued a large-firm modernization industrial policy could at the same time have enacted such pro-SF legislation and assistance. It is from her work that I take the term, “keeping the social peace.”

¹³I apologize for any confusion I may create by borrowing the term “universalist” from the social-policy literature. In the social-policy literature, for both developed and developing countries, “universalist” is conveyed as the opposite of targeting. It is portrayed as more inclusive of beneficiaries—usually, middle class as well as lower class—than is an approach that, although more accurately targeting the poor, causes the left-out middle class to deny political support for the measure. Recently, many researchers—of both developed as well as developing countries—have argued that targeted approaches, though in some ways ideal in terms of restricting benefits to the intended beneficiaries, are quite cumbersome to administer (means-testing, etc.). They therefore end up alienating the middle classes whose political support is needed to enact such measures in the first place. In applying the term “universalist” here to economic-development-related matters and pointing out its problems, then, I am not thereby criticizing the universalist approach with respect to social policy. Rather, I borrow the term for its usefulness in conveying the same sense of an initiative being more politically appealing when it more conspicuously and efficiently benefits a larger number of voters, even at the cost of diluting program intentions.

benefit directly—at least at first—only those firms most capable and most interested in upgrading their production which, in turn, often leads to the latter’s formalization. The histories of dynamic small-firm clusters often reveal this particular kind of strategic public support, which, in turn, has been central to the formation of strong local economies and the reduction of unemployment.

Once the “devil’s deal” has been made between firms and politicians, it becomes politically awkward for governments to carry out the above-mentioned strategic and sector-specific support because it does not automatically benefit all small firms. To the extent that it does benefit the region as a whole—as in the breaking of important infrastructure bottlenecks or the linking of local producers to outside buyers through trade fairs—the benefits may be longer in coming and more diffuse, and their effects may be felt by many firms only indirectly. These traits are just the opposite of those characterizing the relief provided by the burden-reducing exemptions and subsidies—immediate, automatic, universal, conspicuous, and directly available to each firm as an individual unit.

Classifying firms by their size (small, medium, or large) for purposes of public policy, rather than by their product or sector, reinforces the tendencies toward the burden-reducing approach. “Small,” that is, can encompass a quite diverse set of firms—rustic and sophisticated, producing in different sectors, and located in different places. For purposes of lobbying for burden-reducing measures, for example, “small” can even be meant to include a rustic brick-making operation in the countryside or a sophisticated software firm in the city. With such heterogeneity, the only way an association can serve a majority of its members is to appeal to the broadest common denominator—namely, size. But the kind of support that best fits the size denominator is the burden-reducing subsidies and exemptions because of, as seen above, their universal and distributive benefits. That is why we often find small-firm associations pressing more for the universalist exemptions than for the strategic supports. In this sense, then, size is also the *lowest* common denominator, in that its associated subsidies and exemptions are the least likely to lead to sustained development.

No one would deny the importance of SF associationalism in the histories of many dynamic clusters. Organizing and lobbying according to firm size, moreover, may be the only way small firms can hope to compete with larger and more powerful firms for the attention of policymakers. At the same time, the attention paid by governments and donors to firms according to their (small) size—and to small-firm associationalism—can also work inadvertently in the same direction as the devil’s deal.

The large volume of research on small firms and their clusters does not tell us much about the circumstances under which universalist concerns and demands will dominate strategic ones in SF associations, let alone the sequence by which universalist concerns and their burden-relieving support sometimes miraculously give way to more strategic episodes. Complicating the story, the two

approaches may coexist within the same association.¹⁴ Putting together and lobbying for a strategic agenda, moreover, requires harder work over a longer period of time—more deliberation, analysis, and consensus—than lobbying for the burden-reducing exemptions and subsidies. In this sense, the universalist exemptions of the devil’s deal will be more appealing to SF associations because they are *easier*, just as they are more appealing to politicians because of their greater *political* yield.

Focusing on the difficulties small and informal firms face in meeting the costs of environmental and labor standards distracts our attention from pursuing opportunities for firms to, indeed, rise to the occasion and meet these standards, rather than be exempt from them. Though we are used to thinking that SFs need protection from these “excessively” burdensome costs, there are many cases in which SFs have actually met those costs and, contrary to the burden-relieving scenario, have been better off for it. They became more efficient, produced higher quality goods, and gained new access to more demanding markets.

How did such dynamic clusters get from where they were before—when they were the pathetic, low-productivity small firms of the welfare scenario—to where they are today? Much of the research on small-firm clusters fails to ask this particular question, dedicated as it has been to understanding how these clusters function at any particular moment in time or drawing best-practice lessons for practitioners. It is the evolutionary sequence of these cluster histories, however, that will reveal lessons on how to promote SF dynamism while not compromising—in contrast to the burden-reducing approach—our concerns for increasing the rule of law, reducing environmental problems, protecting worker rights, and upskilling labor. The histories will also provide insights into the sequences of events and other circumstances under which local actors make the transition from burden-relieving to more strategic and transformative deeds.

Offhand, five recent cases come to my mind of major advances in improving the efficiency, productivity, and other sector-wide aspects of partly small-firm clusters in which standards were increased rather than waived. In three of these cases, the advances were triggered in part by suddenly-imposed bans of importing countries on a developing country’s export. Germany banned the import of leather goods produced with certain chemicals, all used by the Tamil Nadu leather-goods cluster in India; the U.S. banned the import of precision surgical instruments from Pakistan, made in the Sialkhot cluster, because of problems with the quality of steel; and El Salvador banned the import of Nicaraguan cheese because it did not meet the importing country’s new hygienic standards.¹⁵ In each of these cases,

¹⁴I thank Nichola Lowe for pointing out these possibilities to me—based on a case from Jalisco state (Lowe forthcoming)

¹⁵For the German-Indian case, see Pillai (2000). For the U.S.-Pakistan case, see Nadvi (1999) and for El Salvador, see Perez-Aleman (2002). Note that, in the U.S.-Pakistan case, Nadvi comments that there was more cross-cluster success in improving the quality of the precision steel than with respect to labor and environmental standards (personal communication).

the importing country had been a major buyer of the export of that product for some time. The firms, acting through previously existing collective, public, and public-private institutions, rose to the occasion—meeting the costs of the new standards, resuming exporting, and becoming more competitive. One would not want to count on such wrenching import bans, of course, as a “best practice” for upgrading small-firm clusters.

The remaining two examples did not need the import bans by customer countries to fuel them, and hence show another possible path to similar results. These two cases were also triggered by problems in the international market—namely, increasing competition to SF clusters caused by the entry of cheaper or better products into the international market from other countries. One case involved a footwear cluster in southern Brazil and the other, a marble cluster in Andalusian Spain.¹⁶

In both these cases, importantly, the SF associations first lobbied government for the typical burden-reducing measures—tax exemptions, credit amnesties and subsidies. But, unusually, the government explicitly *rejected* the burden-reducing approach as a way of coping with the crisis provoked by the outside competition. Making its own counter-demand, the government agency involved offered a *different* kind of deal in exchange for support: it required that the firms gather together and engage in a time-consuming and difficult exercise that identified problems and proposed sector-specific solutions.

In the Andalusian case, the marble cluster had declined through the years partly because of increasing competition in the international market from the Italian marble industry. The Planning Ministry offered the following deal: the firms would themselves have to get together, decide what the problems were and how they might be overcome, and then arrive at a proposal on what to do. In addition, the Ministry required 100% consensus among the sector’s firms, in return for which it offered technical and facilitating assistance for this process, and the promise of financing for whatever proposal for upgrading that might emerge. This was a deal also, then, but in certain ways it was just the opposite of the devil’s deal: what it demanded in return was not political loyalty, but a set of behaviors that would lead to greater economic dynamism.

In the Brazilian case, similarly, the association of small footwear producers—faced with a crushing increase in cheap footwear imports in the late 1990s—lobbied the state government of Rio Grande do Sul for tax relief. The government denied the burden-reducing relief, but proposed a different kind of exchange. It offered to finance and assist in other ways the participation of these firms in an important major trade fair, an annual event held in the shoe-producing Franca region of Brazil, so

¹⁶For the Andalusian case, see Barzelay (2000). For the Brazilian case, I thank Luiz Miranda of the Economics Department of the Federal University of Rio Grande do Sul.

as to increase their exposure to the large Brazilian market. As a result, their sales increased significantly, which also increased the state's sales-tax return by more than the amount expended for this support.

The Brazilian story also shows that such strategic deals can yield political returns as robust as those of the burden-reducing measures. The state's footwear cluster, located a few hours from the capital city, had typically voted against the party in power at the time of this offer—the left-wing Workers' Party. Many of the smaller firms who benefited from the trade-fair experience, however, subsequently shifted their allegiance to that party, in a first-time split of the political loyalties of the footwear-producing sector as a whole.

Obviously, not all small-firm clusters would be able to respond as successfully as happened in these cases. But the general sympathy in the SF/IS agenda for protecting small firms as a group from various burdens—often in the name of protecting the “only” source of employment in particular local economies—distracts our attention from possibilities among such firms to meet these costs in a way that leaves them and the local economy better off. Such an economically robust outcome might provide more sustained employment, let alone better environmental and labor standards and tax collection, than would protecting small firms as a category.

I am arguing, then, that the widespread sympathy for small firms as a special category—and in particular their “inability” to pay taxes and conform to environmental and labor standards—tends to undermine other important concerns about appropriate strategies for reducing poverty, increasing employment and development, and improving governance. These include reducing environmental degradation (to which small-firm clusters can be major contributors); protecting worker rights to organize, and improving health and safety in the workplace; expanding the coverage of social security, health, and other social insurance to poorer workers; increasing the tax yield of governments so as to better finance public services and, in so doing, drawing government and firms together in a contract—in this case, to promote a more inclusive style of economic development.

UNRISD could contribute to breaking the stranglehold of the devil's deal by exploring the paths by which SF/IS firms or sectors actually grew into formality, treated workers better and upgraded their skills, and worked toward improving their environmental practices. These kinds of cases—where firm agglomerations succeeded in meeting regulatory requirements, became more competitive, and were better off for it—need to be sought out and chronicled, such that lessons for policy can be learned from them. This would help to show policymakers—particularly at the subnational level, where such enforcement and economic-development support increasingly takes place—another path and another set of possibilities. Showing that such outcomes are perfectly imaginable, and familiarizing planners with

the felicitous outcomes of actual cases and the paths that led to them, might also contribute toward reducing the generalized antipathy in the economic-development sector of many countries toward the enactment or enforcement of environmental and labor standards.

The policy sympathy for small firms as a category of assistance, in sum, is desirable on many grounds. At the same time, the concern about protecting SFs from reasonable regulations—let alone from the vicissitudes of the market—can become toxic when combined with the political dynamics of the devil’s deal. The waiving of tax, labor, and environmental regulations that results from sympathy for the “plight” of small firms may hinder rather than help local economies if it condemns them to low-level economic stagnation, degradation of the environment, and violation of worker rights. The latter all clearly increase unemployment and poverty, as well as burdening unnecessarily the task of poverty-reducing social policy.

Where did all the labour Unions go?

The poverty-reducing and human-rights agenda of the international development community now includes the protection of workers’ rights to organize. Inadvertently, however, other parts of the anti-poverty agenda have translated in certain ways, and sometimes inadvertently, into an *anti-labor* agenda—or, in some ways worse, a “labor-ignoring” agenda. This has contributed to further weakening the case for worker organizing *within* countries, thereby depriving the poverty agenda of domestic support from a potentially powerful ally.

Labor unions and other worker associations have actually figured prominently in some of the recent writing and policy advice on poverty and unemployment, but negatively. Namely, they have been castigated for their role in *blocking* important reforms that would benefit the poor, such as increasing employment through the flexibilization of the labor market. Unions are said to pursue a narrow self-interested policy agenda, acting as a labor aristocracy to protect their own bread-and-butter gains, and to advance their cause through unsavory relationships with political parties. They are blamed, among other things, for the gap between formal-sector and informal-sector wages, which condemns the informal sector to low wages and disguised unemployment.¹⁷ More generally, government officials—as

¹⁷The research record on this assertion is by no means clear. Recent research by Maloney (1999). In Latin America, for example, found *other* determinants of the informal-sector/formal-sector (IS/FS) wage gap to be more significant than the degree to which formal-sector labor is organized and has won minimum-wage legislation. In particular, the IS/FS wage gap in his study varied positively across countries with the degree of *illiteracy*—the higher the illiteracy, the higher the gap. He explains this finding in terms of the behavior of large firms (not unions) in trying to compensate for the illiteracy of the workforce. In more illiterate countries, that is, large firms compensate by investing *more* in training—paradoxically—than in the literate countries and, in turn, have to pay their workers a higher “efficiency wage” in order to keep them from leaving, given that exit causes the firms to lose this investment in worker training. (The interest rate was the other important factor contributing to the gap.)

well as business—see labor organizing and upward wage pressures as jeopardizing any project of economic growth in an era of global competition.

Though these portrayals of labor unions and other worker associations may in many cases be accurate, it is also true that, within countries, there are often no other as-powerful actors to defend workers' rights to organize and press successfully for other protections such as health and safety legislation, social insurance, etc. In addition, and in contrast to the image of a self-serving labor aristocracy, labor unions with power have often worked successfully—against serious opposition or inertia—to bring about broader policy changes that spill benefits substantially outside their own ranks. Examples are the role of the South African labor unions in the struggle against apartheid,¹⁸ or the key role of rural labor unions in Brazil in advocating agrarian reform, or the centrality of the metal-mechanic unions in Brazil in spearheading the formation of the new Workers' Party in the mid-1980s, and putting their weight behind the country's democratization struggle of that period. At the firm level, and in the best of cases, labor unions and management have actually succeeded in working together to identify problems of inefficiency and other bottlenecks in the firm and the sector, and have jointly made relevant policy recommendations to government. The Sectoral Chambers (*Câmaras Setoriais*) in the auto industry in Brazil of the early and mid-1990s are one example of a sectoral nature.¹⁹

The less explicit labor-ignoring aspects of the sidelining of worker organizing are, in certain ways, more undermining of worker causes than the oft-heard direct criticisms of labor unions noted above. Four features of the last decade's anti-poverty agenda contribute inadvertently to this state of affairs:

First is the aforementioned tendency to “projectize” interventions, and “micro-ize” or decentralize their decisions to the community level—a level at which labor unions, or at least their often stronger and more knowledgeable federations, do not necessarily operate, or are at their weakest.

Second is the aforementioned focus on small firms and the informal sector as the locus of unemployment- and poverty-reducing policy, with its accompanying sympathy for and strengthening of their pleas to be exempt from myriad regulations, including those protecting workers.

Third is the focus on NGOs as the most suited to carry out poverty-reducing programs. They are said to be more committed to the poor than government, “apolitical” and untainted by politics in comparison to labor unions, more flexible than government, and more able to mobilize and express the

¹⁸Beckman make this same point in a recent paper about South Africa (Beckman 2000); see also Andr  (1998) for similar work on the textile unions in Nigeria.

¹⁹ Arbix (2001). The Sectoral Chambers have since passed out of existence after the mid-1990s for a variety of reasons, one of which was the federal government's growing distaste for the substantial power of such a labor-business alliance.

needs of “the community.” It is not that anyone explicitly excludes labor unions and other worker associations from this nongovernment category but, rather, that they are rarely *included*. They are often nowhere to be found in the cast of ‘civil-society’ characters portrayed as representing “the community” in today’s more decentralized and participatory programs, and “public-private” partnerships.

Fourth, and finally, the image of “community” decision making that pervades many safety-net programs presumes, without saying so, a harmony of interests at the community level. The assumption of harmony also pervades the vision, underlying the discourse of decentralization, of a community united in demanding better service from local government, and hence better able to make government more accountable at the local level. In certain ways, this vision of harmony represents the opposite end of the spectrum from that of the 1960s and 1970s, when class conflict was viewed as enduring and irremediable, dooming any proposed reform. Today’s *no-conflict* vision of harmony commits the same error of over-simplification.

There are, obviously, generic conflicts of interest between labor and capital—as there are between other economic actors in the same community, such as producers of intermediate goods and the firms that buy them. But such conflicts of interest are best faced through institutionalized processes that mediate them, rather than by wishing them away. Building permanent institutions that mediate these conflicts, as Rodrik has argued, is *really* what macroeconomics is about; he finds, in a cross-country analysis, that those countries that were more institutionally equipped to mediate the conflict between labor and management actually grew better.²⁰

How different Rodrik’s view sounds from the development discourse of today, which posits a harmonious and single-voiced “community” to which government actions can be fruitfully decentralized. This latter view, so common to the “micro-ized” perspective outlined in the first section of this chapter, assumes Rodrik’s conflict away. In this sense, it is blind to the persistence of generic conflicts and, hence, to the need to pay attention to building institutions for mediating them. UNRISD could bring a more tempered and realistic perspective to bear on this picture by encouraging research on the processes that lead to the creation of sustained institutions—representing or cutting across labor and management—that manage this conflict according to norms of behavior recognized by both sides.

The absence of local or national labor unions in the donors’ poverty-reducing scenarios has been matched by a growing enthusiasm about international human-rights NGOs as the new key actors in the struggle for worker rights. These NGOs, as with NGOs in general, are seen as responsible, sincere, and high-minded in the campaign to protect workers from abuse, particularly in the plants or

²⁰ Rodrik (1997; 1999). See also Messner (1997) and Schmitz (2001).

subcontractors of multinational brand-name firms, such as Nike.²¹ In contrast, the donor community's image of *traditional* labor unions—those within specific countries—is just the opposite: sullied by self-interest and corruption, burly and obstreperous, and compromised by political involvements.

This is not to criticize, in any way, the international human-rights campaigns regarding labor and other practices. These groups have raised international consciousness around these issues markedly. At the same time, the shift of the focus away from national or subnational labor organizations to international rather than national arenas, and Northern-NGOs rather than within-country labor unions, has given added strength to those groups *within* developing countries that traditionally *oppose* the right of labor to organize, or feel uncomfortable with unions in their presence—particular certain sectors of business elites. Now, they can cloak their arguments against labor organizing in the mantle of “anti-North” nationalism—that “foreign” norms are being “imposed” by the more developed “North.” The argument is similar to that frequently heard from certain sectors of business and government in developing countries against international environmental and labor standards—namely, that such standards are a way of allowing the now-developed countries to restrain the growth of traded goods and hence trade competition by developing countries.

Ironically, then, the shifting of the worker-rights agenda to the international arena, and its concomitant de-fanging from an “old” and national labor-union agenda to a fresh and young human-rights and NGO-driven agenda, has emboldened the *anti-labor-rights* position *within* developing countries. More importantly, the indifference to institutions that represent workers *within* countries, and the repeated portrayal of them as compromising the poverty-reducing agenda as well as the growth agenda, does a disservice to the cause of building the institutions of conflict mediation that are so necessary to both the growth and the poverty-reducing project.

The final nail in this coffin is the frequently-noted trend that formal-sector employment is declining steadily as the informal sector becomes an ever-increasing share of employment—and that, correspondingly, the share of unionized labor is also declining, even within the formal sector. Formal-sector employment and labor unions, it is often concluded from these trends, are simply no longer “where it’s at.” I am not denying the significance of informal-sector labor and firms, nor the decline of formal-sector unions and other worker associations in many countries. But part of this weakening of worker organizing is a result of the economic crises and adjustment policies of the past two decades—the very policies that have contributed to sidelining the social-policy agenda. More importantly, this decline is exacerbated by the sustained portrayal of labor unions by the development-policy discourse as part of

²¹See, for example O'Rourke (1997; forthcoming) and Fung (2001).

the *problem* of poverty, rather than of its solution. In this sense, declaring labor unions and the formal sector to be “not where it’s at” also works to bring about this very turn of events.

In some ways, it is the ultimate irony that whereas business interests have often been portrayed historically as “the bad guys” with respect to the fate of proposed reforms meant to reduce poverty and unemployment, the bad-guy role is now assigned in today’s development discourse to labor unions. Business, in turn, has now been transformed into the happy camper of this vision—witness, for example, the recent wave of studies of public-private partnerships, with business elites often speaking for the good of “the community” in various decentralized programs.

Reflecting or contributing to this turn of events, the scholarly literature on business associations in economic development has proliferated, while that on labor unions in developing countries is hard to find, except in specialized “labor studies.” This despite the fact that anyone who does field work in developing countries runs across enough cases of gains from labor organizing and non-conflictual and positive-sum outcomes to provide substantial raw material for drawing a set of policy-relevant lessons. One such example, noted briefly for purposes of illustration, comes from a sector and a place where one would least expect it—previously temporary workers on grape-growing (for export) farms in the poorest region of Brazil, for export to Europe.

Within a few years of organizing by a local rural workers’ union, and supported by the state federation and central-government confederation of rural unions, this organizing effort brought growers to the bargaining table—and, remarkably, without conflict. The result was the agreement to a permanent system of collective bargaining, formalization of the work force, agreement to pay the minimum wage plus 10%, respect for child-labor prohibitions, and a variety of other protections. Importantly, several years after the first accord, this system of conflict mediation is still in existence, and has spread to other fruit-growing areas in the region.²²

Also significant, the increase in wages, unionization, and other labor protections did *not* cause the fruit growers to be less competitive in international markets. This flies in the face of the standard objection raised against improving labor standards in labor-intensive products that are internationally traded—that the resulting increased costs will price the product out of the international market, since there will always be a cheaper-labor producing country. Indeed, in this case, just the opposite occurred:

²²This case is part of a larger study by Damiani (1999) of the development of the Petrolina-Juazeiro region of the states of Pernambuco and Bahia as an agricultural growth pole and successful fruit exporter. The labor story itself is the subject of a separate article by Damiani (forthcoming). For a study documenting the spread of these labor practices to another state in the same region and even poorer—the melon-growing region of Mossoró in Rio Grande do Norte, see Gomes (1999; forthcoming). It is interesting to note that the Petrolina-Juazeiro region, which straddles Brazil’s San Francisco River Valley, marketed itself to its first European and U.S. buyers as “the California of Brazil,” implying world-class modernity in agriculture. Ironically, the Brazilian “California” seems to have achieved significantly greater advances in labor than those revealed in the history of organizing among the grape growers in the “real” California of the U.S.

the advances in unionization and labor standards were accompanied by ever-increasing upgrading of product quality and international market penetration, just the opposite of the usual feared scenario. Why in this case—or class of cases, yet to be discovered—and not in the others?

Answering questions like these should be the task of an UNRISD-supported research agenda. Such cases should be unearthed, chronicled, and searched for lessons—in the Brazilian example, as to why conflict was avoided, why the increased wages did *not* make the product less competitive in foreign markets, and how unionization occurred in an environment of constant upgrading of the quality of the product. It is not that such cases represent a majority, but that they pose a mystery and we need to know how it was solved. Such cases should serve as models for inspiration, for imitation, and for the reduction of fear of the unknown among government officials and business. Though one might argue that the proper domain for such research and dissemination is labor-specific organizations, such as the International Labor Organization, this places the issue back in the narrower box of labor unions, rather than the broader one of a socially-appropriate economic development. UNRISD is particularly suited to play a role here, then, precisely because it is a *not* a labor-specific organization.

By envisioning a project of employment creation and poverty reduction in which labor unions are the bad guys, we ignore at our peril important social and political institutions that will advance that project. Though labor unions are often portrayed as tainted by their “political” involvements, moreover, the poverty-reducing project is, indeed, a highly political one—as history shows us. But much of the thinking about poverty reduction in the international development community takes place beyond national borders in international fora, and is often rather technocratic in excluding such forces as key variables for study and discussion. All this adds up to a serious lapse in thinking about building sustainable institutions *within* countries for protecting worker rights.

No matter how hard we work to dream up a better approach to reducing poverty—and no matter how much we bring economists to the table to sit with other social scientists—we are making the task even more difficult by allowing the subject of labor organizing within countries to slip into oblivion. We also lose thereby a scarce ally to stand behind the poverty-reducing agenda, and miss the opportunity to build essential institutions for the mediation of conflict between management and workers.

UNRISD could make an important contribution to correcting this imbalance through its research, and the way it disseminates it. It could support the chronicling of a set of cases of labor organizing with positive outcomes, such as that noted above for Brazilian agricultural workers. The criterion for selection of such cases for study would be that production and sales increased, or product quality was improved, or successful exporting ensued, or the right to bargain collectively with producers

was won without conflict. The point would be not to argue that such outcomes are the norm, but to show that they are possible, and to illuminate the dynamic that runs across a series of such cases.

This latter contribution is particularly important, because government officials—not to mention business—fear that worker organizing will “spoil” the growth project, particularly in today’s trade-liberalized world. Added to this is the institutional newness of such organizing in many places—government officials do not know how to manage the conflict, in the sense of even the most trivial details. These kinds of studies—with results disseminated in the countries where the cases took place—could work to allay this fear of the unknown, reduce resistance, and set an example for labor unions, business, and government.

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