

**COMMENTS ON KEVIN FANDL’S  
ARTICLE: MAKING TRADE  
LIBERALIZATION WORK FOR THE POOR:  
TRADE LAW AND THE INFORMAL  
ECONOMY IN COLOMBIA**

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*“[L]as mejores soluciones que podemos ofrecer al problema de la pobreza y la injusticia son aquellas que nacen directamente de las experiencias mismas de los pobres, aquellas soluciones que se afirman como respuesta a las barreras que deben enfrentar y que surgen como alternativa a las instituciones de las que carecen.”<sup>1</sup>*

As a Latin-American citizen who has lived and seen the consequences of poverty, inequality, weak institutions, and informality in his country and amongst his people, the purpose of this document is to present an insight on Mr. Kevin Fandl’s article *Making Trade Liberalization Work for the Poor: Trade Law and the Informal Economy in Colombia*. Colombia, like other Latin American and Caribbean countries, is a developing nation where the rule of law is not strictly followed, mainly due to poverty, inequality, and weak institutions. The significance of Mr. Fandl’s research is due to this country’s current need for qualified guidance. As I told Mr. Fandl when he requested my insight on his research and article, “I hope qualified professors, like you, keep coming to help and research in order to reach Colombian development.”

One of the premises of this research agrees with the above-quoted De Soto’s idea, stating that the best solutions for poverty and injustice are those that take into account the perspective and behavior of the poor regarding their lack of institutions. According to Fandl, “[I]t is imperative that we examine the effects this process has on the people living in the liberalizing countries.”<sup>2</sup> This imperative premise is considered in every step his study takes to develop its central idea, which suggests a solution to the alarming panorama of informality in this country: “Colombia maintains one of the largest informal economies in the developing world, with roughly 60% of its population working outside the bounds of the law.”<sup>3</sup> Before this panorama, Fandl asks “why the outward-orientation of the Colombian

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1. Hernando de Soto, *Caminando el Otro Sendero*, in SERIE DIÁLOGO 1, 25 (Oct. 1990) (“The best solutions that we can offer to the problem of poverty and injustice are those that are born directly out of the very experiences of the poor, those solutions that are born as a response to the obstacles that they must face and that emerge as an alternative to institutions that they lack.”).

2. Kevin Fandl, *Making Trade Liberalization Work for the Poor: Trade Law and the Informal Economy in Colombia*, 43 TEX. INT’L L.J. 161, 162 (2008).

3. *Id.* at 169.

economy brought economic growth without equivalent reductions in poverty and inequality.”<sup>4</sup>

Actually, during the 1990s some labor and commercial reforms were launched in Colombia to implement the Washington Consensus and thus liberalize labor movement (hiring and firing) and trade. Fandl bases his research on valid statistical sources to show that there is a correlation between these labor and trade reforms and the growth of unemployment, informality, and poverty present during the 1990s and currently.<sup>5</sup> Though there actually were some increases in growth after these reforms were launched, neither inequality nor poverty showed any important decrease.<sup>6</sup> This correlation that Fandl presents in his text is supported by the statistics on poverty and inequality presented by the Economic Commission for Latin America and the Caribbean (ECLAC).

Neither poverty nor inequality showed any important decrease after trade liberalization was launched in Colombia. Based on the ECLAC’s “income method,”<sup>7</sup> poverty in Colombia has only declined from 54.9% in 1999 to 46.8% in 2005.<sup>8</sup> Besides, Colombian Gini coefficient (0.584 by 2005<sup>9</sup>) and ECLAC’s analysis on income distribution denote how alarming inequality is in Colombia. By 2005, 63% of the Colombian income was concentrated in the richest quintile (20%) of the national population. Meanwhile, by the same year, the poorest quintile of the national population only had access to 2.9% of Colombian income!<sup>10</sup> Colombian poverty and inequality pose an alarming problem, even when labor and trade liberalization reforms have been launched to increase growth in the country.

As Fandl, supported by De Soto, states, one possible reason why labor and trade reforms did not have a great impact on poverty and inequality, and instead increased both deployment and informality, could be that such reforms created additional costs for domestic companies to be legal and competitive.<sup>11</sup> After these reforms were launched, a

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4. *Id.* at 163.

5. *Id.* at 179 (“As reforms that opened the Colombian economy to foreign trade were implemented, primarily during the 1990s, unemployment increased sharply; the informal sector grew upwards of 60%; and poverty reduction, while on the decline prior to 1991, began climbing steadily until 1998, when it again began to decline.”).

6. *Id.* at 180 (“Despite the aggregate economic growth of the Colombian economy, poverty reduction has slowed, inequality has not improved, and the informal sector has grown.”).

7. The ECLAC’s “income method” analyzes poverty as well as indigence, by referring to a basket of stable goods in order to consider whether a household can afford both its nutritional requirements and its other basic housing needs not related to feeding. *See* STATISTICS AND ECONOMIC PROJECTIONS DIVISION OF THE ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN, STATISTICAL YEARBOOK FOR LATIN AMERICA AND THE CARIBBEAN 366 (2007) [hereinafter ECLAC] (“The estimates of extreme poverty were prepared by ECLAC using the ‘income method,’ which is based on the calculation of poverty and indigence lines. These lines represent the level of income required by a household in order to meet the basic needs of all its members. The poverty lines for each country and geographical area were determined on the basis of the estimated cost of a basket of staple foods—taking into account eating habits and the actual availability of food in each country as well as relative prices—which meets the nutritional requirements of the population. The value of this basket was then added to the total estimated sum required by households to meet their basic non-food needs.”).

8. *Id.* at 74.

9. *Id.* at 79.

10. *Id.* at 76.

11. Fandl, *supra* note 2, at 179. (“The laws passed in Colombia in the early 1990s that liberalized trade also increased competition, lowered the cost of factor inputs, and improved technology. All of these secondary effects are consistent with a decline in formal employment and a growing informal sector due to a decrease in demand for labor.”). *See also* HERNANDO DE SOTO, THE OTHER PATH: THE INVISIBLE REVOLUTION IN THE THIRD WORLD 133 (June Abbott trans., Harper & Row 1989) (“Our research shows that Peruvians’ decisions to conduct their activities informally are in large measure the result of a rational, though less detailed, evaluation of the costs of formality.”).

labor agreement implied some benefits for the worker and high costs that could not be backed by the domestic companies that had to compete with foreign ones.<sup>12</sup> This increase in labor costs implied a decrease in formal labor demand, which can be explained by two facts. First, some companies began to replace part of their human capital by new technologies that accomplished the same functions. Second, some companies tried to skip the labor benefits by hiring the workers that could not be technologically replaced through low-paying service contracts that did not entail any labor costs.<sup>13</sup> Thus, formal labor demand decreased and both unemployment and informality increased.

Nowadays, there are more people in Colombia who are available to supply their work than people demanding it. The current rate of occupied people, which includes formal and informal activities, is 51.6%, which means that only a half part of the supply is currently demanded.<sup>14</sup> Understanding a monopsony to be a situation where market prices and conditions are set by the firms that demand a good or service, the Colombian labor market could then be analyzed in this light: demanders (employers) set low prices (wages) and bad conditions (lack of labor benefits) for the good (work) supplied.<sup>15</sup> This is beyond the natural superiority and control that an employer has over the worker in a labor relation. This situation should be regulated in order for the monopsonist employers not to abuse the system by setting unfair prices and conditions.

Plus, further regulation should be launched and implemented in order to formalize informal activities. Assistance and benefits to small enterprises could give an incentive for those executing informal activities to formalize and for those unoccupied to run their own businesses. In some measure, informal activities that are not illicit and do not harm society could be considered to be flourishing entrepreneurship and therefore should not be indiscriminately banned; namely those activities addressed by Fandl: "Operating in the extralegal sector, informal market vendors meet a critical need in developing countries: providing goods such as foodstuffs, crafts, textiles and services such as phone calls and transportation."<sup>16</sup>

In conclusion, this perspective of considering informal activities that are not illicit and do not harm society to signify flourishing entrepreneurship requires an immediate change in the way these activities have normally been viewed. In fact, some part of Colombian society either discriminates or ignores such activities without any valid reason. Changing this perspective could give voice to those who usually are not heard. At the end of the day, these

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12. Fandl, *supra* note 2, at 168 ("However, despite the loosening of labor restrictions on firing workers, formal employers were also required at this time to provide social services, savings accounts, and vacation time for workers. Accordingly, many employers resorted to the use of service contracts to hire workers, thereby avoiding formality and the need to offer these protections to their workers.").

13. The Colombian Constitutional Court stated in several decisions the difference between a labor contract and a service contract, in order to establish when a labor relation was being hidden by a service contract. *See* Corte Constitucional [Constitutional Court] Sentencia C-397/06, (Col.).

14. DEPARTAMENTO ADMINISTRATIVO NACIONAL DE ESTADÍSTICA, BOLETIN DE PRENSA (MERCADO LABORAL) 2008, [http://www.dane.gov.co/files/investigaciones/boletines/ech/ech/bol\\_ech\\_mar08.pdf](http://www.dane.gov.co/files/investigaciones/boletines/ech/ech/bol_ech_mar08.pdf) (last visited May 10, 2008).

15. *See* Alan Manning, *Monopsony*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS* (Steven N. Durlauf & Lawrence E. Blume eds., 2nd ed. Palgrave Macmillan, 2008) ("Monopsony refers to the situation where a firm has some market power over the price it pays for its inputs, so that a higher price must be paid the more input is used. Monopsony could exist in any input market but is usually discussed in the context of the labour market. Employers will have monopsony power over their workers because of frictions in the labour market. Employers will use this monopsony power to pay workers less than their marginal product. This gap between marginal product and wage offers policy an opportunity to raise the wage of workers without necessarily jeopardizing their employment.").

16. Fandl, *supra* note 2, at 165.

activities are informal only because the relevant actors lack the financial means to fulfill extra regulations and become formal.