Exiting from the crisis: towards a model of more equitable and sustainable growth

Edited by
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Report of a trade union task force

Edited by David Coats

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Preface

Even before the crisis, as the chapters in this book point out, there were several alternative forms of market economy, with different policy frameworks. While in most metrics, the Nordic model delivered better performance over longer periods of time than alternative models, including the American model, there was an active policy debate: could the Nordic model apply to countries with markedly different circumstances? Could it compete in delivering high levels of innovation over an extended period of time?

The crisis has called into question the strengths and weaknesses of various models, and the criteria by which we evaluate alternative policy frameworks. The broad landscape of issues and countries examined in this book provides a vital background for the reassessments that are, and should be, going on in countries, all over the world. Some countries have weathered the storm better than others. Some countries and policies were more responsible for creating the storm. Some policies, long advocated by financial markets and international financial institutions, contributed to the rapid spread of the crisis around the world.

The moment when everyone was a Keynesian economist has now passed. There was even a moment when Alan Greenspan would cast doubt on the viability of the notion of self-regulated markets. This has now passed. Financial markets are demanding a return to the old ways and, as fiscal debts have increased, to consolidations – which almost always entail cutbacks in services vital to working men and women. And in a world with already high levels of unemployment, the austerity they demand will imply even higher levels of unemployment; and that in turn will put downward pressure on wages. The conservatives' old blame game has continued apace: it was the government's attempt to provide housing for more Americans and its support for rigid wage policies that underlie the current problems. It is a matter of structural unemployment, not cyclical unemployment: if workers were only 'flexible' in their wage demands, we could get the world back to work.

Any economic system has to be graded on its ability to provide sustainable increases in well-being to the vast majority of its citizens – that is the central message of the International Commission on the Measurement of Economic Performance and Social Progress (Stiglitz et al. 2010). In recent years, America's economic system has not been scoring well – even before the crisis. Those in the middle have seen their income stagnate or decline. Today, the vast majority of Americans are worse off than they were a decade ago – and this account does not even reckon with the increase in insecurity as a result of the risk of higher unemployment, accompanied by inadequate unemployment insurance and the loss of health insurance.

This growing inequality in the US and many other countries has been linked by the UN Commission of Experts (Stiglitz and Members of a UN Commission of Experts 2010) to the deficiencies in global aggregate demand, that in turn were and are at the centre of the current crisis. In a sense, lower-income Americans were told not to worry about the decrease in their incomes, but to maintain their standards of living by borrowing. This policy worked for the short run, but was clearly unsustainable. It will be hard for robust *sustainable* consumption to be restored without improving equality. Unfortunately, downward pressures on wages from unemployment may result in exactly the opposite, one of several instances demonstrating that markets on their own are not stable.

By the same token, calls for more wage flexibility – hidden calls for reducing the wages of the most vulnerable – will also weaken aggregate demand and be counterproductive. Such calls are particularly foolish in a context of widespread debt contracts which are not indexed. Lower wages will make it more difficult for workers to make their debt payments, compounding their suffering and increasing the turmoil on already unsettled financial markets.

Not surprisingly, some of the countries that have better systems of social protection have done better than those with inadequate systems, even as they faced much worse external shocks. So-called reforms in recent decades have had the unintentional effect of weakening the economy's automatic stabilisers, thereby weakening the resilience of the economy.

Most of the increases in national indebtedness in the advanced industrial countries in the aftermath of the crisis are a result of the working of these automatic stabilisers, and it would be a mistake to undercut them.

Fiscal conservatives say that cutbacks in spending now are imperative, or else the US will face a Greece or Ireland style crisis. Ireland has faced a crisis largely because it followed the standard free market orthodoxy: unfettered markets led to a bloated financial sector which put at risk the entire economy; while politicians boasted of the growth (the benefits of which were not uniformly shared) they took little note of the risks to which they were exposing the economy. The core lesson of Ireland's experience – and that of the US – is that one cannot rely on unfettered markets or self-regulation.

Spain provides an answer to those who say that *all* one has to do is enforce more strictly the fiscal guidelines of Maastricht, not letting governments have unbridled deficits. Before the crisis, Spain had a surplus. Government leaders even recognised that markets were leading to a distorted economy (although those of the previous government were wedded to free market fundamentalism, as were many in the Central Bank.) But they didn't have the time and tools: today, Spain has a large deficit, with 20 per cent unemployment and 40 per cent youth unemployment.

It is remarkable that reasonable economists, when assigned to think about public policy, quickly lose their grounding. When looking at the health of a firm, they would look at its cash flows and its balance sheet – assets and liabilities. But when it comes to the government, they only look at liabilities. One can't help thinking that these blinders are political in nature: by reducing debt, they hope to force (in times such as these) cutbacks in social spending. There is a more rational economic response: increasing investments, even if debt financed, can improve the nation's overall strength and even reduce the medium-term debt/GDP ratio. For countries such as the US with a backlog of high return investments and with the ability to borrow at close to zero interest rates, government tax revenues will increase far more than the interest that will have to be paid, so debt will be lower and GDP higher. With a lower numerator and a higher denominator, economic growth is *more* sustainable.

These are win–win policies. There are other policies that can help to improve the overall efficiency of the economy today and promote long-term growth. Forcing firms to pay for the costs they impose on their environment amounts to the elimination of a distortionary subsidy, thereby increasing economic efficiency. Societal well-being has improved since the introduction of environmental regulations, which have led to air that is more breathable and water that is safer. Using market-based incentives – taxing bad things rather than good things, such as work and savings – can both generate revenue and increase economic efficiency. America's toxic financial products polluted the global economy, and imposed enormous costs on others. There are a variety of taxes on the financial sector (including a financial transactions tax) which would generate considerable amounts of revenue and potentially even lead to a more stable economy. By the same token, taxes on the oil and other carbon emitting sectors could help increase the energy and carbon efficiency of the economy at the same time that such taxes provide revenues for dealing with the deficit.

Finally, there are policies that involve hard trade-offs – not everyone may gain in the short run. If there is to be fiscal consolidation, it should not be on the backs of those who have been suffering from a dysfunctional system for the past quarter century, but rather of those who have benefited from the system. In the United States, for instance, with approximately a quarter of all income accruing to the upper 1 per cent, moderate increases in income, capital gains, and estate taxes could generate substantial revenues without significantly compromising their standards of living. Even a small financial transactions tax could raise large amounts of money.

The economic system is governed by a set of rules. Any set of rules advantage some players of the game at the expense of others. And the rules affect how the system as a whole performs. Over the past thirty years, we have changed a large number of rules on a piecemeal basis, under the influence of an ideology which said that the best rules were those that interfered least with the markets. That, at least, was what the advocates of the rules said. But in fact, there was another agenda. Deregulation did not, in fact, result in less involvement in the market, but more: there was less involvement in the years before the crisis, but far more in its aftermath. This was predictable and predicted. What these advocates of so-called free markets were doing was creating a system I have called 'ersatz capitalism', the essential ingredient of which is the socialisation of losses and the privatisation of gains. This ersatz capitalism is closely related to the corporate capitalism that flourished under Bush and Reagan. In some cases, who pays for these gifts to corporations is not so transparent: in the end, of course, it is ordinary citizens, whether as taxpayers or consumers who pay, but often in ways that are not easy to detect, for example, through tax expenditure or through higher prices on the goods they purchase.

But some of the changes in the rules during the Bush years were targeted on the most vulnerable. Reforms that made it more difficult for those with large debts – combined with no limits on the usurious rates which banks could charge – reintroduced into the United States a system of partial bonded servitude. It enabled banks to be more reckless in their lending, knowing that they had a better chance of getting back their loans, with interest, no matter how outrageous the contract. One might have hoped that moral scruples would have prevented the widespread predatory practices, but evidently greed triumphed; and with free market regulators either in bed with the banks or succumbing to free market ideologies, there was no check on these abusive practices. The banks had discovered that there was money at the bottom of the pyramid, and they created techniques, and a legal framework, to help move it towards the top. No one looking at what happened would say that these 'voluntary' but all too often deceptive transactions enhanced the well-being of those at the bottom. But in the end, our entire global system paid the price.

Four years after America's real estate bubble broke, bringing down the global economy, the price for these misdeeds has not yet been fully paid. Output remains well below its potential in most advanced industrial countries, with the losses in trillions of dollars – in addition to the losses due to the financial sector's misallocation of capital and mismanagement of risk before the crisis. No government outside of war has ever been responsible for the magnitude of losses that have resulted from the financial sector's misdeeds. And yet, four years later, the rules of the game, the regulations which government imposes on banks, have yet to be adequately changed. Incentives for excessive risk taking and short-sighted behaviour remain; indeed, the problem of moral hazard posed by too-big-to-fail banks is worse, not better. In some areas, there have been improvements, but even then the laws remain riddled with exemptions and exceptions, determined not on the basis of economic principles but raw political muscle.

Any society functions on the basis of a sense of social cohesion and trust, a sense of fairness. We should not underestimate the extent to which the crisis and how it has been dealt with has broken the social contract and all of these elements which make a society function well. That the bankers have lost the trust of those they have served is obvious; one bank that had engaged in deceptive practices simply said that it was the responsibility of others to take care (caveat emptor); banks that you can trust are evidently a thing of the past. Inequality is typically justified on the ground that those who are paid well have made more of a contribution to society, from which we all benefit. But when taxpayers financed bank bonuses in the millions – paid to those who were responsible for losses to their firms in the billions, and to society in the hundreds of billions – this story no longer made any sense. When an Obama Administration official announced the double standard – workers had to rewrite their contracts to make the car companies competitive, but the bankers' contracts were sacrosanct and could not be rewritten – it too contributed to a perspective that the system was fundamentally unfair, and that the government, rather than correcting the inequities, was there to maintain them.

Worse, ordinary citizens are being asked to bear more austerity, higher unemployment and cutbacks in public services, all to pay down debts that were created by the actions of the financial sector, and in part to protect banks' bondholders and shareholders.

An economy cannot work without trust, but when banks insist on trying to return to the world as it was before the crisis, citizens rightly feel sceptical. Trust will not return until good and strong regulations are passed, and until a sense of balance has been restored. The financial sector is supposed to serve the economy – not vice versa. We have been confusing ends and means.

We have the same resources – human and real capital – today that we had before the crisis. There is no reason we should compound the financial sector's mistake of misallocating capital *before* the crisis with the further mistake of underutilizing society's resources *after* the crisis. Modern technology has the capacity to enhance the well-being of *all* citizens – and yet in some countries (including the United States) we have created an economy in which *most* citizens are worse off, year after year. We might boast of the increases in our GDP, but what good is that if that increase in GDP does not redound to the benefit of ordinary citizens? If that growth does not lead to broader increases in well-being? Or if the increases are ephemeral, and not sustainable, either economically or environmentally?

The challenges facing governments, our societies and our economies are enormous. We may have pulled back from the brink at which we stood in the fall of 2008, but we are not out of the woods. Even if profits, bonuses and growth are restored, we cannot claim victory until unemployment is brought down to where it was before the crisis, and until the real incomes of workers are not just growing, but have made up for the losses that have been suffered in the interim. We can do it – but only if we correct the mistakes of the past, change course and keep in mind the true objectives for which we should be striving.

Professor Joseph Stiglitz, Columbia University
April 2011

Foreword to the report of the trade union task force

At the time of writing, the global economy is still struggling to emerge from the worst financial crisis and global recession since the Second World War. The recovery is uneven and still very fragile. For most working families an economic recovery has yet to be felt. Unemployment rates in industrialised countries remain 50 per cent higher than in 2008. One hundred million more people live in extreme poverty than before the crisis. The shift announced by governments to fiscal consolidation and austerity policies, before the recovery is self-sustaining, risks slowing, if not stalling the recovery and raising unemployment further.

Thrust into prominence in the near financial meltdown of 2008, the G20 has emerged as a policy coordination forum that in its first two years was successful to the extent that the world's leading economies largely avoided a second Great Depression. However, governments must step up their coordinated efforts to reduce unemployment and restore effective social protection. If employment and social protection are not addressed global social unrest will grow. If financial regulation with real constraints on speculative activity in food and other commodities is not implemented global inequality, deprivation and poverty will escalate, as will the risk of a renewed economic crisis.

Beyond the immediate crisis response the scale of the recent economic disaster raises questions about the policies that led to the crisis. OECD Secretary-General Angel Gurría has said that the crisis reflected massive failures of financial regulation, supervision and governance. The IMF Managing Director Dominique Strauss-Kahn has said that '[f]undamentally, the growth model that co-existed with globalisation was unbalanced and unsustainable ... Inequality may have actually stoked this unsustainable model.' The crisis should be provoking a serious rethink in all these areas, but the scenario looks very much like 'business as usual'. On the one hand, profits are booming and bonuses are back, symbolising the lack of fundamental financial sector reform. On the other hand, attacks are being launched on the very social protection and labour market institutions that helped to shield (some) economies from the worst effects of the crisis.

Following the crisis, it has been striking that the more regulated labour markets of the Nordic area and Germany have fared best in terms of unemployment, while the more 'flexible' labour markets of the US and some other EU countries have been dominated by brutal layoffs of workers by firms, with a reluctance to hire back not seen in any previous post-war cycle. Despite this, many mainstream economists and commentators continue to call for the weakening of employment protection legislation, decentralisation of collective bargaining and the encouragement of workers to 'price themselves into jobs'.

The lessons of recent experience need to be learnt and a new model of growth developed based on a more balanced relationship between government and the economy. Governments must ensure that banks return to their core task of allocating capital efficiently, and that corporations recognise their responsibilities to their customers, employees and the wider community. Governments must ensure that the growth process emerging from the crisis is both socially just and environmental sustainable.

To provide a forum for debate, TUAC, the European Trade Union Institute, the Global Union Research Network and the ITUC created a Task Force to define the parameters of a new growth model. This report is the initial result of its work. It consists of contributions by more than 30 authors from both industrialised and developing countries. The report has been edited by David Coats, Research Fellow at the Smith Institute, supported by John Evans, Andrew Watt and Frank Hoffer. We are pleased to include a preface by the Nobel Laureate Joseph Stiglitz.

As the report's conclusion states, faith in unconstrained markets should have been undermined by the collapse of the banking sector and the ensuing global crash, but it now appears that policymakers are retreating to the comforting nostrums of economic orthodoxy. This would be a strategic error. Returning to policies that failed in the run-up to the crisis cannot be expected to return the global economy to growth following a very deep recession. TUAC, the ITUC and the ETUC will be seeking to ensure that policymakers take this message to heart, both this year and beyond.

Sharan Burrow (General Secretary, ITUC)
John Evans (General Secretary, TUAC)
John Monks (General Secretary, ETUC)
April 2011

Towards a new growth model: introduction

David Coats

The collapse

> I made a mistake in presuming that the self-interests of organisations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms … This modern risk-management paradigm held sway for decades … the whole intellectual edifice collapsed in the summer of last year.
>
> Alan Greenspan, former Chairman of the Federal Reserve, testimony to the House Committee of Government Oversight and Reform, 23 October 2008

For most of his time as chairman of the Federal Reserve Alan Greenspan's interventions in policy debates had a Delphic quality. 'Just what did he mean by that?' was a question that often perplexed the 'commentariat'. It is all the more surprising, then, that he should have been absolutely clear in his evidence to Congress in 2008 following the collapse of Lehman Brothers and the most serious banking crisis for eighty years. By admitting that he made a mistake in believing that enlightened self-interest was the most important element of market discipline, Greenspan was accepting the failure of a mindset, a model and a faith that had held sway over public policy for the preceding three decades.

The essence of the model is easy to explain. It tells us that markets are 'smart' (in the American English sense of 'clever'), while governments are dumb. Regulatory interventions intended to do good are more likely than not to do harm. Indeed, most regulations are a burden on business and the best solution to any economic problem is to liberate markets to do their best (or worst). High taxation is bound to have disincentive effects that hold back economic growth and keep countries poorer than they would otherwise be. Strong welfare states, especially if they offer generous out of work benefits, may be good at protecting people from poverty, but economies – and ultimately workers – pay the price in high structural unemployment. Strong trade unions create rigidities in the labour market. By forcing up wages to uneconomic levels trade unions achieve nothing more than a combination of high inflation and high unemployment.

Central to the model is a profound hostility to action by the state and a touching faith in the perfection of markets. Governments, once they branch out from their night-watchman role, are said to be agents of economic destruction. Financial markets and asset markets in particular, if left to their own devices, will ensure that the right prices are offered at all times. A rather crude interpretation of Adam Smith's 'invisible hand' – that a kind of selfishness is the coordinating instrument in markets – is easily conflated with the notion that 'greed is good', that rising income inequality is unavoidable and that any attempt to put a cap on the earnings of the richest will lead to an exodus of talent to those countries with low taxes and a high tolerance of excess.

What is most alarming about the market fundamentalist faith is that it allows no room for disagreement or debate: this view is right and all others are wrong. Before the crisis hit, anyone who suggested that the model might be flawed, or partial, or based more on faith than evidence rapidly found themselves marginalised in the public debate and exposed to ridicule. Often such critics were bluntly told that they simply did not understand economics. Experience has proved that the critics were more prescient than the enthusiasts. But while there is some satisfaction to be drawn from being proved right – and many of the contributors to this volume have a record of speaking out against market fundamentalism going back years before the crisis – the challenge now is to construct a credible alternative.

That is broadly the purpose of this volume, which flows from the work of an international trade union task force established by the European Trade Union Institute, the Trade Union Advisory Committee to the OECD, the ITUC and the Global Unions Research Network. It draws together the best thinking from across the world, with contributions from trade unions themselves and commentators sympathetic to the labour agenda. Far from being a restatement of entrenched trade union positions, this volume also seeks to generate fresh insights that are relevant to contemporary debates. The issues covered are wide-ranging – from monetary and fiscal policy, to income inequality, industrial policy, the role of public services, the regulation of financial markets, the importance of labour standards, the role of global institutions and the transition to a sustainable growth model. The scope is ambitious, but the recommendations are designed to be practical. They start with the world as it is, not the world as we would wish it to be, and they are rooted in evidence, not the wishful thinking of which trade unions are so often wrongly accused.

Market fundamentalism makes a number of claims about the superior economic performance derived from policies of light-touch regulation, fiscal rectitude and inflation targeting. But even before the crisis broke there was ample evidence to demonstrate that there was more than one route to prosperity. The 'varieties of capitalism' analysis, popularised by Peter Hall and David Soskice, showed that very different institutional arrangements produced rather similar results in terms of GDP per capita (Hall and Soskice 2001). And the OECD's review of their 1994 Jobs Study demonstrated that labour markets with high taxes, high benefits, strong unions and expensive labour market policies were just as likely to achieve full employment as the more liberal economies of the UK and the USA (OECD 2006). Not only that, but they did so while maintaining much higher levels of social cohesion, equality and social mobility, with all the attendant benefits of better health, higher levels of trust and lower levels of incarceration (Wilkinson and Pickett 2009). Moreover, it was not entirely clear that the developing world had benefited from observing the strictures of the conventional wisdom, as Joseph Stiglitz documented so powerfully in his pre-crisis critique of the international financial institutions (Stiglitz 2002 and 2006).

The hard work of rethinking had already begun in some quarters before hubris overtook the global banking system, and trade unions were already part of the coalition offering alternatives to the dominant ideology. We have sought in this collection of articles to take the argument further and offer prescriptions as well as analysis.

When the crisis broke, policymakers were confronted with the immediate challenge of preventing a global depression, the strategic task of rebuilding the structures of global economic governance to ensure sustainable growth in the future and the strenuous political test of explaining all of this to sceptical or hostile electorates. Initially, at least, there was a degree of panic and confusion. Finance ministers were trapped by the status quo and only reluctantly intervened to prevent the failure of significant financial institutions. But then it seemed that policy measures that had been off the agenda for the previous thirty years – such as deficit spending and public ownership – were suddenly back in vogue. After the failure of Lehman Brothers, governments did take action to recapitalise the banks. And when it was clear that the banking crisis had pushed the real economy into recession, a (more or less) coordinated global fiscal stimulus was administered, combined with what central bankers described as unorthodox monetary policy: quantitative easing to inject more liquidity into the financial system and the economy.

The G20 appeared to play an important role, suggesting that the richest countries in the world had understood the need to involve emerging economies in critical economic policy decisions. Support for the G20's approach came from what would have been unlikely quarters in the 1980s and 1990s. For example, the IMF supported the stimulus policies and emphasised that if the household and corporate sectors continued to grow sluggishly then governments should do more. Keynesianism was being taken seriously again. This was a dramatic and welcome development and some saw it as a fundamental change in the dynamics of capitalism. Just as Thatcherism and Reaganism had overthrown the post-war consensus in the developed English-speaking countries, so the banking crisis had overthrown the belief in the perfection of markets and the optimality of all market outcomes (Kaletsky 2010).

This suggestion that we are witnessing a paradigm shift is not entirely groundless, but subsequent experience has suggested that it may overstate the nature of the change taking place. A dramatic swing in the direction of state action has been swiftly followed by an equal and opposite clamour for immediate fiscal consolidation. The banking crisis, which generated the right policy response, has been followed in a number of countries by a sovereign debt crisis, with policymakers retreating at high speed to the comforting nostrums of orthodoxy. Financial markets are determining the policy context once again, just as they did in the pre-crisis period, despite the fact that the markets were largely responsible for the crash and are now seeking to penalise those governments that saved the banking system from catastrophe.

In the euro area (more popularly known as the 'Eurozone'), for example, austerity policies are back with a vengeance. Even countries with a current account surplus, such as Germany, are cutting budget deficits immediately. And public sector retrenchment across the Eurozone, even as households pay down debt ('deleverage') and firms see little incentive to invest, is likely to lead to sluggish growth, and might even tip the entire economy back into recession. Unless the household and corporate sectors in Germany and other surplus countries take up the slack and start consuming imports from elsewhere in Europe the nascent recovery could be snuffed out. Unemployment could remain high, and the threat of a misguided attack on the European socio-economic model – as in similar circumstances in the mid-1990s – would be very real.

The muted nature of the recovery in the USA leaves open the possibility of a double dip recession. And in the UK, fiscal consolidation is being pursued at a reckless pace, with the public sector bearing the brunt of the pain – 80 per cent of the reduction in the deficit is to be achieved through cuts in services and only 20 per cent through tax increases.

Put simply, a measured response to the crisis in its initial phases (following some moments of perplexity) which, while insufficient, at least averted the threat of a repeat of the Great Depression, has been followed by the return of a rising sense of panic. The moderately good start has been largely wasted and there is a serious risk that policymakers are now, through fear of the bond markets, about to plunge the global economy into a prolonged slump.

These choices are inevitably related to the shifting sands of politics. Govern ments that were enthusiastic about stimulus policies or a measured approach to fiscal consolidation are either in difficulty or have lost power. Electorates across the developed world appear to be turning to the centre-right and a more conventional set of economic policies – although this is not true everywhere, with South America (most recently Brazil) as a notable counter-example. Politicians of the centre and the left have struggled to articulate a clear economic policy prospectus and continue to pay the political price. The questions they need to answer are clear: How should the exit from the crisis be managed? How can fiscal consolidation be achieved without compromising progressive objectives, including the pursuit of greater income equality and a higher level of social cohesion? And how can a new growth model be constructed that offers decent jobs, rising living standards and a sustainable approach to the environment?

In the meantime, trade unions are therefore confronted by three significant challenges: the return of austerity policies as governments seek to deal with the fiscal consequences of the crisis; the return of the argument that an immediate job-rich recovery requires deregulation; and the belief that high structural unemployment can be avoided over the long term only if labour markets are flexible, taxes are low, unions are enfeebled and welfare states are weak. Any impartial observer will be driven to conclude that the market fundamentalist orthodoxy is staging something of a comeback, despite the empirical evidence casting doubt on the model before the crisis and its self-evident failure during the crisis. To a degree, then, the contributors to this volume are fighting old battles at the same time as they seek to develop a new approach to sustainable growth.

More than anything else, the objective of this volume is to offer a clear description of an alternative. The goals of the trade union movement remain the same: to give working people a voice in determining their futures; to guarantee sustainable, decent jobs for all those who wish to work; to ensure that developing nations can experience rising incomes and rising labour standards; to establish a growth model consistent with environmental responsibility; and to secure greater income equality as the best route to social cohesion. Nonetheless, simply to call for a return to the policies of the post-war boom period would be a catastrophic mistake. The world has changed and the trade union movement has changed with it. The arguments presented here are designed to show that both unions and other progressive voices linked to the labour movement have new, relevant and credible policies for the difficult period ahead. It is for others to judge whether we have succeeded.

I Measuring economic performance and social progress

Measuring economic performance and social progress

John Evans and Anousheh Karvar

Events since 2007 have confirmed the failure of the market fundamentalist paradigm and have added urgency to the quest for a viable alternative. Perhaps one of the biggest weaknesses of the market fundamentalist model was the belief that the rate of increase in measured GDP per capita was the only relevant benchmark of economic performance. In one sense it is surprising that policymakers were seduced by what many people would regard as an unsophisticated approach. There is ample evidence to show that increases in GDP per capita are important for developing countries, enabling them to offer decent health care, education, housing and employment to their populations. But there is just as much compelling evidence to show that once a country has achieved developed status measured increases in GDP have very little impact on happiness or life chances (absent a reasonably egalitarian distribution of income) (Layard 2004; Wilkinson and Pickett 2009). Amartya Sen has expressed the argument very well, emphasising that the goal of policy must be to equip citizens with the capabilities they need to choose lives that they have reason to value:

> [I]t is simply not adequate to take as our basic objective just the maximisation of income or wealth, which is, as Aristotle noted 'merely useful and for the sake of something else'. For the same reason, economic growth cannot sensibly be treated as an end in itself. Development has to be more concerned with enhancing the lives we lead and the freedoms we enjoy. Expanding the freedoms we have reason to value not only makes our lives richer and more unfettered, but also allows us to be fuller social persons, exercising our own volitions and interacting with – and influencing – the world in which we live. (Sen 1999: 14)

The social and economic cost of what the IMF has dubbed the 'Great Recession' of 2007–2009 (IMF-ILO 2010) should therefore provoke a fundamental rethink of not just why so many policymakers and institutions failed to foresee the financial collapse that triggered it, but also what should be the objectives of economic policy and how best to measure progress towards these objectives. The OECD has defined its aim as 'to achieve the highest sustainable economic growth and employment,'[1] which could be taken as a proxy for the objectives of economic policy for most of its member governments. In common with most international organisations, it has taken the per capita level and growth of GDP as the prime measure of living standards and development.

Other things being equal, changes in GDP do reflect changes in living standards and have a central impact on employment and levels of unemployment. In the short term, GDP remains perhaps the key indicator of economic performance. However, GDP – and in particular GDP per capita – has been elevated over the past two decades to be the sole objective of policy in many cases where objectives such as higher employment as well as living standards are seen as automatically flowing from higher GDP growth. The fact that it measures market activity rather than welfare, while commonly agreed on, has largely been ignored by policymakers.

This has been particularly problematic when GDP per capita has been used to compare and rank economic performance between countries, without qualification. The OECD's 'Going for Growth' approach (OECD 2006) for the past decade initially explicitly and subsequently implicitly took US GDP per capita as the benchmark against which the performance of all OECD countries should be measured. The fact that measured US GDP per capita is the highest in the major economies has also been used to promote what over the first part of the 2000s was seen as the 'US model' of deregulated labour markets, financial market hegemony and shareholder value systems of corporate governance. It is these very features that have been identified as contributory factors in the financial collapse of September 2008 that sparked the 'Great Recession'.

The dangers of taking the wrong benchmark as the basis for policy was stated clearly by Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi, the authors of the 'Report of the Commission for the Measurement of Economic Performance and Social Progress' (CMEPSP) that was estab-

1. OECD Convention: www.oecd.org

lished by the President of France and reported at the end of 2009. They pointed out that 'What we measure affects what we do; and if our measurements are flawed, decisions may be distorted.' In the wake of the crisis they commented that '[p]art of the reason why the crisis took many by such surprise is that the "measurement" systems we use to assess and monitor economic performance failed'.[2]

This can be seen most clearly in the issues that are obscured rather than illuminated by the measure of US GDP. One feature is the financialisation of the economy[3] that has been a feature of industrialised countries for the past two decades but is seen most clearly in the 'Anglo-Saxon' model of market economies. In the US, the share of the financial sector in domestic corporate profits rose from 19 per cent in 1986 to over 40 per cent in the mid-2000s. Following the financial collapse it has become clear that a significant part of the transactions and assets on which those profits were made were, in fact, worthless. Nevertheless, the policies of financial deregulation that permitted this financialisation process were justified by the expansion of measured GDP in the US that measures market activity, irrespective of the fact that the wealth creation was to a significant extent an illusion.

A relentless focus on GDP offers us a distorted view of general economic performance. It tells us nothing about the quality of life, or life chances or sustainability. Despite having the highest measured GDP per capita in the OECD, therefore, the US model depends on unsustainable energy intensive growth. GDP figures have failed to measure the excessive energy dependence of the transport sector based on comparatively low energy prices in transportation compared to other OECD countries. They have also failed to measure the excessive expenditure on health care (16 per cent of GDP in the US in 2009 compared to an OECD average of 8 per cent). Furthermore, this expenditure is not reflected in better health outcomes in terms of life expectancy and infant mortality compared with average OECD countries.

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2. *The measurement of economic performance and social progress revisited – reflections and overview*, 16 September 2009.
3. Financialisation is best defined as the process by which the financial sector assumes greater weight and importance in developed country economies, as the process of restructuring leads to a focus on financial engineering as the most significant source of 'wealth creation'.

Most importantly the figures of GDP per capita fail to take account of how income is distributed and how that changes over time. The US is both one of the most unequal countries in the OECD in terms of income distribution and one in which inequality has increased over the past two decades. From 1980 to 2005 in the US more than 80 per cent of the total income increase went to the top 1 per cent of the population. As argued elsewhere in this report the growth of inequality and the failure of low incomes to rise were major factors in driving the credit-based model of growth in the US and, behind that, the bubble economy.

Beyond the immediate crisis there has been a recognition of the gap in measurement of growth as seen in GDP per capita and the sense of economic well-being of the population. The OECD itself has acknowledged that 'for a number of years there has been evidence of a growing gap between the image conveyed by official macroeconomic statistics, such as GDP, and the perceptions of ordinary people about their own socio-economic conditions' and that 'addressing such perceptions of the citizens is of crucial importance for the credibility and accountability of public policies and the very functioning of democracy'.[4]

Box 1 **France – A case study**

Following the publication of the CMEPSP report the Economic, Social and Environmental Council (CESE) was determined to ensure that these recommendations had some impact on public policy and the measurement of economic performance.

In September 2009 the Ministry for Sustainable Development established a Commission to prepare a national conference on sustainable development indicators following a CESE recommendation. The aim is to establish a draft list of indicators that can better measure progress made in achieving the national sustainable development strategy.

Under the three bodies – the Commission for Sustainable Development, the National Council for Statistical Information (CNIS) and the Economic, Social and Environmental Council (CESE) – the initiative has brought together the five stakeholder groups in the 'Grenelle de

4. OECD Statistics Newsletter 2010.

Box 1 (cont.)

l'Environnement' process: trade unions, businesses, local authorities, environmental NGOs and governments. Other groups were also involved via the CNIS and the CESE.

A conference was held in January 2010 and eleven 'spotlight' indicators (*indicateurs phares*) were presented against which to assess the French (and European) sustainable development strategy. These were concentrated on environmental objectives. There were fifteen complementary indicators targeted at more precise goals. Some of them were surprising, such as GDP per capita to measure the 'knowledge society'. They were preceded by five contextual indicators.

The contextual indicators are designed to integrate the environmental benchmarks with a more general set of social and economic indicators. So, for example, the Commission is developing indicators that relate the environmental measures to measures of income inequality, unemployment and under-employment. Moreover, other indicators related to public health (health inequality), economic security and social integration have been added.

While this looks positive, a more participatory approach might have produced a better or more useful series of benchmarks. There is still some potential, for example, to develop additional measures of the quality of work, training, access to housing, as well as environmental concerns, such as the level of nitrates and pesticides in ground water or the sustainable habitat.

One priority is to be able to break down indicators to give information by region and, where relevant, by gender. Another is to be able to give information on the dispersion of results and not only averages.

It is also necessary to work seriously on the presentation of dashboard information and ensure that it is updated annually so as to achieve the widest possible diffusion among households, so that they can verify the impact of policy or ensure change when necessary. It is possible to imagine the publication of a synthetic report of twenty pages, each devoted to one of the indicators, using graphics showing changes compared with the desired objectives.

Box 1 (cont.)

Finally, it is necessary to experiment with forms of engagement with 'men and the women in the street' to verify that indicators do match their needs and expectations.

It is not easy for statisticians to accept that they do not possess all the knowledge on an issue, just as it is not easy for representatives of civil society to go beyond their role of criticism or advice and get directly involved. However, after the initial work of the Commission, significant progress has been made to bring together divergent points of view. Already at this stage one thing is clear: even if the expertise of statisticians is essential it is not they on their own who will define the list of indicators but statisticians and civil society representatives together. A decisive step has been taken so that the French public can take ownership of the debates surrounding sustainable development, while recognising that sustainable development is not just an environmental question but above all an economic and social one.

If analysis and performance were less obsessively based on levels and growth of GDP per capita, more care would have been taken in interpreting the strong growth of the first years of the twenty-first century. There would have been less triumphalism in promoting the very policies and models that led to the crisis. Economic policymakers and the majority of economists failed their populations.

Towards a balanced set of indicators

One could therefore say that simply to focus on measured increases in GDP per capita tells us little about the quality of life enjoyed by the citizens of a developed country. It tells us nothing about the distribution of incomes, nothing about differences between rich and poor in terms of health and life expectancy, nothing about social mobility, nothing about environmental sustainability and little or nothing about the quality of life. Most importantly, it tells us nothing at all about whether most citizens have, following Amartya Sen's formulation, the capabilities they need to choose lives that they have reason to value.

How might we go about devising better measures of economic performance? An important first step must be to develop a dashboard of indicators that tell us something about the following: median GDP rather than GDP per capita; the equality (or inequality) of income distribution measured by the Gini coefficient; the employment rate broken down by population groups; life expectancy indicators; measures of economic security; and the carbon-intensity of economic activity. Second, these indicators must be seen as credible and legitimate by all stakeholders, including business and the trade unions. In France, a generally participatory approach was adopted to the selection of indicators (a short account is given in Box 1) and this offers a number of positive lessons for other OECD countries. Third, the information must be updated on a regular basis so that evaluation can be made of the impact of policy. Finally, the trade-offs between the objectives should be stated clearly and the indicators themselves should be integrated into policymaking in finance ministries and treasuries, as well as in other ministries.

A great deal of weight is to be placed on a range of indicators measured by official statistics. But there is real doubt about whether all OECD countries collect all the information needed to develop this more sophisticated approach to the measurement of economic progress. Similarly, there may be doubts about the veracity or accuracy of the data and governments are notorious for manipulating statistics to tell a positive story. One clear recommendation, then, is that the authority responsible for gathering and publishing the data must be independent of political influence. Otherwise, there is a risk that the whole ambitious enterprise could be undermined. The public in some countries already has little confidence in conventional measures of economic performance. It would be disastrous if the more sophisticated approach outlined here met the same fate.

II The failure of market fundamentalism and the case for a new approach

Incomplete responses to the Great Recession: costs and policy implications[5]

Raymond Torres

Introduction

The financial crisis which erupted in the wake of the collapse of Lehman Brothers in 2008 led to a reconsideration of earlier policy approaches based on the self-regulating ability of markets. In particular, the role of anti-cyclical macroeconomic policies in sustaining the economy and jobs was widely acknowledged (IMF 2009). In addition, unlike in earlier crises, social protection was reinforced and, in particular, the level and duration of unemployment benefits were improved – thereby departing from the view that higher benefits aggravate market distortions (Howell 2008). The initial results of this new approach were positive. Indeed, another Great Depression has probably been avoided thanks to the anti-cyclical monetary measures and socially-inclusive fiscal stimulus packages adopted in 2008 and 2009.

However, as from 2010, a change in the policy stance took place without addressing the market-driven factors that had provoked the crisis. Indeed, the economic imbalances resulting from inefficient and unequal income distribution have not been properly addressed (ILO 2008; Rajan 2010). Furthermore, little progress has been made in regulating the financial system. The result is that, progressively, the scope for stimulatory macroeconomic policies to revive the world economy has become very narrow.

This chapter starts by highlighting the real and financial causes of the crisis and their inter-linkages. It examines the extent to which fiscal and

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5. This chapter draws heavily on an article published recently in the *International Labour Review* – see Torres (2010a).

monetary policies – that is, remedies which, crucial as they are, do not address the real causes of the crisis – can support a return to balanced growth. Policy lessons from the analysis are drawn in a final section.

Income inequalities and the crisis: the forgotten link

While the crisis originated in the financial system, a more fundamental trend was the inefficient distribution of the gains from growth during the pre-crisis period. In most countries, wages grew less than justified on the basis of productivity developments during the two decades preceding the crisis. This is why wages as a percentage of GDP declined in the majority of countries (Table 1), while the share of gross profits in GDP correspondingly increased. In many countries, wage moderation meant stagnant real incomes for low-paid workers and their families. In the United States, for example, median real wages grew by a mere 0.3 per cent per year between 2000 and 2006. During the same period, labour productivity increased by 2.5 per cent per year. Simultaneously, the revenue share that goes to the richest 10 per cent of households has been on the rise, suggesting that the moderation in wage growth of low- and middle-income households is even more pronounced than that indicated by the fall in the wage share. Given the relatively high consumption propensity of low-income households, wage moderation introduced a downward bias in aggregate demand in both advanced and emerging economies.

Wage moderation had two mutually-reinforcing effects. First, in some advanced economies – such as the US, the UK, Spain and Ireland – wage moderation caused a build-up of private debt. Despite stagnant real incomes, households could purchase durable goods and housing through recourse to bank credit (ILO 2008; Stiglitz 2009). Reflecting inadequate regulations, banks were in a position to provide credit to these households – even though, on prudent criteria, such loans would not have been provided. Thus, the expansion in domestic demand in the US and some other advanced economies was funded from an accumulation of private debt.

Second, in the case of emerging economies where the financial system was more tightly regulated, wage moderation had a direct impact on weaker domestic demand (Gosh 2010). In these countries, domestic demand was further depressed owing to the weak social safety net. In the absence of adequate pension and health systems, households tend

Table 1 **Wage moderation around the world (share of wages as a percentage of GDP)**

	1995	2000	2007
China	52.3	51.9	39.7
Korea, Republic of	83.8	76.9	77
Japan	63.6	61.7	57.7
India	67.2	75.0	74.1
Canada	63	61.3	60.8
France	68.8	67.5	67.3
Germany	69.8	70	64.9
Italy	70.3	66.2	67.2
United Kingdom	67.7	69.2	68.5
United States	67.4	68.6	65.7
Brazil	42.6	40.5	40.1

Note: Table 1 shows the share of total compensation of employees as a percentage of GDP, corrected for changes in the incidence of salaried employment (except in China, where such a correction could not be made due to lack of data). This correction is standard practice and is necessary in order to control for the mechanical impacts on wage shares of changes in the composition of employment.

Source: Author's estimates based on national accounts.

to hold large precautionary savings, thus depressing spending. It was therefore crucial for economic growth in these countries that wider access be obtained to the markets of advanced economies, especially those where domestic demand was especially dynamic – partly fuelled by debt creation. This is how several emerging economies as well as resource-rich countries generated growing external surpluses and a global 'savings glut' that allowed interest rates to reach historic lows in the early 2000s, providing cheap financing conditions to even risky borrowers and fuelling housing bubbles (Bernanke 2005).

For a while, the coexistence of debt-led growth in certain developed countries with export-led growth in large emerging economies seemed sustainable. The surpluses of the latter countries served to finance the deficits of debt-led countries (Table 2). And the world economy was expanding fast. However, debt-led demand proved to be the Achilles' heel of the growth process. As US monetary authorities raised interest rates

Table 2 **Wage moderation has not translated into higher investment globally (real fixed capital formation as a percentage of GDP)**

	1988-95	1996-2003	2004-2008	2009
World	23.4	22.1	23.1	21.5
Advanced economies	22.7	21.3	21.2	18.0
Emerging & Developing economies	26.2	24.9	28.5	29.2

Source: IMF (2010a).

in 2006–2007, the small increase in borrowing costs which resulted from this measure was enough to provoke a cascade of failures in loan repayments. This quickly spread throughout the financial system as a result of both the complexity of financial products – which made it difficult to assess the degree of risk – and the close international connections between financial institutions.

Finally, it is important to note that wage moderation and the associated increase in profit shares did not support real investment. The share of real fixed capital formation in GDP has tended to decline in advanced economies – as well as for the world as a whole (Table 2). This vividly illustrates the failure of wage moderation and debt-led growth to boost potential growth. Reflecting the sluggish performance of real investment before the crisis, studies have shown that trend productivity has tended to decline in advanced economies since the early 2000s (Blackfield and Oliveira Martins 2009). In short, growing income inequalities have proved to be economically inefficient.

Responding to the crisis without addressing its root causes: benefits, limits and costs

Governments acted quickly and on a large scale to address the consequences of the crisis. First, they substituted private debt-led demand – which had come to a standstill as a result of the crisis – with public debt-led stimulus. Most countries that had budget space implemented fiscal measures in the form of discretionary tax cuts, higher government spending or a combination of both. According to ILO estimates, the fiscal stimulus measures amounted in 2009 to around 1.7 per cent of world GDP (ILO 2009).

Second, in the face of the paralysis of inter-bank lending and the risk of a systemic collapse of the financial system, monetary authorities reduced interest rates to historically low levels. They also provided massive support to banks in the form of loan guarantees, capital injections and outright nationalisation of ailing banks, among other things.

Third, an attempt was made to avoid inward-looking solutions which would aggravate the collapse in demand and trade associated with the crisis. This was especially important for developing and emerging economies which had relied on exports as a driver of their growth strategy. The risks of wage deflation were also acknowledged. In June 2009, governments and employers' and workers' representations from around the world agreed on a Global Jobs Pact which warned against a spiral of wage cuts.

Benefits of curing the symptoms without treating the causes of the crisis

Overall, the measures have managed to support the economy but also to avoid further significant job losses (ILO 2009). This relatively favourable outcome reflects, first, the rapidity of the policy response. By adopting stimulus measures soon after the start of the crisis, countries could expect a significant positive impact on employment by mid-2010. By contrast, a postponement of the measures by three months would delay employment recovery by six months – illustrating the disproportionate costs of inaction for employment (ILO 2009).

Second, the fall in employment was cushioned by the nature of the policy response itself (Torres 2010b), which also benefitted from evidence of socially-inclusive employment policies gathered before the crisis (OECD 2006). In many of the most successful recoveries, crisis responses focused on stimulating aggregate demand while at the same supporting existing jobs. In particular, an effort was made to enhance social protection (Brazil, India), extend unemployment benefits (Japan, US), avoid cuts in minimum wages and adopt other support measures for low-income groups. In countries such as France, Germany and the Netherlands, short-time working was promoted, aided by government subsidies. In other countries, including Australia and the US, part-time employment surged. These interventions, by sustaining the purchasing power of low-income groups, effectively boosted aggregate demand, while also alleviating somewhat the social costs of the crisis.

Limits to partial remedies

Despite these initial results, the strategy did not succeed in addressing the main imbalances that led to the crisis. This is particularly the case with regard to the dysfunctional financial system. As stated by the BIS, 'a financial crisis bears striking similarities to medical illness. In both cases, finding a cure requires identifying and treating the causes of the disease' (BIS 2009).

In its 80th Annual report, the BIS notes progress with international agreements on the direction of the reforms (BIS 2010). There is recognition among the most important central banks that banks' capital bases need to be improved both quantitatively and qualitatively. Guidelines have been presented to 'reduce the perverse incentives that drive managers to increase short-term profits without regard to the long-term risks imposed on the firm and the system'. New monitoring tools have been developed. Improvements in the regulation of the perimeter of bank operations – to avoid excessive off-balance-sheet banking – have been discussed. However, these much-needed guidelines and promised reforms do not seem up to the task.

A first consequence of the gradualness of financial reform is that the volume of lending to the real economy has been slow to recover in many advanced economies. The situation is especially worrisome for small business. According to existing surveys, for example, in the European Union it is still the case that many enterprises – in particular, small and medium-sized enterprises – continue to have difficulty accessing credit.

Second, a significant moral hazard problem has been created by bailing out banks without imposing deep reforms. It is an issue of incentives rather than bank size (Blundell-Wignall et al. 2009).

Third, in an unreformed financial system, international capital flows will remain highly volatile. There is evidence that international capital flows have become much more volatile in the area of financial globalisation than before, and the result of that is a larger number of financial crises. Even before the crisis of 2008, there had been a series of crises. A particularly well-known one is the Asian crisis at the end of the 1990s, but in Latin America, too, there have been several financial crises, provoked in part by mismanagement of the macroeconomic system but also by volatile capital flows.

Fourth, a more fundamental problem is that the financial sector has developed beyond reasonable boundaries and its practices have spread through the non-financial economy. It has long been claimed that today's profits will be tomorrow's investments and the day after tomorrow's jobs. But reality has not borne out this promise. A large share of the increase in profits has accrued to the financial sector – the financial sector's share of total corporate profit reached 42 per cent before the crisis, up from about 25 per cent in the early 1980s (ILO 2009b). During the 2000s, less than 40 per cent of the profits of non-financial firms in developed countries were used to invest in physical capacity, which is 8 percentage points lower than during the early 1980s.

Costs and social implications

The exceptional measures adopted in the wake of the crisis have come at a significant cost to the public purse. Government debt has increased significantly, mechanically offsetting the decline in private debt which has taken place since the start of the crisis – so-called 'deleveraging' (Table 3). In addition, the role of monetary policy has been pushed to the limits. With nearly zero interest rates and significant increases in liquidity, central banks have approached the limit of how much they can compensate for the credit crunch. As a result, since 2010 governments have started to shift from stimulus to austerity.

The Greek crisis which blew up at the end of 2009, and with renewed vigour in early 2010, gave the first major signal that fiscal policy would move to austerity. Investors, who had been saved by generous support – which, in turn, partly explained rising public debt – became reluctant to finance growing government deficits.

The result is the spread of fiscal austerity across Europe and beyond, weakening the economy recovery that was under way. Given the bleak domestic demand outlook, it is unclear whether foreign demand can become the main engine of economic growth and job creation. Someone else has to import. This is unlikely if the austerity contagion spreads, or if emerging economies, especially China – which have tended to rely on exports to drive growth – fail to boost domestic demand to a sufficient extent.

Fiscal austerity will also have a direct impact on employment, both now and in years to come. Many workers are employed in enterprises that

Table 3 **Public debt has taken the place of private debt (percentage point change in the ratio of household debt and general government debt as a percentage of GDP)**

	Change in household debt 2002–2007	Change in government debt 2007–2009	Change in household debt 2007–2009
Canada	18.3	5.6	–8.5
France	14	13.7	–3.4
Germany	–10.4	5.9	–10.4
Italy	12.1	12	–4.8
Japan	14.1	14.7	–6.4
Spain	28.0	19.1	–12.9
UK	24	23.5	–34.3
US	19.1	16	–8.5
Average	14.9	13.8	–11.2

Note: The change in household debt for Japan and the UK is calculated over the period 2002–2008 and 2002–2006, respectively. The change in government debt is calculated over the period 2008–2009 for Japan and 2006–2009 for the UK.

Source: Author's calculations based on OECD National Accounts and IMF (2010b).

benefit from shorter hours and other partial unemployment support which, if withdrawn, would provoke new job losses. For those already unemployed, it is crucial to maintain well-designed social protection and programmes to support job search and update skills. Otherwise the unemployed tend to get discouraged and exit the labour market, depriving the economy of valuable resources and eroding social cohesion.

Depressed employment trends impact on low-income groups disproportionately. The process of long-term unemployment and loss of skills is particularly acute for these groups. The result is wider income inequalities, which come on top of inequalities produced by the imbalanced growth patterns of the pre-crisis period.

It is not surprising that perceptions of social injustice are spreading rapidly in nearly all developed countries. The youth unemployment rate, now nearly 2.5 times higher than for adults, will only aggravate perceptions of injustice. Confidence in government is on the decline. Among advanced economies, it has fallen by over 10 percentage points over the course of the crisis. In short, the shift to austerity measures without treating the causes of the crisis has created fertile ground for social discontent.

Ways forward

It is crucial to ensure that wages increase in line with productivity. Before the crisis, wages had grown less than productivity in most countries, which is one reason why households in developed countries had recourse to debt to finance housing investment and consumption. In some emerging economies, subdued wage gains have depressed domestic demand, which was offset for a while by growing net exports to deficit, debt-ridden countries. In addition, there is social discontent among workers, as recent events in the Arab region as well as in some Asian countries demonstrate.

Several authors have already stressed that economic growth in emerging economies needs to rely more on domestic demand, thereby moving away from the export model that prevailed before the crisis (Blanchard and Miles-Ferretti 2009). Strengthening social protection could play a critical role in this respect. This would not only serve social goals, but also reduce excess savings, boost domestic demand and contribute to alleviate global imbalances. There are encouraging signs that such a rebalancing process may have started already. In China, for instance, the fiscal stimulus package adopted in the wake of the crisis included a major component of social assistance and retirement income transfers. According to a recent study, a cautious expansion of the public pension and health systems in China would raise the share of consumption in GDP by between 0.2 to 1.1 per cent by 2025 (McKinsey Institute 2009). This would help to make domestic demand a greater engine of economic growth in China and support sustainable recovery worldwide.

Of course, exchange rate changes would also help to reduce global imbalances. However, a revaluation of currencies in surplus countries vis-à-vis deficit countries will affect the real economy with a relatively long lag. By contrast, a boost to domestic demand in surplus countries will act quickly while addressing some of the root causes of the crisis (von Arnim 2009).

Tax and benefit systems need to be more supportive of employment and fair income distribution. There are good examples of this. For example, in Nordic countries it has been possible to limit economic damage and to facilitate job creation and at the same time avoid too much income inequality. There are examples of social protection systems that both protect people and provide adequate work incentives.

The tax system itself should be more progressive. Over the past two decades, top marginal income taxes declined in the majority of countries and therefore the tax system has become less redistributive.

It is also important to make sure that international labour standards are better implemented. There are a wide variety of Conventions and Recommendations, but the fact is that before the crisis there was an increase in income inequality, job precariousness was on the rise and it was certainly the case that economic growth was not followed by equivalent and parallel developments with regard to social progress.

Financial reform is needed to ensure adequate funding of sustainable enterprises. A clearer separation between investment banking and commercial banking would help in this respect. The adoption of a bank tax, as recently announced by EU countries, would also be a step in the right direction. Finally, a levy on financial transactions would help make the financial system less subject to 'manias' and panics, which are so destabilising to the real economy.

What should replace the Washington Consensus?

Peter Bakvis

The term 'Washington Consensus' was formulated in 1989 by academic and former International Monetary Fund advisor John Williamson to describe 'what would be regarded in Washington as constituting a desirable set of economic policy reforms' to deal with the debt crisis in Latin America, with 'Washington' defined as including 'the international financial institutions [IFIs], the economic agencies of the US government, the Federal Reserve Board and the think tanks'.[6] The implementation of such policies was supposed to increase economic growth, reduce inflation and produce a viable balance of payments and equitable income distribution.

Williamson neatly summarised the Washington Consensus in terms of ten 'policy instruments':[7]

(1) Fiscal discipline, meaning an operational deficit of less than 1 to 2 per cent of GDP, should be enforced.
(2) Deficits should be cut, preferably through expenditure reduction or by redirecting spending that interferes with markets – for example, subsidies – towards services that are 'proper objects of government expenditure', such as basic health and education.
(3) Whatever tax revenue is needed should come from a tax regime that is broad-based and has moderate marginal rates.
(4) Real interest rates should be positive and market-determined.
(5) Exchange rates should be 'competitive', and not necessarily market-determined, so as to foster an 'outward orientation' and export growth.

6. Williamson, J., 'What Washington means by policy reform', Chapter 2 in Williamson (1990).
7. Ibid.

(6) Imports should be liberalised, as part of an outward-oriented economic policy.
(7) Restrictions on foreign direct investment should be removed.
(8) State-owned enterprises should be privatised.
(9) Deregulation, of labour and other markets, should be implemented.
(10) Property rights should be more firmly entrenched.

The Washington Consensus survived well beyond the 1980s, most notably in the structural adjustment policies applied by the IMF and World Bank. But after two decades of application, the external debt crisis that the Washington Consensus purported to resolve had only grown deeper; GDP growth rates in developing regions that applied the policies most diligently, such as Latin America and Sub-Saharan Africa, were actually lower in the 1980s and 1990s than in the previous two decades; and inequality and the number of the poor had increased in most developing countries. The one developing region that set itself apart in terms of higher growth and substantially reduced poverty was East Asia, a region which, for the most part, had not followed the Washington Consensus policies and had grown faster than any other region of the world.

By the early 2000s, the failure of the Washington Consensus was widely acknowledged. It was dramatically exemplified in 2001–2002 by the economic collapse and default of Argentina, which all through the 1990s had been held up by the IFIs as a model to follow in implementing radical free-market policies. But whatever lessons the IFIs had learned from the Asian financial crisis of 1997–1998, the Argentine collapse and other turn-of-the-century economic failures seemed to have been forgotten by the time a new financial crisis broke out in 2008, this time in the world's most powerful economy, the United States. As was the case a decade earlier the IFIs along with most finance ministries failed to heed the warnings that the global banking system was about to implode. The first response of IMF management to the unfolding crisis, before a change in leadership took place in late 2007, was to caution against the temptation to increase the regulation of financial markets: '[P]olicy-makers should be careful to work with, rather than against the grain of markets. Policies should not stifle the process of financial innovation, given the very constructive role recent innovations have played in this unprecedented global economic expansion.'

By early 2008 the IMF had begun to offer a rather different policy prospectus. The new managing director joined in the call for increased financial regulation and began proposing that countries adopt counter-cyclical fiscal stimulus policies. But two years later, the IMF switched back to promoting fiscal discipline in order to reduce public debt, even though unemployment in most countries had not yet declined from the high levels reached in the 2009 recession. Some of the emergency IMF loan agreements with countries affected by the crisis – the largest number of which were in Central and Eastern Europe where EU institutions co-financed and co-administered the loans – also included Washington Consensus-style privatisation and labour market deregulation conditions.

It is clear that an alternative policy approach is needed, not a return – after a brief interlude – to the same policies that failed to bring sustainable growth and equitable income distribution during three decades of implementation. Policymakers must learn the lessons of the crisis. There can be no return to the status quo ante. Quite how policy should be adapted is considered in more detail later in this volume, but the following are offered as instruments that might, taken together, constitute a new approach that allows for sustainable growth in what is likely to remain a largely capitalist economy.

Counter-cyclical fiscal policy, rather than the blind fiscal discipline of the Washington Consensus, should be used to stimulate growth during recessions and to bring down public debt during periods of strong growth. In other words, policymakers should embrace the central arguments presented by John Maynard Keynes in the *General Theory* (Keynes 1936). Had austerity policies been rigorously applied during the 2008–2009 recession, the downturn would have been far deeper and unemployment higher than it was: the ILO estimates that stimulus policies saved 7–11 million jobs. The IFIs wisely put aside the 'fiscal discipline' mantra for two years, only to restore it in 2010 despite the fact that unemployment had not diminished substantially from its peak and the global recovery remained fragile. This increased the probability of repeating the 1937 scenario of a double-dip recession caused when government support was withdrawn too rapidly. Stimulus measures should therefore continue until sustainable growth is restored. The goal must be to minimise unemployment and return to full-employment as soon as possible. Only once the economy has returned to a stable growth path should countries embark on fiscal consolidation.

The prejudice against public spending has led to long-term damage in Latin America and other developing regions, for example through lost productivity due to a sharp decline in funding for public infrastructure. Higher growth in East Asia than in other regions was partly due to the fact that governments in the region rejected the directive to get out of all but the most basic public services. Quality public services and infrastructure are essential to building a modern economy and to achieving strong, sustainable and equitable development.

Governments must aim to generate sufficient revenue – over the medium term, so as to allow for counter-cyclical fiscal policy – in order to finance quality public services through a progressive tax system that reduces income inequality. Financial transaction taxes should be introduced to produce additional revenue while dampening damaging speculative transactions. This approach replaces the Washington Consensus prescription that governments should keep taxes low and marginal tax rates 'moderate'. Following the market fundamentalist prescription has led to misconceived policy choices affecting the adequacy and stability of government revenues, including 'flat tax' regimes in some countries of Central and Eastern Europe and a suggestion by the World Bank (in *Doing business*) that some countries should abandon business taxation entirely. Governments need adequate revenues to fund infrastructure and public services. The policies recommended by market fundamentalist orthodoxy are entirely inconsistent with the achievement of that objective.

The policy that interest rates should be positive and market-determined appeared to exclude any counter-cyclical use of monetary policy; it would have had disastrous consequences if countries had abided by this rule during the 2008–2009 crisis. There should be a capacity for central banks to make use of counter-cyclical monetary policy to contribute to high and stable levels of employment while holding inflation low. Equally important, central banks should be required to control excessive risk-taking by banks and asset-price bubbles, phenomena that were largely ignored by central bankers prior to the 2008 crisis, with catastrophic results. Countries should ensure that small and medium-sized enterprises and low- and medium-income consumers have adequate access to low-cost credit. The refusal of most financial institutions to increase credit except to large corporations and other preferred clients was one of the causes of the slow post-crisis recovery.

When it came to exchange rates, the Washington Consensus dispensed with market rules and opted for mercantilism: countries were supposed to establish rates that were 'competitive' rather than market-determined, and to foster an ‘outward orientation’. The attention given during the crisis to global trade imbalances, which resulted in part from some countries’ deliberate undervaluation of exchange rates, should logically lead to a rejection of the precept that ‘beggar-thy-neighbour’ is a valid strategy for economic development. Countries should use their productive capacity first and foremost in order to meet the needs of their population, not to generate huge trade surpluses. Policymakers should embrace the principle that workers’ incomes must grow in line with productivity if there is to be a stable process of demand generation. Moreover, as we shall see, encouraging domestic consumption in those countries with a current account surplus is a necessary step towards the removal of imbalances from the global economy.

The directive to liberalise imports led to the IFIs pressuring dozens of developing countries to rapidly decrease import barriers. This resulted in untold damage as poor countries dismantled protections without which some industries could not survive, and they had no assurance that new markets for other products would open up for them. They actually gave up bargaining power with other countries during trade negotiations by lowering import barriers unilaterally, on the IFIs’ advice. The East Asian countries, as Stiglitz and other authors have noted, rejected the Washington Consensus policy of rapidly liberalizing trade and only did so gradually. Indeed, this was the development path followed by many now developed countries as they progressed through the process of industrialisation (Chang 2002). Two policy conclusions flow from this. First, it may be appropriate for developing countries to engage in limited infant industry protection as they develop their economic capabilities. And second, some protection may be needed for small agricultural producers. Countries should pursue food security objectives, which can entail supporting domestic production so as to protect populations against the vagaries of international commodity markets.

Countries should be able to impose obligations on foreign investors (contrary to the strictures of market fundamentalism) and should be able to impose controls on capital flows, which may otherwise have a damaging impact on developing economies. It is worth noting that in the mid-2000s the IMF lifted its earlier opposition to capital controls and even supported countries implementing them in certain cases, although only as temporary measures during periods of instability. We know from historical experience that rapid capital market liberalisation is often followed by a banking crisis (Reinhart and Rogoff 2009). Policymakers must have access to all possible instruments to prevent hot money flows from having an adverse impact on the real economy. Capital controls, far from being impediments to efficiency, may be essential to deal with what might otherwise be a period of catastrophic instability.

Deregulation was a major component of the Washington Consensus, whether applied to financial services, labour markets or elsewhere. It hardly seems necessary in the post-2008 crisis world to emphasise the folly of taking such an approach to the financial sector. Less well known is the IFIs' promotion of deregulation in labour markets. In 2007, the World Bank bestowed its 'Top Reformer of the Year' award to the Republic of Georgia after the government did away with most labour regulations. The reform led to Georgia's condemnation by the ILO for violating fundamental workers' rights, but to effusive praise from the Bank for its improved *Doing Business* rating. The long-term pressure against labour regulations from the IFIs has contributed to a falling wage share in national production and increased inequality in most countries of the world (see the discussion by O'Farrell and Jackson in Chapter 7). It would be far better and not at all damaging to employment to ensure that a floor of employment rights (including minimum wages) protects workers from exploitation and unfair treatment.

Nowhere was the bias of the Washington Consensus more evident than in the assertion that there should be stronger enforcement of property rights while, as pointed out in the previous paragraph, rights for workers could be weakened. The policy of conferring greater importance on the rights of property owners, including enterprises, while demoting or ignoring other rights is one of the factors that explains the growing income inequality the world has experienced since 1980. The idea that the rights of asset owners should come before those of everyone else, even to the detriment of society as a whole, also contributed to the push for financial deregulation in the 1990s. Countries should effectively enforce all rights, not just those of property owners, and pay particular attention to the rights and interests of the most vulnerable members of society rather than the most affluent.

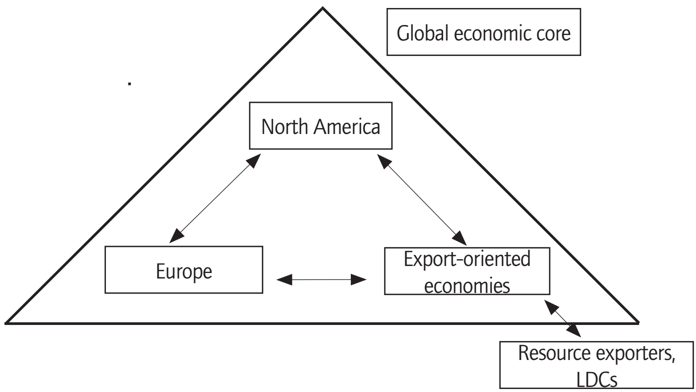
III Balancing growth between major economic regions at levels consistent with full employment

A new approach to growth

Thomas I. Palley

The global economy is still struggling to escape the Great Recession: the core problems are shortage of demand and financial fragility, which affect all countries in various degrees. Figure 1 provides a heuristic map of the global economy which consists of four parts. The global economic core consists of North America, Europe and the export-oriented emerging economies. The resource-based economies and less developed countries are placed outside the core. This placement outside the core reflects the fact that the less developed economies are substantially disengaged from it, while the resource-based economies conform to traditional periphery status in terms of centre–periphery relations.[8] The triangle

Figure 1 **A map of the global economy**



8. Mexico, Japan, China and other East Asian economies can be considered among the export-oriented economies. Brazil, Russia, Australia and Latin American economies are part of the resource-based bloc. India is a little difficult to peg. Despite its size and recent economic growth success it should probably be placed with the less developed countries because of its still relatively low level of global engagement.

(bold) binding together the core represents the global production and sourcing networks established under globalisation, global trade rules and the global financial architecture governing exchange rates and international capital markets.

The map helps us to understand the nature of the challenges faced by the global economy. Against background conditions of demand shortage and financial fragility affecting all regions, each region confronts specific additional difficulties and challenges.

The US economy is beset by stubborn high unemployment; the continuing fallout from the bursting of a property bubble that affected both the residential and the commercial real estate markets; a distressed and over-indebted household sector; a financially strapped state and local government sector; and a continuing large trade deficit that combines with the off-shoring of investment to undermine the manufacturing sector.

Whereas conditions in the US economy are relatively homogenous, conditions in Europe are much more heterogeneous. Europe also has high unemployment and its financial sector has been even more heavily battered by the financial crash of 2008 and the Great Recession. This reflects the fact that European banks were massive buyers of toxic assets issued by Wall Street.

The European economy can be divided into North (roughly Germany, Holland and Scandinavia) and South (the PIIGS economies of Portugal, Italy, Ireland, Greece, Spain, plus some Central and Eastern European economies) and there are significant economic tensions between the two blocs. Europe's North has relatively sound public finances, is internationally competitive, and runs trade surpluses with the global economy and with the South: Europe's South is the mirror opposite.

The export-oriented economies of Japan, China, East Asia and Southeast Asia have weathered the recession relatively well. Immediately following the financial crash of 2008 there was a collapse in exports but they have now rebounded with the recovery of global trade. Japan remains trapped in a stagnation that has persisted, on and off, for almost two decades since the implosion of its asset bubble in 1991. China has continued to grow on the back of its export-led growth strategy, combined with a large fiscal stimulus. The remaining economies in East and Southeast

Asia have weathered the financial storm relatively well because of strong national balance sheets. This was because these economies experienced a financial crisis in 1997, and thereafter they adopted export-led growth policies that increased foreign reserves and reduced debt exposures.

Finally, the resource exporters and less developed countries have also weathered the crisis relatively well. The resource exporters have continued to benefit from high commodity prices driven by China's continuing rapid growth. Commodity prices are also being driven up by extraordinarily low global interest rates and emerging inflation fears that are prompting financial investors to buy commodities as a hedge against potential future inflationary monetary disorder. The less developed countries continue to struggle with the problems of inadequate governance capital, human capital and physical and financial capital that have always afflicted them. The Great Recession has simply added additional economic headwinds.

The global policy challenge

Each region confronts specific circumstances and challenges that call for regionally specific policy responses. The US needs to address its demand shortage resulting from its atrophied income generation process, trade deficits and off-shoring of investment.

Europe must address its own demand shortage, internal structural imbalances and the public finance crisis in its southern economies. A particularly daunting challenge is its economic heterogeneity which needs to be addressed within the confines of a monetary union that lacks fiscal federalism.

The export-oriented economies need to shift toward greater reliance on domestic demand-led growth given the deteriorated outlook for exports to the US and the need for the US to rebalance its external accounts. Natural resource exporters, such as Brazil and South Africa, confront the problem of exchange rate appreciation driven by high commodity prices. That threatens to generate 'Dutch disease', which undermines industrial development.

Considered on their own, each region's challenges would pose considerable difficulties. However, globalisation enormously compounds the problem in two ways. First, in a globalised economy policies need to be consistent across countries and regions or else they stand to undermine each other, as well as producing economic and political conflict. Second, national policies that were once effective and feasible may now be of reduced effectiveness and maybe even infeasible. That is because globalisation has increased national economic leakiness by increasing imports, job and investment off-shoring and financial capital flows.

Inconsistency of economic policies, reflected in the problem of global imbalances, has already proved costly and is widely viewed as having contributed to the making of the financial crisis and Great Recession. Now, this problem is threatening to worsen as yet more countries (including the US) are looking to adopt the export-led growth model that has proved so successful for China and East Asia.

This global turn to export-led growth is dangerous and suffers from flawed logic rooted in a fallacy of composition. Whereas export-led growth is feasible for an individual country, it does not work when all try to go down that route because some countries have to be net importers.

Rather than alleviating the problem of global demand shortage, the spread of export-led growth strategies stands to amplify the problem as countries try to poach global demand via exports. This risks deepening the recession hangover in countries running trade deficits. It also promises to aggravate the problem of exchange rate conflict as countries engage in competitive devaluations to gain international competitive advantage. That, in turn, risks triggering international financial turmoil.

Reforming the architecture of globalisation

In the era of globalisation, international economic policy coordination is more important than ever and its importance is further elevated by the distressed state of the global economy. But instead of increased coordination the global economy appears headed in the direction of policy inconsistency and conflict.

Part of the problem is national economic policy intransigence. Thus, countries that have benefitted from export-led growth see no need to abandon a strategy that appears still to be working. However, a deeper cause is faulty structural design of the architecture of globalisation. This architecture encourages uncooperative national policy behaviour and also discourages the domestic demand-led growth strategies needed in this time of global demand shortage.

The core problem is the increased economic leakiness resulting from globalisation. This leakiness has created a competitive dynamic that fosters a 'race to the bottom'. With jobs and investment highly mobile internationally, countries have an incentive to adopt policies that suppress wages, demand growth, and labour, social, and environmental protection. The reasoning is that this will make them more attractive to corporations and as a site for foreign direct investment (FDI). Such policies also tend to please the financial markets. As a result, the deep structure of globalisation exerts a deflationary bias, encourages export-led growth and discourages domestic demand-led growth strategies

These structural tendencies speak to a need to reform the architecture of globalisation. A first reform concerns exchange rates. The current system of unmanaged exchange rates has proved incapable of delivering sustainable current account balances across countries. It has also proved susceptible to exchange rate manipulation by countries seeking to enhance their international competitiveness, the poster child in this respect being China. Now the system is degenerating further as more and more countries seek to prevent their currencies from appreciating, which threatens to bring about destabilising competitive devaluation. The solution is to adopt a system of globally managed exchange rates that targets approximate current account balance.

A second reform concerns capital flows and capital controls. Unstable capital flows were a critical ingredient in the financial crises of the 1990s and early 2000s, and that problem remains unresolved. Indeed, one reason for the current crisis is that the earlier experience of unstable capital flows drove many countries to pursue export-led growth policies that produced trade surpluses and enabled accumulation of foreign reserves. This speaks to the need for the regulation of capital flows to be a legitimate and standard part of the economic policy tool box.

A third reform concerns the need for global labour standards. The global economy is beset by demand shortage and a big part of that is the worsened income distribution of the past thirty years. Part of that worsening is attributable to globalisation which has placed workers in international competition without labour market protection. This has put downward pressure on wages everywhere, undermining wage development in both the mature industrialised economies and the emerging market economies. The clear implication is that solving the demand shortage and encouraging a shift to domestic demand-led growth need a new structure of competition that allows wages to rise with productivity. Strict globally enforced labour standards are central to this required new structure of competition.

A fourth and final reform concerns trade agreements and their impact on national policy space. Here the problem is the gradual stripping away of policy space via the imposition of limits on national policy sovereignty. One area where policy has been weakened is intellectual property rights. A second area concerns the right of international investors to sue governments in international arbitration panels. These and other restrictions on sovereign policy need to be reversed, and the architecture of future trade agreements should incline towards increasing national policy space rather than shrinking it.

Europe

Andrew Watt

The difficulty of assessing the question of Europe's role in the global economy stems from the fact that it incorporates countries whose growth patterns varied considerably in the years leading up to the crisis. The EU average figures, in which these stark differences often net out, are frequently not particularly helpful in analysing the issue. Having said that, a stylised account of developments during the era of neoliberalism or financialisation preceding the crisis can be given, as follows.

European countries, individually and as a whole – that is, at the level of the European Union (EU) – largely adopted the mainstream neoliberal policy recommendations, albeit with varying enthusiasm, from, at the latest, the early 1990s. This has to be seen against the background of high unemployment in most of the continent at that time and disappointment with Europe's growth performance and prospects compared to the more dynamic economies of North America and Asia. This was diagnosed as reflecting so-called 'eurosclerosis'. The cure was radical market-oriented reform.

This trend succeeded a long historical phase, going back to 1945 and in some cases beyond, in which (west) European countries had developed 'stakeholder' models of capitalism with, among other things, redistributive taxation systems, developed welfare states and codified forms of industrial relations and social dialogue, constituting a 'European Social Model' distinct from Anglo-Saxon capitalism.

Two key historical events characterise the period: the establishment of European Monetary Union (EMU) in 1999 and the enlargement of the EU in 2004 and again in 2007 to take in much of what had previously been Communist central and eastern Europe.

In Europe the neoliberal period was characterised by features also seen elsewhere in the world, notably: the focus of monetary policy on price stability, the rejection of counter-cyclical fiscal policy and an emphasis on deregulation, liberalisation and privatisation. In some cases these trends took specific European forms. In particular, when EMU was established the European Central Bank was given the clearest anti-inflation mandate and the greatest degree of independence of any central bank in the world. The Stability and Growth Pact (which underwent several mutations) sought to constrain national scope for fiscal policymaking by establishing limits on the ability of national governments to run deficits. The deregulation and liberalisation agenda was, to some extent, also driven by European integration: partly this was a 'natural' knock-on effect of greater trade integration, but to a considerable extent it constituted a political agenda based on using the principle of the freedom of movement of production factors to undermine existing national regulations, driven forward by both European and national-level policymakers.

The outcomes of these policies were decidedly mixed. On a positive note there was considerable regional convergence in living standards. Trade and in particular enlargement and EMU helped the eastern and southern countries, respectively, to catch up with the north and west of the Continent. Slow but steady progress was achieved in reducing unemployment – by some smaller countries from the mid-1990s, more widely in early to mid-2000s. The overall position of the EU in the world economy was one of broad balance: the current account fluctuated in most years around +/–1 per cent of GDP. On the negative side, economic growth was largely disappointing. At times it was employment, at other times productivity growth that was lagging: the US feat of raising the rate of productivity growth while at the same time increasing employment rates proved elusive. Job creation often involved a deterioration in job quality in terms of the spread of precarious forms of employment (although there were improvements in other dimensions) (Leschke and Watt 2008). Many countries experienced widening social inequalities over the period, and labour's share of national income fell substantially. Last but not least, the aggregate balanced position of the EU in the global economy concealed substantial trade imbalances between EU countries. Notably, massive German (and Austrian and Dutch) trade surpluses were matched by equally huge deficits on the part of a string of southern and eastern European countries. These, in turn, required capital imports by the surplus countries, which meant that their banks loaded up on securities issued by banks, companies and governments of the deficit countries.

It is important to recognise that the EU was split into different economic camps. On the one hand, there were the countries (such as the UK, Spain, Ireland and a number of east European countries) whose growth models resembled that of the United States: a housing boom, rapid demand growth fuelled by rising household debt and large and growing current account deficits. On the other hand, Germany and, to a lesser degree, Austria and the Netherlands, resembled Japan and (in some respects) China, with high domestic savings and large current account surpluses. Particularly in the case of Germany this was achieved at the price of a severe policy of relative wage deflation which, along with other factors, not least welfare reform (Hartz IV), depressed German domestic demand. Especially within the euro area, this dichotomised model resulted from the workings of monetary union. The lowering of interest rates for members with traditionally high inflation (such as Spain and Greece) engendered an economic boom there. This kept wage and price inflation relatively high which, in turn, meant lower than average real interest rates. High nominal growth rates made the fiscal positions look good. The situation was the opposite for low inflation countries. Here, in addition, the one-sided nature of the SGP forced countries already struggling with sluggish growth into pro-cyclical fiscal consolidation. For the first decade of EMU the two sets of countries were in, respectively, a virtuous and a vicious circle. However, the diverging nominal price and wage trends, with no safety valve in the form of nominal exchange rate adjustment, was storing up problems in the form of, again respectively, steadily deteriorating and improving international competitiveness.

The crisis hit the European economies in different ways, depending on their industrial structure, the extent of problems in the banking sector and, not least, by their position in this dichotomised European economic 'model'. Alongside the problem of sluggish demand growth high unemployment and deteriorating government finances found also in the US and elsewhere, currently Europe is struggling with massive adjustment problems, particularly in the former deficit countries. These countries face the problem of – put simply – needing faster demand growth to boost output and reduce unemployment, and at the same time having to deflate nominal wages and prices. The crucial problem here is that the institutional architecture described above is not able to achieve the needed rebalancing while maintaining rapid demand growth in Europe as a whole. For that to be possible the obvious need is for surplus countries to take on the role of locomotive in Europe, by expanding demand (maintaining stimulus) and moving to above-average wage and price increases. However, they are reluctant to do so (especially Germany) and the one-sided European rules exert no pressure on them to move in this direction. Meanwhile, the ECB is equally reluctant to do more to reflate the European economy, notably by purchasing government bonds from deficit countries, easing their financing constraints. So far, support measures have been quantitatively very limited. The ECB has not engaged in quantitative easing on anything like the scale seen in the US or the UK.

The result of this impasse is that Europe – which from a global point of view ought to be a demand locomotive, enabling the US to recover and repair its tattered balance sheets – is expected to grow only slowly in the coming years as it sorts out its own very different adjustment problems, handicapped by an institutional machinery that is not fit for purpose. Economic governance reforms are being discussed at present but there is little sign of the breakthroughs that would be necessary for Europe to have an economic model that allows all its members to have balanced, job-creating economic growth at the same time, instead of engaging in beggar-thy-neighbour policies within an overall framework that is too restrictive. Not only does this deprive Europe of opportunities for its own citizens, but it is also an obstacle to global rebalancing.

What is needed?

In the short run, surplus countries must do all they can to expand demand and ensure faster growth of wages and prices; fiscal consolidation should be postponed. Deficit countries should seek to freeze or lower nominal wages and prices, as far as possible by means of social pacts and other corporatist arrangements that avoid costly output and employment losses. They also need generous assistance from the European authorities, including the ECB, to shield their government bond markets from speculative attacks and prevent the wholesale dismantling of vital public services and permit continued public investment.

In the medium term, substantial reform of the economic governance architecture is required. Recent reform proposals are a mixed bag of progress (greater consideration of macroeconomic imbalances) and regress (a significant tightening of the SGP) (Watt 2010). An obvious starting point is to change the balance between fiscal and macroeconomic surveillance. The sensible solution is to focus primarily on the external (that is, current account) balances, which have been shown by the crisis to make countries so vulnerable, and, *as part of that*, to examine fiscal positions rather than prioritise the public over the private sector (im) balance. In other words, the debt position of the public *and* private sectors (which together are equal and opposite to the current account position) of each country should be examined *in equal measure, at the same time and in a single procedure*.

Within this altered assessment framework, what could be sensible guidelines for fiscal policy? Ideally, Europe needs mechanisms for establishing the desired aggregate fiscal stance given the expected economic situation. Then the appropriate 'allocation' of national fiscal positions, such as to take account of national and the overall European requirements and, in particular, the private sector (im)balances, would be made so as to arrive at the desired aggregate stance. Clearly, given the endogeneity of the fiscal position, this could be no more than indicative. European-level coercion can refer only to the implementation (or failure to implement) discretionary measures, never to fiscal outturns which are driven by too many factors. Some provision for (limited) fiscal transfers between countries would be desirable. Agreement is needed on a definition of *additional* investment-spending that raises growth potential; such spending increases should be excluded from deficit calculations. A simple first step would be to exclude from consideration countries' co-financing of (an expanded programme of) lending by the European Investment Bank. For both the macroeconomic and fiscal surveillance processes a much more nuanced set of 'sticks and carrots', positive and negative sanctions, needs to be developed in agreement between the member states (Council) and the Commission.

These measures at the national level would need to be supplemented with European-level arrangements that, in particular, effectively limit undesirable tax competition (poaching revenues from taxes on mobile production factors) and provide European funding for needed public investment projects, notably in infrastructure and the transition to a green economy.

Particularly with regard to wage- and price-setting, which is crucial for the whole idea of monitoring macroeconomic imbalances, the social partners need to be involved at both the European and the national level. An obvious way to achieve this is to strengthen the existing Macroeconomic Dialogue (MED) at European level and ensure its better articulation with national-level social dialogue processes and institutions (Koll and Hallwirth 2010). The former should become a permanent secretariat rather than a series of ad hoc discussion meetings. Tripartite institutions to liaise with the EU MED should be established. Meanwhile, trade unions should seek to develop further their autonomous attempts to bring about greater coordination of wage-setting; in this, they should receive support from the public authorities. More generally, collective bargaining institutions at national level must be strengthened. This is a prerequisite for (nominal) wage-setting to take macroeconomic considerations into account.

Finally, it is vital to bring monetary policy under genuine European economic governance. Inflation targeting could be supplemented by more explicit mandates to consider financial stability, growth and employment, requiring additional monetary policy tools (Palley 2010). A system is needed to enable ECB financing of government debt, subject to strict conditions to avoid moral hazard, for example, linked to targets for additional public investment.

Africa

Kwabena Nyarko Otoo

In the two decades after independence, growth in Africa was curtailed and, in some instances, arrested by the overbearing dominance of a state that was in its formative stages. The state supplanted markets and the private sector. In the past three decades, growth has been equally subdued by a development paradigm that puts absolute faith in the ability of markets to solve all the development problems of the continent.

Since long before the advent of the current global economic and financial crisis,[9] Africa and its peoples have had to face a series of crises. In the past 30 years Africa's share of global trade has plummeted. Income inequality is on the rise everywhere on the continent. Educational outcomes remain low. Adult literacy rates have actually fallen over the past three decades. More than half of the population survives on less than a dollar a day. Life expectancy remains at below 60 years, the lowest in the world. Three decades of structural adjustment and poverty reduction strategies have produced real per capita income that is lower today than it was in the 1970s. The number of Africans living in poverty almost doubled between 1981 and 2002. And despite all the hype about halving poverty from its 1990 levels by 2015 as part of the Millennium compact, the United Nations estimates that by 2015 more than a third of the world's poor will be in Africa, compared to a fifth in 1990. On top of these challenges, much of the continent is mired in civil and political conflicts.

This is against the background of substantial 'improvements' in the policy environment and governance indicators achieved under the guidance of the World Bank and the International Monetary Fund (IMF). Most countries on the continent have abandoned their 'statist' policies and

9. The current crisis has been termed a 'global crisis' primarily because it emanated from and affected America and Europe.

have adopted market-led policies. Many countries have managed to put in place democratic and reasonably accountable governments.

Budget deficits have largely been contained, inflation is low and inflationary expectations are subdued. On average, Sub-Saharan Africa has registered 5 per cent GDP growth rates over the past three decades. Some countries have sustained growth rates of 6 per cent in the past five years. Trade has been liberalised; many countries have also liberalised their capital accounts and adopted overly generous investment policies that protect investor interests (sometimes over and above those of workers and communities).

But African countries are not attracting the volume of investment needed to sustain growth and employment generation. Africa's share of global FDI inflow remains at 3 per cent, with a handful of oil-rich countries receiving the lion's share. In 2005, South Africa alone received more than one-fifth of FDI inflows into the continent. We might also observe that FDI may not be having the expected spillovers witnessed elsewhere in the world. In many cases, the activities of multinationals seemed divorced from the real economies of the host countries. There is a strong sense that in many cases FDI, far from being a source of significant new investment, is a device to extract capital from the continent.

Productive infrastructure lies in ruins. Road networks are in a deplorable condition; health and educational infrastructure is deteriorating in many countries; energy demand has outpaced supply, leading to erratic service for both industry and households; and water systems can no longer cope with demand, leaving many people without access to potable water.

The continuing global financial and economic crisis has already added to the challenges confronting Africa. For 2009, Africa's GDP growth rate was expected to decrease to 1.7 per cent, from 6.9 per cent in 2007 and 5.5 per cent in 2008. Chen and Ravallion (2009) estimated that the global crisis would add 7 million more to the population of Africans living on less than US$1.25 a day in 2009 and a further 3 million in 2010.

The reality is that an intensification of the policies demanded by the IFIs in the pre-crisis era will not secure Africa's recovery. But nor will the various models of African socialism attempted in the immediate post-independence era. However, as with the developed world, recovery will depend on an enhanced role for the state. Africa needs stimulus policies, not fiscal restraints. The path of austerity is the path to stagnation and continued economic decline. If the IMF believes that stimulus policies are still appropriate for the developed world then they should accept that this logic applies to Africa too. In other words, the Fund should stop demanding policies in the South that are deemed inappropriate, counterproductive or dangerous in the North.

Countries in Africa require massive government spending to build or repair roads, schools and hospitals. Classrooms must be filled with qualified teachers and doctors and nurses must be induced to stay in their own countries and not migrate. By building and rehabilitating the roads, foodstuffs from the hinterlands could be brought to the markets and help stabilise food prices. This will be a more sustainable way of dealing with inflation than a cosmetic attempt to hold down government expenditure. But it will also boost employment creation both directly and indirectly.

African governments can raise the necessary resources for the proposed fiscal stimulus from within (although complemented by external assistance) by restoring to the state its regulatory powers to tax and to ensure that citizens derive maximum benefits from their natural resource endowments. By restoring the regulatory powers of the state, it would be better able to support and protect budding enterprises that are an important source of decent employment by shielding them from unfair and unsustainable competition. It will further require reversing the policies of unbridled liberalisation of both trade and capital accounts, focusing on employment and regarding efforts towards curbing inflation only as a means to end and not an end in itself.

Africa needs much more than economic growth as measured by GDP or per capita GDP. Africa is in urgent need of transformative growth; growth that is based on overcoming the developmental challenges the continent faces; growth that is participatory, inclusive and shared; growth that enables Africa to build and maintain productive infrastructure. Above all, the continent needs growth that is based on employment and which positively affects the lives of the majority. Trickledown economics has failed and a new approach is needed.

First, the scale of the development challenges can be met only by strong democratic states. Reliance on market forces in societies where markets do not exist for many activities is not an optimal solution. It is doubtful whether market incentives could ever deliver all the schools, hospitals and roads that need to be built. State intervention in these and many other areas is necessary. State intervention is also necessary in guiding the markets towards optimal outcomes. As the current global crisis and Africa's own experience with market fundamentalism in the past 30 years have shown, market left to their own devices do not produce optimal outcomes. But for African states to be effective in strategic intervention, they have to be rehabilitated. Strong democratic states are required to kick-start transformative growth that benefits the majority of the people rather than existing elites and multinational corporations.

Second, the growth process must be consciously guided to ensure that it is employment-intensive. The view that employment creation is a residual outcome of growth has not helped. Relatively high growth rates have coincided with loss of formal employment and the rise of informal employment. Concerns about inflation should not constrain the necessity for transformative growth that creates employment. If, indeed, the most abundant asset of the poor is their labour, then employment creation must be the basis for economic growth. For the most lasting way to eliminate poverty will be to ensure that people can access productive employment that offers fair incomes. The obsession with inflation – in particular, single-digit inflation – must stop. The endless pursuit of macroeconomic stability as an end in itself must give way to a new thinking that recognises people as the ultimate beneficiary of growth.

Third, countries must be given space to determine their policy choices. The top-down approach where World Bank and IMF officials dictate and impose on countries what they consider appropriate policies must give way to a process that encourages popular participation in policy formulation and implementation. A bottom-up approach will make for domestic consensus on key policy issues, a vital ingredient of successful development outcomes. What many foreign development experts do not realise is that, in many instances, government officials, including civil servants, do not believe in the policies they are compelled to implement. And that presents a perfect recipe for policy failure.

The democratic route to state organisation and policymaking is an affirmation of the multi-lingual and multi-ethnic nature of African societies. That recognition will inform the absolute necessity of achieving domestic elite consensus on key development policy issues. It informs the need to shift from the top-down approach to a programme of bottom-up initiatives in which contending interests are recognised and reconciled.

Asia

Patuan Samosir

The global economic crisis did not originate in Asia and the Pacific; nevertheless the region found itself adversely affected by the crisis. Millions of workers have lost their jobs and incomes since 2007 and the recovery has barely begun – although the rebound has been fast. A recent estimate suggests that as many as 24 million people in the Asia Pacific region could lose their jobs as a result of the crisis, with women and young people at highest risk (ESCAP 2009). The crisis confirmed that some labour markets are simply not able to offer an adequate level of security to workers. Moreover, globalisation (defined as market opening and intensification of trade) has led to an increase in the number of informal and precarious workers. Redundant workers often receive either no or inadequate compensation for job loss. Structural change is often simply left to the market and workers suffer the consequences.

Nonetheless, Asia is recovering remarkably rapidly from the global financial crisis. Asian Development Outlook 2010 (ADO 2010) forecast robust growth of 7.5 per cent in 2010. In East Asia, where the recovery is strongest, growth is forecast to accelerate to 8.3 per cent in 2010, from 5.9 per cent in 2009, with solid recoveries in the three economies that shrank last year (Hong Kong [China], Mongolia and Taiwan ROC). South Korea is expected to rebound to 5.2 per cent growth, driven by stronger private investment and consumption and the rise in global trade. In Southeast Asia, aggregate growth is likely to rebound to 5.1 per cent in 2010, from just 1.2 per cent in 2009, when five of ten economies shrank significantly (Brunei Darussalam, Cambodia, Malaysia, Singapore and Thailand).

South Asia will also pick up in 2010, led by the projected performance in India, but also strong growth in Sri Lanka (6 per cent) as it continues to benefit from its recent return to peace after a long civil conflict. Pakistan is likely to pick up with growth of 3 per cent, reflecting better domestic economic fundamentals, while growth is likely to ease slightly in Bangladesh and Nepal. In the Pacific, the overall growth rate is forecast to rise to 3.7 per cent in 2010, from 2.3 per cent in 2009.

What is the real reason for the strong economic momentum across the region? First, by and large, countries in Asia came into the crisis with fairly strong macroeconomic fundamentals, including low inflation and favourable fiscal positions. Good fundamentals, in turn, provided scope for strong policy responses in many countries. China, Japan, Korea and Singapore were among those employing relatively aggressive policy strategies; in particular, China undertook a sizable fiscal programme, supplemented by accommodative monetary and bank lending policies.

Second, stimulus packages as emergency measures to protect the economy from a global economic crisis have been timely and appropriate. Various countries in the region have used an extension of social protection as a form of stimulus. The form and extent of intervention varies across countries: in more developed countries, such as Singapore, housing assistance for low and middle-income household is the main type of intervention, while in developing countries, more direct and targeted measures, such as cash transfers or subsides to the poor, are prominent.

In China, the fiscal stimulus package launched in November 2008 totalled 4 trillion yuan, equivalent to 16 per cent of 2007 nominal GDP. The stimulus was largely focused on infrastructure development to foster construction and related industries, generate employment and promote social stability. Measures were included to provide employment for laid-off migrant workers and fresh university graduates (ADB 2009).

For most economies in the region, the rebound of exports in 2009 also reflected an increase in market shares. Part of the explanation may be the ability of Asia's exporters to respond to challenging market conditions by increasing the price competitiveness of their market products, expanding the variety of goods to be exported, and entering new markets (for example, China). This, in turn, has been made possible both by Asia's superior productivity and by still relatively weaker exchange rates than in other regions, which allowed Asian exporters to cushion the impact on (domestic currency) profits from a reduction in foreign currency prices (IMF, Regional Economic Outlook 2010). Furthermore, in response to the crisis, as of 31 October 2009, ADB had allocated a total of $8.94 billion in crisis support for 43 projects (ADB 2009).

Meanwhile, Asia and Pacific are leading the global economy recovery, but major uncertainties remain about the extent and durability of the resurgence. The collapse in Western demand in 2008 led swiftly to a precipitous drop in Asian exports – a fact that laid bare the deficiencies of the region's export-dependent growth model. One of the consequences of the Asian development model has been that production outgrew consumption for decades. Inevitably, this meant that businesses could grow only by exporting to foreign markets. And the Chinese model, in particular, depended on a high level of compulsory domestic saving which inevitably meant that the growth of consumption would remain subdued. There are real questions about whether this approach is sustainable in the medium term and, as is argued elsewhere in this volume, policymakers at international level need to devote more attention to the rebalancing of the global economy.

Asia's economic growth model will need to be re-oriented, shifting from a primary dependence on exports to a more balanced model that is also dependent on services and domestic consumption. The logic for closer economic integration is becoming more compelling as intraregional trade becomes more important compared to Asia's trade with the West. Indeed, a strategy that relies mainly on cheap factors of production – labour and other input – is not likely to work as well in the future, especially in economies which do not have the labour reserves possessed by China, India, Indochina and Indonesia. Instead, the rest of Asia will need to look at its institutions and markets to drive more sustainable and higher quality growth via strong productivity improvements. In this economic environment, the winners will be those countries that can evolve to be among the world's leading innovators and designers, rather than countries whose factory floors are buffeted by the volatility of structural change and intensifying competition from large labour surplus economies. It is true that Asia's export-led growth model has generated enormous increases in output, higher incomes and new job opportunities. But it has also stalled the necessary rebalancing of the economy to one geared more towards private and public consumption.

In one sense, therefore, the region has weathered the economic storm fairly well. Growth is fairly robust and unemployment is likely to begin to fall over the next year. But the crisis has revealed structural weaknesses in labour markets, which a simple return to growth will do little or nothing to address. Dealing with the structural challenges demands action in four areas.

First, increasing union density through organising workers across all occupations and industries, including informal and atypical workers, is a must. Only strong and independent trade unions can ensure that workers are properly represented. Collective bargaining is essential in tackling income inequality, low labour standards and precarious employment. Similarly, trade unions must be seen as legitimate actors with relevant views on industrial policy, employment creation and labour law reform. Just as in Europe, trade unions in the Asia-Pacific region have the right to be respected as social partners.

Second, stabilising the macro-economy through policy reforms – including more rigorous regulation of financial markets – is essential. Economic growth in the past few decades has not been distributed to employment in terms of quality and quantity. Trade unions have to continue their action to establish effective economic governance and to ensure that sustainable growth is matched by distributive justice. The market fundamentalist paradigm should be abandoned and a new model developed, in which core labour standards/decent work are incorporated into macroeconomic policy. Full employment must be an explicit goal of public policy.

Third, we should promote better social protection for all workers, including informal workers. A higher priority for social protection must involve not only commitments to higher expenditure but also fundamental reforms to establish a strong social safety net with effective job-creation schemes, skills training and re-training and unemployment insurance.

Fourth, we need to establish productive, high quality employment. As in the past few decades, because of deregulation of the labour market, the employment structure has drastically changed, from formal employment to atypical and informal employment. Therefore, national labour laws should ensure that regular, secure jobs should be available to all who want them. Economic development should lead to the gradual disappearance of informal work, but public policy must limit the operation of any incentives in the opposite direction. The principle of equal remuneration for work of equal value should prevail in all types of employment and social safety nets for employment, with universal coverage (including migrant workers), should be established and improved.

Latin America

Adhemar Mineiro

When the banking crisis erupted in the final quarter of 2008, Latin American countries were facing an uneven situation of generalised growth that had not been experienced for the preceding three decades. Beginning in 2004, this period, characterised by an average growth rate of more than 5 per cent per annum (excluding Mexico), was the first time that democratic governments had enjoyed the benefits of strong growth. This could be seen as a reward for the difficult democratic and social transitions made since the 1980s.

The causes of this return to growth had two different strands. The first was related to the overcoming of structural balance of payments constraints that historically had affected all the economies of the region. Having experienced a profound financial crisis in the second half of the 1990s, Latin American countries were very concerned about the shortage of foreign exchange, particularly at a time of trade and financial liberalisation. Recently elected governments were seeking a new development path and were particularly sensitive to this problem. The overcoming of this situation seems to have been possible due to the huge increase in commodity prices, related partly to the increase in Asian demand – particularly from China – and partly to financial speculation. This was expressed by the United Nations Economic Commission for Latin America and the Caribbean's (ECLAC) indices of the terms of trade and purchasing power in this period. High commodity prices also led to an accumulation of foreign exchange reserves (of around US$350 billion by the end of 2009) that helped calm the financial markets in the region.

Rising commodity prices ensured that there were no balance of payments problems, creating further opportunities for economic growth. Another explanation for GDP growth since 2004 is the determined effort made by many national governments (including Brazil) to improve the purchasing power of the poor. Higher minimum wages and income transfers had the effect of boosting domestic demand, leading to an increase in private investment and higher tax revenues for the state. In other words, for the first time in more than a century, Latin America seemed to have devised a virtuous circle of economic growth, combining robust commodity prices with an expansion of domestic consumption.

Some governments were able to capture a portion of the gains from the rising prices of important export goods (copper in Chile, oil in Venezuela, soy beans in Argentina, for example) and use those resources to finance public expenditure. Rising incomes and strong demand helped to reduce unemployment and poverty, as well as to formalise jobs that had hitherto been in the informal sector. Slowly but surely the quality of the labour market was improving in most countries.

This was the general economic situation in the region when hit by the international turmoil on the financial markets in the second half of 2008. The effects in each country were different. For example, those countries more integrated with or more dependent on the USA were hit hardest; most obviously, Mexico and Central American countries, but also Venezuela (because of the reliance on oil exports, with the USA as a major consumer). The same can be said for the recovery process: falling demand affected commodity prices and raised questions about whether the growth cycle that began in 2003/2004 could be restored. Multinational corporations also began to remit profits to their home countries, which raised questions about the region's reliance on foreign direct investment.

There was at this moment a profound discussion about the appropriate response to the crisis. Business groups, especially those attached to financial interests, advocated the traditional policy measures (fiscal adjustment through lower public spending and tighter monetary policy through higher interest rates), combined with another cycle of 'reform', by which they meant the further deregulation of labour markets. Had governments followed this advice the likely outcome would have been a prolonged recession. Others had different advice for policymakers. For example, social movements in general and trade unions in particular pressed governments to maintain pro-growth policies. Some countries in the region (Argentina, Brazil, Mexico) were also influenced by the discussions at the G20 (2008–2009), where the emphasis was on fiscal stimulus, accommodative monetary policy (quantitative easing) and reform of the international architecture of financial regulation.

The responses varied fairly widely across the region. Countries that experienced a rapid recovery, or a vigorous recovery, or those that were least affected by the crisis took measures aiming to:

– protect and reinforce internal markets, by maintaining income transfer programmes and wage increases;
– maintain or raise private consumption through tax exemptions, tax reductions or expansion of credit to consumers;
– offer financial support to the enterprise sector, whether through public credit or government incentives to private lenders. The goal was to guarantee liquidity to the private sector and maintain business conditions to support the real economy, particularly the export sector;
– support business through tax exemptions, tax reductions, support of public credit, for example to prevent job losses, improve working conditions or environmental performance, encourage compliance with collective agreements or facilitate negotiations with trade unions;
– increase, or attempt to increase, international reserves;
– increase public expenditure and public investment.

These proved to be good policies and the result has been a fairly rapid recovery across Latin America. Figures for 2009 (ECLAC estimations) showed a halt to growth, but figures estimated for 2010 (UNCTAD, TDR 2010, Geneva, September 2010) indicate growth of around 5 per cent this year. Estimates are even more optimistic for the Mercosur countries (Argentina, Brazil, Paraguay and Uruguay) (according to ECLAC's estimations – ECLAC, Economic Survey of Latin America and the Caribbean 2009–2010, Santiago, July 2010), growing at an average of a little above 7 per cent. This trajectory of recovery was initiated in the second half of 2009 and is stronger in countries that had not only tried to maintain or reinforce measures stimulating internal markets, especially through the expansion of popular consumption, but had also dedicated themselves in recent years to deepening their regional integration policies and coordination of domestic markets, beyond the search for the integration of productive chains.

These experiences offer some useful insights into how policies can be devised to overcome the crisis and set economies on a new growth path in the future:

- Supporting domestic consumption is essential, particularly by enhancing the incomes of the poor, whether through direct income transfers or through minimum wage policies.
- Policymakers should continue to worry about the balance of payments and should take measures to avoid outcomes that might break the virtuous circle. This might include increasing the volume of international reserves, diversifying the set of exported products, avoiding national currency appreciation, controlling capital flows, increasing regional integration and reducing the dependence on foreign hard currency. In particular, there is a case for devising new financial instruments in the region that might help countries in Latin America deal with external vulnerabilities (see the discussion of the proposed Banco del Sur in Chapter 4). Nation-states continue to be relevant, not only in conceiving and implementing measures to deal with the crisis (including expanding public expenditure and investment), but also in discussing, creating and operating the policy mechanisms related to structuring a new path of development, especially through the regional integration process.
- Regional integration is a necessary condition for strong growth in the future and this means creating regional markets, building regional supply chains and developing a new regional financial architecture to support this integration process. Moreover, as in Europe, market opening arrangements like this demand effective governance arrangements that take into consideration the views of the citizens of the region and recognise the legitimacy of the trade unions and other popular movements. Furthermore, political and institutional tools are necessary that can make this process not only possible but also democratic and able to take into consideration the will of the peoples of the region and the participation of trade unions and popular movements.

USA

Thomas I. Palley

In the wake of the Great Recession, the core problem afflicting the US economy is the atrophied income and demand generation process produced by thirty years of market fundamentalist policy. As a result, measures that stimulate demand, such as monetary and fiscal stimulus, cannot sustain recovery. Generating sustained recovery requires repairing the income and demand generation process.

In past recessions, policymakers merely had to jumpstart the economy. In the current recession, the road to recovery and shared prosperity requires that policymakers simultaneously jumpstart the economy and rebuild the system. One without the other will fail. Stimulus without structural rebuilding will mean that recovery is unsustainable, while structural rebuilding without stimulus will leave the economy trapped in stagnation and unable to achieve recovery velocity.

US policymakers have failed to recognise this imperative. Having successfully stabilised the economy after the financial crisis, policymakers implemented inadequate stimulus and failed to initiate structural rebuilding. Consequently, the recovery has been weak and risks stalling, while a return to full employment is not even on the horizon.

Escaping the trap of stagnation requires a comprehensive new economic strategy. The Great Recession symbolises the implosion of the neoliberal growth model and means it is time for a post-neoliberal shared prosperity growth model that includes the following:

Sustained, substantial, smart stimulus

The US economy confronts a structural demand shortage that looks set to be long-lived. The outlook for manufacturing investment spending is weak because of global excess capacity, while the outlook for construction spending is weak owing to the over-building hangover from the property bubble. The consumer spending outlook is also weak because households are deleveraging and increasing saving. The net result is a structural excess of saving that promises to depress economic activity.

Under such conditions, government must step in and run large sustained budget deficits that help fill the demand shortfall. In the short- to medium-term the economy needs stimulus to establish recovery momentum and ward off the effects of deleveraging. That can be accomplished by targeted tax cuts putting money in the hands of low- and middle-income families, and by transfers to state and local governments that help them to avoid additional job cuts. Over the long term the economy needs a new growth model, which is where deficit-financed public infrastructure investment has an important role as it meets public needs and also stimulates private investment by raising the productivity of private capital.

The grave danger is that policymakers will turn to fiscal austerity which will only aggravate the structural demand shortage, thereby undermining growth and worsening the budget outlook. To the extent that there are long-term budget deficit concerns, the solution is to grow the economy, not to contract it.

Cauterise the housing market

The housing market is a critical hot spot that must be cauterised or else its adverse effects will linger for years. To date, policy has disproportionately benefited banks and corporations and largely failed to help households, which has been a grievous error.

Whereas banks and the corporate sector have been refinanced with assistance from Federal Reserve special lending facilities and the Treasury's Tarnished Asset Relief Program (TARP), the household sector has not received equivalent help. Banks have resisted meaningful loan modifications, while many households have been unable to refinance mortgages at lower interest rates because of zero or negative home equity. Consequently, the household sector remains distressed and trapped in a foreclosure tsunami that has traumatised the economy.

Policy must immediately put a floor under existing homeowners. The solution is to use the Federal Housing Administration to refinance Fannie Mae and Freddie Mac mortgages with low or even negative equity and then to have Fannie and Freddie use the proceeds to repay some of their federal government borrowings. The test criteria should be whether a mortgage is viable once refinanced at low rates. Additionally, the Federal Reserve must continue with purchases of mortgage-backed securities to ensure that mortgage rates stay low until the housing market has stabilised.

Refinancing the household sector will yield a huge boost by reducing foreclosures and lowering mortgage interest payments. Reduced foreclosures will, in turn, stabilise house prices and help the construction sector, while lower mortgage payments will increase consumer spending and spur higher employment.

Longer term, the US must reconsider its housing policy and abandon its strategy of relying on house price inflation to fuel demand. This strategy promotes indebtedness; creates volatile fictitious wealth; and penalises younger workers who have to buy over-priced housing. Instead, the goal should be the provision of affordable quality housing for all.

Neutralise the trade deficit

A third critical measure is to neutralise the trade deficit. The adverse effects of the trade deficit can be understood through the metaphor of a bathtub. Fiscal and monetary stimulus is being poured into the tub but demand is leaking out through the plughole of the trade deficit. Moreover, it is not just demand that leaks out, but also jobs and investment due to off-shoring.

The trade deficit and off-shoring are significantly attributable to China's undervalued exchange rate, which also forces other countries to undervalue their exchange rates to stay competitive. This has resulted in an overvalued dollar which makes the US economy internationally uncompetitive.

The immediate task is to get China to significantly revalue its currency, which will help staunch the triple haemorrhage of spending on imports, off-shoring jobs and off-shoring investment. China can be pressured to cooperate via administrative interventions that limit its subsidised exports and by legislation making countries with undervalued exchange rates subject to countervailing duties.

Longer term there is a need to address the global question of how to ensure stable fairly valued exchange rates and to prevent countries from seeking unfair international competitive advantage via undervalued exchange rates. Over the past three decades US manufacturing has paid a heavy price during extended bouts of dollar overvaluation. Now, the exchange rate problem is going viral and turning into a currency war, with countries engaging in competitive devaluation aimed at poaching global demand and increasing their exports. This threatens the stability of the global economy and points to the urgency of a new global system of coordinated exchange rates.

Rebuild the wage–productivity growth link

A paramount problem of the past thirty years has been the severing of the wage–productivity growth link. That severing has contributed significantly to undermining demand generation, which helps explain why the economy is now trapped in stagnation.

Rebuilding the wage–productivity growth link is therefore critical to both recovery and establishing growth with shared prosperity, and it requires rebuilding worker bargaining power. One immediate measure is passage of the Employee Free Choice Act that will enable unions to organise on a level playing field.

A second measure is to index the minimum wage to the median wage. That will create a real wage floor and limit wage inequality because the minimum wage will automatically increase as median wages rise in line with productivity

The Federal Reserve and monetary policy

The need to rebuild the wage–productivity growth link points to the need to restore full employment as a policy priority, which leads to the Federal Reserve and monetary policy. Over the past thirty years, the triumph of neoliberal economics has seen central bankers elevate the significance of anti-inflation policy while lowering their concern with full employment. That tilt in priorities must be reversed as weak employment conditions undermine the link between wages and productivity growth and may also lower productivity growth. Moreover, modest inflation lowers the rate of unemployment by greasing the wheels of labour market adjustment. Effectively, it lets wages in tight sector labour markets rise relative to wages in weaker sector labour markets, thereby encouraging job formation in sectors where there is unemployment.

Financial market regulation

Financial market regulation is the cousin of monetary policy and here too policy has failed dramatically. These failures include allowing excessive risk taking; the build-up of unstable excessively leveraged financial structures; and tolerance of incentive pay arrangements that promoted managerial conflicts of interest and wildly imprudent and self-serving lending. These practices created the house of cards that came tumbling down in the financial crash of 2008.

Once again, neoliberal philosophy played an important role as it opposed regulation on principle. That speaks to restoring the philosophical standing of regulation, which is needed to ensure financial markets function efficiently.

With regard to specifics, financial market regulation should limit speculation, increase transparency and enable central banks to address asset price bubbles and preserve financial stability. To this end, market participants should be subject to position limits and margin requirements when deemed appropriate. In the absence of a compelling case otherwise, all financial trading should be channelled through clearing houses. And financial institutions should be subject to balance sheet requirements that can be adjusted at the discretion of policymakers. Such requirements include liquidity requirements, capital requirements, asset based reserve requirements and leverage restrictions. Financial transaction taxes also have a place, as a means of both limiting destabilizing speculation and raising revenue.

The recently enacted Dodd–Frank Wall Street and Consumer Protection Act (2010) has begun the process of restoring stability and integrity to the financial system. However, more reforms of the sort listed above are needed. Moreover, the legislation's effectiveness will depend on how agencies write and implement the rules required by the new law. That points to the massive problem of Wall Street's ability to capture regulators and legislators through campaign contributions and the bait of future high paid jobs in return for 'going easy' now. This is a profound political problem which speaks in favour of downsizing banks. This political concern complements the economic argument that banks which are 'too big to fail' should be downsized because they are a systemic risk, and because they distort competition through the implicit funding subsidy they receive from those who lend to large banks knowing they will be bailed out.

Reforming corporate governance and accountability

Along with improved financial market regulation there is a need for a new corporate governance agenda. That agenda must restrict managerial power by enhancing shareholder control; use the tax system to discourage excessive managerial pay and short-term incentive pay that promotes speculation and myopic business management; limit unproductive corporate financial engineering (particularly stock buy-backs); and provide representation for other stakeholders in corporations.

The right to incorporate and the benefit of limited liability are constructs of law. The laws behind these rights are intended to advance public welfare, which means that corporate activity should advance the public's welfare. That should be the litmus test for issues regarding corporate governance and accountability.

Tax reform

Lastly, there is need for tax reform that increases economic efficiency and promotes fairness. In addition to promoting widened pre-tax income inequality, the neoliberal era also promoted after-tax income inequality.

One reform should be restoration of tax progressivity which has been eroded over the past three decades. A second reform should be to eliminate the preferential treatment given to capital income (dividends and capital gains) relative to labour income (wages and salaries). A third reform should be to abolish ‘job taxes’ that link taxes to jobs. This means finding other ways of paying for social security and unemployment insurance. Health care financing also needs to be changed since it, too, is a job cost, albeit privately paid for under the current system. A fourth reform should reduce the huge tax expenditure that gives away tax revenue in the form of deductions. In particular, the mortgage interest deduction, which distorts property prices, should be phased out. A fifth reform should be the elimination of tax provisions (such as deferral of taxes on foreign profits) that promote off-shoring jobs and investment. A sixth reform could be abolition of corporate income taxes, but only as part of a package that increased tax progressivity and eliminated tax favouritism for capital income. Taxing corporations gives them an incentive to move: instead, government should tax the owners who receive the profits.

Do it all

The Great Recession and the ensuing prospect of stagnation signal the implosion of the neoliberal growth model that was implemented some thirty years ago. That makes this recession different and it means conventional stimulus policy, even in large doses, cannot deliver sustainable recovery or shared prosperity. Instead, there is a need for a more comprehensive recovery package that is embedded in a new growth model.

It is vital that policy is enacted as a comprehensive package. Implemented alone, policy measures will be far less successful. Without tackling the trade deficit, fiscal stimulus and the benefits from cauterizing the housing market will leak out of the economy. Similarly, increasing union membership and wages will result in an acceleration of job and investment off-shoring. Fixing the trade deficit without fixing the income generation process and cauterizing the housing market will leave the economy permanently short of demand.

Escaping the Great Recession requires jumpstarting the economy by increasing demand. Preventing the economy from falling back into stagnation requires a new growth model that rebuilds the income and demand generating process. Success requires the full policy package of stimulus and structural rebuilding. Until US policymakers grasp this imperative the economy will remain trapped in the pull of stagnation.

Assessing the policies

David Coats

What is most remarkable, perhaps, is the similarity of the policy mix adopted by economies at very different stages of development. In part because of the success of the G20 process, stimulus policies were initially applied almost everywhere. This has had the effect of reducing the depth of the trough into which the global economy fell and has, to some extent, restored modest economic growth across the world. But – and this is the crucial point – there is a real risk that governments in OECD countries are withdrawing stimulus policies prematurely. Economic orthodoxy is back with a vengeance in the euro area with fiscal consolidation on the agenda for almost all countries. Those economies worst hit by the crisis (Greece, Ireland and Portugal, for example), may be following the strictures of the IMF and the ECB but so far the consequences for both citizens and the real economy have been negative rather than positive.

Moreover, the coordinated action that followed the advent of the crisis has now been superseded by a straightforward return to the protection of national interests. G20 finance ministers may talk about the importance of global rebalancing, but they seem unwilling to accept the consequences of their rhetoric. Indeed, most countries are looking for an export-led recovery, including those with current account surpluses (like Germany), which really ought to be boosting domestic demand. Unless some agreement is reached on exchange rates – particularly in relation to the US dollar and the yuan – then the global economy could be in for a bumpy ride.

Since the collapse of Lehman Brothers policymakers have had to do the following things: recapitalise the banking system; use stimulus policies to prevent the world falling into a catastrophic depression; lay the foundations for a return to growth driven by the private and household sectors; make credible commitments to the reduction of deficits over time;

regulate financial markets to prevent a similar crisis occurring again; and ensure that a rebalanced global economy can grow sustainably in the future.

To what extent have policymakers passed these tests? So far as the short-term response to the crisis is concerned enough was done to prevent a disaster. Banks were recapitalised, deficits were allowed to rise and in some countries (like the UK, for example in relation to young people) the state recognised the need to act as an employer of last resort to prevent the scarring effects of unemployment.[10] Short-time working policies in much of continental Europe had a similar effect and helped to sustain employment during the downturn (Watt and Leschke 2010). These interventions were effective and ensured that the great banking collapse did not force the world into a second great depression.

Central banks have also been willing to use unorthodox monetary policies. The purchase of government securities using 'newly printed' money to inject liquidity into the system may have had some effect, although the precise usefulness of these measures is contested. Keynes pointed out that in certain circumstances the use of monetary policy could be rather like pushing on a piece of string. Increasing the supply of money will make little difference to the level of overall activity if both businesses and households are 'deleveraging' – repaying their debts. Richard Koo of the Nomura Research Institute has suggested that the global economy is witnessing a balance sheet recession, that monetary policy is unlikely to be sufficient to the task and that further stimulus policies may be needed.[11] Unfortunately, as Thomas Palley and Andrew Watt make clear, these policies are unlikely to be adopted in either the USA or the Eurozone. And it is rather ambitious to expect China and the other Asian economies to do the heavy lifting for the rest of the world – particularly because China is continuing to pursue a policy of export-led growth rather than a currency revaluation that might lead to more imports being soaked up by higher domestic demand. Policymakers may regret their failure to take action now, and while it would be premature to forecast a double dip recession the contributions to this section are all consistent with a sluggish (and probably jobless) recovery across the OECD.

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10. The *Future Jobs Fund* in the UK (now abolished by the coalition government) guaranteed a short-term job or training place to every unemployed person under the age of 24.

11. See his presentation to the *Institute for New Economic Thinking*, available at http://ineteconomics.org/sites/inet.civicactions.net/files/INETOS-KooPresentation.pdf

We might also question, therefore, whether governments have done enough to put the private and household sectors in a position where they can drive forward the growth process. It is more than a little absurd to argue that consumers should start spending in countries like the UK and the USA when property prices are falling and many households are dealing with a very high level of indebtedness. This is not true everywhere of course, but recent experience should make us wary of believing that high levels of consumption driven by rising property values will be a source of growth in the immediate future. These arguments reinforce Koo's point that further government action may be necessary to get the global economy moving. Perhaps we should go further and say that growth in the future must be sustainable; it cannot be driven by consumption leveraged by rising property values. Bubble economies are pre-destined to burst and every effort should be made to avoid a similar experience in the future.

That brings us to the challenge of deficit reduction. The central question here is whether governments are acting too soon and seeking to cut deficits too rapidly? Certainly, there is very little evidence of robust economic activity and in most countries reviewed here private sector investment is subdued. Furthermore, governments seem to have been panicked by the need to maintain the confidence of the markets and are responding immediately to any threat (however small) to their credit ratings.[12] However, the best evidence tells us that a rise in deficits and debt to GDP ratios is an inevitable consequence of major banking crises, whether stimulus polices have been applied or not. Reinhart and Rogoff, in their comprehensive review of the data, find that debt rises by an average of 86 per cent in the wake of a crisis. Far from being a consequence of profligate 'stimulus' spending or the costs of bailing out the banking system, most of the increase is accounted for by the decline in tax receipts as a result of the recession (Reinhart and Rogoff 2009).[13]

Of course, it is right that governments should put the public finances on a sound footing. But it is easy to act in haste and repent at leisure. Throughout the crisis the IMF, in supporting stimulus policies, demand-

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12. One might ask why governments should be living in fear of those ratings agencies that played such an important role in failing properly to evaluate the risks associated with the exotic financial instruments that caused the crisis in the first place.

13. See also IMF, *World Economic Outlook 2010*, especially Chapter 3, 'Unemployment dynamics during recessions and recoveries: Okun's Law and beyond' (2010).

ed that governments make credible commitments to deficit reduction when growth returned. In principle, this is a sensible position (and eminently Keynesian). But it cannot be right to embark on rapid fiscal consolidation when the economy has scarcely recovered, or worry about an excessive debt burden that will only be made worse by sluggish growth. In other words, governments should have had the courage of their convictions and should have embarked on a measured course of deficit reduction. There is a strong case for saying that the Eurozone in particular is getting the policy mix wrong – and the USA may follow suit as a result of the mid-term elections to Congress.

So far as financial market regulation is concerned there seems to be a disconnection between the discussion taking place among policy elites and the legitimate anger about the excesses of bankers felt by most citizens and trade unionists. It is all very well to say that higher capital requirements and a global early warning system will prevent future crises, but a technocratic conversation about the Basel 2 standards has done little to quell public discontent. Furthermore, where national action has been taken (the Dodd-Frank Act in the USA, the regulation of hedge funds by the EU, the banking review in the UK) the measures look very modest and have done little if anything to prevent a rapid return to business as usual – the 2011 bonus season has confirmed this point. There is a widespread belief that citizens have bailed out the bankers and now have to shoulder the additional burden of fiscal consolidation. Policies designed to achieve a more appropriate sharing of the responsibility (through banking levies or a small tax on financial transactions, as proposed in Chapter 6 of this volume) have yet to achieve the international support needed to make them a reality – after all, the financial system is global and coordinated action (initially by the G20) is essential if these policies are to be successful. As it is, governments are more inclined to consider straightforward reductions in public spending and cuts to welfare bills than to demand that financial institutions accept their fair share of the fiscal consolidation process. Policy may pass a test of rigorous austerity, but it fails the test of fairness, is bad economically (because a sluggish recovery is in prospect) and bad politically (because governments struggle to remain popular when confronted by high unemployment).

We have already noted that the global imbalances at the root of the crisis still exist and that, so far, very limited action has been taken to rebalance the global economy. Unless policymakers devote more attention to this question the chances of a return to strong and sustainable growth are significantly diminished and the risks of future crises enhanced. For Africa, the global region under the most economic strain, the consequences could be severe. The pre-crisis problems remain and weak global demand will mean that millions of people remain in poverty. From a moral standpoint this is unacceptable.

Most seriously, perhaps, the policy discourse seems to have turned away from a radical rethinking of economic models to ensure that growth continues, offers decent incomes to an increasing proportion of the world's population and does so without threatening the environment. International policy elites appear to have reverted to the prescriptions that pre-dated the crisis: small states, low taxes, flexible labour markets and market liberalisation. One can only view this as an enormous missed opportunity and ask, quite reasonably, why policies that failed in the past are likely to be successful in much tougher global conditions. It remains an open question whether the British commentator Anatole Kaletsky is right and we are witnessing the emergence of a new model of capitalism. More positively, one can say that the argument continues and that some prominent economic commentators (including Paul Krugman, Joseph Stiglitz, Christopher Pissarides and other Nobel Prize winners) have refused to accept a return of the status quo. The remaining essays in this volume seek to build on that foundation and link trade union thinking to the work of those professional economists seeking to build a new paradigm. In the short term, policy may be moving in the wrong direction, but in the medium term there remains the prospect, even though it may appear to be receding, of a new settlement. The likelihood, however, is that policymakers may have as much to learn from the unorthodox approaches adopted by countries such as Brazil as they do from a more conventional set of policies in the developed world. And it is to these lessons from 'the South' that we now turn.

IV New development models – lessons from the South

A trade union approach to development and growth

James Howard

Introduction

Among the fourteen resolutions adopted by the 2nd World Congress of the ITUC, held in Vancouver on 21–25 June 2010, one in particular was intended to define a specific Confederation perspective on development. Originally proposed by the ITUC's regional organisation for the Americas, TUCA, the resolution was entitled 'a sustainable and just development model for the twenty-first century'. Over the course of a lengthy preparatory process that lasted almost twelve months, the draft resolution received a host of amendments from ITUC affiliates from all parts of the world, including both developing and industrialised countries, as well as Global Union Federations (GUFs). This was complemented by a number of further amendments discussed and adopted at the Congress itself. As such, the resolution can be considered to constitute a truly consensual document that maps out the joint position of the international trade union family with regard to development issues. This short paper summarises the content of that document.

Failure of the neoliberal paradigm: need for a new model

The resolution begins by affirming that the global economic crisis constitutes the definitive failure of the unjust neoliberal orthodoxies that have guided development policy in recent decades. It notes that the current model of development, based on market fundamentalism with its emphasis on export-led growth, failed to deliver sustainable growth and social progress whether in the developing world, emerging countries or the industrialised world. While some modest gains in poverty reduction occurred, these could not be considered a serious international response to the shared challenge of achieving development; nor could they make up for the growth of inequality, the acceleration of environmental degradation or the brutal impact of the crisis on the lives of millions of working families. Accordingly, the resolution calls for an alternative system of global production that is humane and socially responsible, and for ITUC affiliates to fight against growing inequalities, underdevelopment and economic injustice in the global system.

The resolution further notes that the current development paradigm has contributed to an erosion of workers' rights and a weakening of workers' organisations in many developing countries through its advocacy of labour market flexibility, privatisation, deregulation and market liberalisation. This has created a downward trend in wages through increased competition between developing countries, increased informalisation or casualisation of work, and fiscal austerity and negative corporate tax competition between states with damaging consequences for access to, and the quality of, social protection.

The resolution pays particular attention to the global trend towards the privatisation of public services, due to which millions of people have been deprived of their fundamental human rights. The provision of universally accessible, quality public services would contribute greatly to the reduction of poverty and inequality and the expansion of decent work and enhance social integration and cohesion. In particular, free, universal and public education provides opportunities for all and is a crucial underpinning for democratic societies. It is a key factor enabling individuals and communities to break out of cycles of poverty and provide them with equal opportunities.

Specific trade union contribution to development

The resolution emphasises the specific role played by trade unions in the development process, particularly since unions' representative credentials confer on them unique democratic legitimacy to interact with governments and employers' organisations and to hold them accountable. By their involvement in social dialogue, trade unions can change unfair government policies and contribute to social progress. By promoting and undertaking collective bargaining they ensure that wealth is distributed more fairly within society, thus contributing to the reduction of poverty and inequalities. By organising workers, including the poorest and the most vulnerable such as those with informal employment relationships, trade unions can play a critical role in changing the dominant structures of power. The organisation of self-employed workers into union-linked cooperatives can be one way to change power relationships and formalise work. Through their struggle for social justice, trade unions are and must be recognised as full partners in the development process. Accordingly, the resolution calls for investment in the strengthening of free trade unions and free collective bargaining in developing countries, as these are two essential pillars of fair and sustainable development.

Domestic growth vs. international trade and investment

The resolution devotes specific attention to the implicit conflict between domestic-led growth and externally-oriented policies. Ultimately, the ITUC Congress recognised that trade and investment are necessary for successful development; however, it rejected undue reliance on export-led growth at the expense of domestic markets and local needs, or respect for workers' rights. It stressed that development must be rooted in domestic market growth, focussed on decent work and equitable income distribution, and investment in people through education and health. This requires an enabling international environment that facilitates balanced economic and social progress and offers developing countries an equitable stake in the global economy. International trade and investment rules and investment in commercial food production by corporations must not undermine the livelihood of small-scale farmers and rural men and women. Accordingly, rather than plundering the natural resources of developing countries by multinationals and corrupt elites, the resolution supports developing countries' efforts to increase their value-added production capacity while fully respecting workers' rights.

With regard to the spread of global production and distribution chains, the resolution warns of the risk of a resurgence of protectionist trends. In this context it calls for a strengthening of relations between trade union organisations at the national and international levels in order to work together against the effects of social dumping, especially when this results in violations of fundamental workers' rights.

Many multilateral and bilateral trade and investment agreements between industrialised and developing economies affect developing countries' integration processes negatively by undermining regional integration and generating or exacerbating unemployment. To counter such risks, the resolution calls for a strengthening of regional integration processes, and recognises the potential of regional markets to boost sustainable growth.

Measuring and achieving growth and progress for all

The resolution rejects an exclusive focus on economic growth and the assumption that social progress is an automatic outcome of economic expansion, stating clearly that current calculations of GDP do not reflect the whole picture of growth and prosperity – a point already explored in Chapter 1 of this volume. The demand is clear: all countries should adopt a wider range of measures of economic and social progress, including environmental protection and sustainability. Governments should seek to reverse the trend towards more jobs in the informal economy and the increasing precariousness of work. Labour market protections should be strengthened, enforcement must be rigorous and workers' organisations must be recognised as legitimate labour market institutions. The ILO Declaration on Social Justice for a Fair Globalisation should be implemented and there must be an ILO Decent Work Country Programme in every developing country.

Fairer distribution of income is a precondition of any sustainable form of development, and reducing inequalities must be an explicit goal of national development policies. The instruments available to achieve this goal include collective bargaining, progressive fiscal policies, living wages or improved minimum wages, high-quality public services accessible at the point of need and improved social protection. Tax justice is central to this new development model (discussed further in Chapter 6). Increased mobilisation of domestic resources for development should focus on fiscal reform, strengthening tax administration and broadening the tax base and eradicating tax fraud and tax evasion. Governments should seek to establish or strengthen the income redistribution function of their tax systems by establishing progressive regimes that require the highest tax contributions from capital gains and from the wealthy and provide tax relief for low income families and the poor. On the investment side, the focus must be on enabling measures for public finance management as well as social infrastructure, including health, education for all to provide people with skills and access to knowledge so that they can take action to protect their living and working conditions, and decent work strategies.

Gender equality must be another specific objective, and governments, donors and trade unions should sharpen the focus and the impact of development policies on gender issues. The provision of basic public services is an essential prerequisite for achieving gender equality and empowering women.

Sustainability and the rural economy

The protection of the environment and those communities most vulnerable to environmental degradation must be an integral part of the new development paradigm. Governments must ensure that their policies are respectful of the environment and that 'just transition' strategies are put in place in order to provide a socially fair and environmentally responsible pathway to sustainable development (see Chapter 8). A full-scale transformation of global production systems and consumption patterns is required in order to safeguard societies and workplaces, while protecting and promoting decent work for all. Trade unions must play a central role in that unprecedented transformation. It is a responsibility of developed countries to provide finance and to transfer the technologies necessary for the success of such strategies in developing countries.

The first task is to ensure that basic needs are met. An ambitious strategy is needed to provide access to water for millions more people (through comprehensive water cycle policies) and to guarantee the availability of decent housing for the majority of citizens. Sustainable agriculture and rural development are also critical. It is not acceptable for large tracts of land in developing countries to be used to grow crops for commercial food export. Indeed, one might view this as a form of agrarian neo-colonialism.

Fighting corruption and ensuring democratic policy space

Achieving sustainable development requires achieving social justice. We have already seen in the previous chapter that democracy, fairness, good governance, strong and accountable institutions and the elimination of corruption are all necessary conditions for economic progress. Both developed and developing countries have responsibilities in these areas. Rigorous measures should be put in place to ensure that funds from donor agencies and IFIs do not contribute to corruption and poor governance. Trade unions in developing countries have played a key role in strengthening democracy and the application of the rule of law, and need continuing support in that work. Perhaps we should go further and say that international organisations, donor agencies and developing country governments need to ensure that developing countries have the necessary democratic policy space and that national parliaments, the social partners and civil society have a say in defining development strategies.

Impact of the International Financial Institutions and the debt crisis

An enabling international environment requires financial stability and space for counter-cyclical stabilisation policies to be implemented in developing countries. The International Financial Institutions must contribute to the establishment of that environment rather than advance the interests of rich elites or of a minority of countries and in that regard there is a need to fundamentally review not just the internal governance of those intergovernmental institutions but their overall orientation, policies, goals and mandate in order to address them adequately to the urgent task of attaining development, ending inequalities and creating jobs for sustainable development, particularly in the developing countries where their devastating impacts have never been felt more.

Furthermore, donors need to cancel the debt of LDCs without economic policy conditionality. The creation of a fair and transparent mechanism for sovereign debt restructuring and cancellation and to review the legitimacy of the debt is urgently needed; the actions of so-called ‘vulture funds’ need to be banned through legislation to prevent their use of the courts to steal developing countries’ money.

Meeting the Millennium Development Goals and implementing a financial transactions tax

Governments must maintain and intensify their commitment to achieving the UN’s Millennium Development Goals (MDGs) by 2015. The promotion of decent work is instrumental to achieving the objective of the first MDG, the eradication of poverty. As well as honouring the UN commitment to allocate 0.7 per cent of Gross National Income (GNI) to

Overseas Development Assistance (ODA), additional finance for development must be provided through new forms of international taxation assessments and contributions and in particular taxes such as an international tax on financial transactions, which could also be used for initiatives against climate change. It is important that aid be predictable and untied, respectful of the democratic development choices of developing countries and supportive of the role of the state. Consideration should be given to the creation of a Development Fund for poor countries for sustainable industrialisation.

An ITUC Action Programme

The ITUC is committed to defending, promoting and advocating this new model of development among national and international institutions. Priority areas for action include:

- reform of the international financial and economic institutions;
- economic recovery programmes that focus on stimulating domestic demand on a counter-cyclical basis;
- new forms of international taxation;
- abolition of tax havens;
- a review of trade and investment treaties and agreements to ensure they promote development; and
- a fairer distribution of wealth within and among states.

The ITUC will work with other civil society organisations and movements, including women's and youth groups, to promote our new development paradigm. At the heart of this campaign is the need to develop new instruments to measure economic and social progress – a development index rather than just a focus on GDP per head. It also embraces the notion that international development assistance should be judged by development effectiveness rather than aid effectiveness. It is an ambitious programme, but the global challenges are hardly likely to be met by piecemeal interventions or half measures. And, as we shall see, developing countries are making a serious effort to move away from the failed prescriptions of the IFIs to develop their own policies for development, growth, prosperity and social cohesion.

A view from Latin America

Adhemar Mineiro

Recent experience in Latin America with regard to the search for a new development model began in the resistance to the neoliberal hegemony and the trade and financial liberalisation policies imposed on the region by the IFIs over the past two decades (see Peter Bakvis in Chapter 2). This process, led by social movements, trade unions, social activists and critical social and political forces, helped to build up political strength and discussion for the formulation of alternative proposals and have influenced the governments that have taken office in the new century.

The common basis is a fundamental critique of the regional application of the liberal model. It was argued that liberalisation (of either finance or trade) and deregulation had caused rising unemployment, income concentration, labour market deregulation and rising prices in basic services (telecommunications, energy, water and so on) following privatisation. Moreover, there were disruptive changes to more traditional forms of the organisation of life and economic organisation, especially in rural areas. The regional economy was stagnant and prone to instability, with recurrent crises throughout the 1990s. The general perception was that those new – and serious – problems had replaced the questions of debt and inflation that led to the imposition of IMF programmes in the 1980s.

This process of resistance and search for alternatives led to the election of new governments more responsive to the demands of social activists. Each one, albeit in different ways, was keen to learn from these negative experiences and devise a new model of economic development.

One of the biggest questions was how Latin American economies could overcome external vulnerabilities and balance of payment problems. These problems afflicted Mexico in 1994, Argentina from 1999 to 2002 and Brazil in 1998–99 and again in 2002. It was generally accepted that the fragility of the balance of payments position was a consequence of more liberal capital flows after 1990. Fortunately, the subsequent rise in commodity prices and the increase of international currency reserves managed to ameliorate the problem. But the causes had not disappeared and a policy discussion continued about the need to either re-regulate the financial sector or tighten the controls on capital flows. This debate was revived by the global credit crunch in 2007 and the sharp recession of 2008, and seems set to continue for the foreseeable future.

Another important point, born from the common resistance to the project of a free trade agreement in all the Americas, was the proposal to implement an alternative regional integration process. Of course, this was not new and had been prefigured by discussions in Brazil beginning in the 1950s. Essentially, the idea was that regional integration could accelerate the process of industrialisation and lead to the development of more robust domestic markets. Complementarities between countries in the region would lead to higher growth – with import substitution at the heart of the policy. Subsequently, ECLAC advanced the idea of a Latin American common market, in which the market would allow for an intensification of Latin American regional trade, which would promote industrialisation and reduce external vulnerability, especially in relation to international currencies. The first steps were taken in 1960 with the creation of ALALC (the Latin American Free Trade Area). The main objective of ALALC was to create a regional free-trade zone 12 years after its founding, and its main guidelines included the important role of the private sector along with the removal of tariff and non-tariff barriers. Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay joined at the outset, with Bolivia, Colombia, Ecuador and Venezuela joining in a second wave. The process was consolidated by the creation of ALADI (Latin American Integration Association) in 1980, with Cuba joining in 1998.

After 1994, ECLAC began to develop the approach know as 'open regionalism', which sought to reconcile the preferential agreements between these countries with the growing liberalisation of trade flows. By the late 1990s, political debates had developed a strong discourse of regional integration. Policymakers believed that they could punch above their weight if they collaborated across national boundaries in a world increasingly characterised by large trade blocs.

Realising this aspiration remains work in progress. Regional integration is now seen as the alternative for Latin America to circumvent the global economic crisis and also to try once again to overcome the balance of payments problems that have hindered sustainable growth. The global recession left countries dependent on exports to the developed world in a dilemma. They could wait for the crisis to pass or they could act.

Latin America as a region seems to have abundant water, environmental, social, cultural and energy resources, minerals and an important technological development capacity. It has, as a region, the possibility of being self-sufficient in food, water and energy compared to other regions of the planet. It has public and private companies willing to play a role in the construction process of regional integration. It has, finally, governments and social movements with a reasonable degree of political solidarity and a positive commitment to integration.

Tackling poverty and inequality are high on the agenda in many countries. Programmes have been developed around income transfers, a basic income, minimum incomes and rising minimum wages. There is now more social awareness and political support for these policies than at any other time in the region's recent history. Increasing the incomes of the poor to maintain domestic demand was a central feature of the policy reaction to the crisis of 2008. Programmes of income distribution and/or redistribution operate in the medium and long term to give important signals of the future path of national demand. They give the private sector the confidence to invest, in the knowledge that domestic markets are growing, especially if the programmes are sustained and have strong political support. Other policies are working in the same direction. Witness, for example, the discussions in Argentina between the government and the trade unions to give employees a share of company profits.

Another important element is the developing discussion of a new regional financial architecture. Argentina, Brazil, Paraguay, Uruguay, Bolivia, Ecuador and Venezuela are exploring the viability of a Banco del Sur (the Southern Development Bank). The Banco del Sur will rest on three pillars. The first is the simple idea of a development bank for projects in the region – a kind of regional development bank – able to overcome the national characteristics of an institution such as the BNDES (Brazilian National Development and Social Bank), and partially replace institutions such as the IADB (Inter-American Development Bank) and the World Bank. Most importantly, the Banco del Sur will not make funding dependent on the implementation of Washington Consensus policies as required by the World Bank or the IMF.

The second pillar is designed to protect currencies against speculative attack. By using rising commodity prices to build up foreign exchange reserves, the Banco del Sur will be able operate a ‘unity is strength’ policy that would allow a higher capacity for resistance. In other words, the Banco del Sur could act as a lender of last resort to those member countries experiencing balance of payments difficulties.

Third, the Banco del Sur will be able to facilitate trade in regional currencies rather than US dollars. Today, if a company in Argentina wants to buy products in Ecuador, it must first find the US dollars it needs to make the purchase. By creating a structure of financial compensation for regional trade, countries could generalise the trade in national currencies. US dollar reserves would be used only as a last resort. Such a process ran for a long period in Europe before the creation of the euro and it remains the cornerstone of the European monetary system. The logical conclusion might seem to be a single currency for participating countries, but whether this is a likely outcome or not is a question beyond the scope of this discussion, not least because it would require much more coordination of monetary, fiscal and trade policies, the difficulties of which are now apparent in the EU.

These are potentially epoch-making changes and for Latin America they are entirely novel. This is the first time that democratic governments in the region have worked together to find viable alternatives to the failed policies imposed in the past by the International Financial Institutions.

The potential is enormous. Regional integration could help to fulfil the needs of citizens, as defined in Chapter 1 of this volume. It could regionalise supply chains, reap economies of scale, develop domestic markets and focus on the demands of environmental sustainability. Moreover, as in the EU, integration could lead to economic convergence with rising incomes for the poorest and the maintenance of prosperity for the more developed countries in the region. There may be lessons here for other developing countries as they seek their own path to sustainable, balanced and inclusive growth.

Of course, Latin America has much to learn from other regions and countries as its develops policies focused on the same goals, above all because it is composed of very new nations, with short histories. But in struggling for alternatives, in trying to make their own history, people learn rapidly and acquire invaluable experience in adapting to rapid change.

A new industrial policy growth paradigm for developing countries

Esther Busser

Many developing countries that have tried to grow by expanding agricultural exports, exploiting mineral resources or developing low value added manufacturing have found that the impact on GDP per head has been limited. They have continued to experience high levels of poverty, sluggish improvements in living standards and (as Jim Baker argues elsewhere in this volume) high levels of precarious work. More successful countries (such as those in East and Southeast Asia) have adopted rather different approaches, to be sure with a focus on export industries, but with a degree of infant industry protection and a desire to move the location of economic activity further up the value chain. This has often involved a shift of capital and labour from low-productivity and low-wage sectors towards high-productivity and high-wage sectors. It is also recognised, although to a lesser extent, that such a structural transformation of the economy requires an active role for the state in the form of an industrial strategy. The need for industrial policy in developing countries has gained some traction over the past few years, and should be further reinforced as a result of the crisis and the increased call for a government role in shaping development and decent work. The exact meaning of what this role should be remains highly contested.

There are essentially two schools of thought concerning industrial policy. The first sees industrial policy as promoting industries in line with a country's comparative advantage. Examples of such policies are infrastructure measures, the provision of education and vocational training, access to finance, policies to attract FDI, and fostering of research and development. These policies have also been called 'horizontal', promoting a better 'enabling environment' for business, without interfering in the matter of which sectors or industries should be promoted. Such a horizontal strategy does not explicitly question the notion that a successful growth strategy inevitably builds on natural comparative advantage.

The second school of thought goes much further. It recognises the value of the horizontal approach but also promotes a so-called vertical approach, targeting specific sectors and industries, thereby going beyond the natural comparative advantage of countries. It is the second approach that has enabled countries in East Asia, such as Korea, Taiwan and China, to industrialise.

Examples of policy instruments that have been used by successful Asian countries are those that provide infant industry support of various kinds (including subsidies, access to cheap finance, access to technology, reverse engineering, investment performance requirements and so on), trade policies (tariffs and non-tariff barriers), public procurement, science and technology policies, technology transfers, the development of domestic markets, an active and strategic sequencing of various rounds of import-substitution and export-oriented industrialisation and export targets. All these policies are aimed at specific sectors and industries characterised by increasing returns to investment, steep learning curves, technological change, synergy and cluster effects, and dynamic imperfect competition.[14] Experience also shows that the role of the state is key in driving the industrialisation process; that national ownership of the industrialisation strategy is important; that experimentation and innovation are essential; and that risks have to be taken to be successful.

A new growth paradigm should therefore not only promote industrialisation, structural transformation and decent work but also embrace the need for active (vertical) industrial policy. This is a very different assumption from the principles applied to development before the crisis, where market liberalisation and little else was seen as *the* condition for growth – although the practical results were disappointing. Policymakers now need to take a more sceptical view of markets and must learn lessons from those countries that have witnessed explosive growth in the past two decades. Industrial policy and infant industry protection followed by phased market opening are essential ingredients in the recipe.

The fact that horizontal policies have their limits can be seen from the example of Chile. *The Economist*[15] recently lauded the success of Chile

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14. For a quality index of economic activities see also Reinert (2009) and Stiglitz (2009), pp. 88, Figure 4.2. For a general account of the role of industrial policy in economic development see Chang (2002).

15. 'Briefing: The global revival of industrial policy: picking winners, saving losers', 7 August 2010.

which 'moved from basic industries such as mining, forestry, fishing and agriculture to aluminium smelting, salmon farming and winemaking thanks to a number of government initiatives'. It added that this was achieved by following its comparative advantage. However, Ha Joon Chang in a rather more sophisticated work describes Chile as a case that 'has lost a lot of manufacturing industries and become excessively dependent on natural resources-based exports' (Chang, Ha Joon 2007).

> Not having the technological capabilities to move into higher productivity activities, Chile faces a clear limit to the level of prosperity it can attain in the long run.

Amsden (2007: 84) reinforces this assessment:

> Chile started the post-war period with a per capita income roughly twice that of Taiwan (same size and arability as Chile) but ended the century with a per capita income barely half Taiwan's, which in the meantime had targeted manufacturing growth.

There is also a lively debate about the role of foreign direct investment (FDI). Some countries (in Eastern Europe and Singapore, for example) have used FDI to build their export capacity – and there have been spillovers to domestic industries too, leading to a general increase in productivity. On the other hand, some have argued that FDI locks countries into low value added manufacturing or fails to benefit the country as a whole because foreign investors are interested only in locating in export processing zones. While the evidence is mixed on these points, there is no doubt that some countries have benefited hugely from FDI, whereas others (such as South Korea) have focused on developing their domestic industries behind tariff barriers – and phasing the reduction of barriers once the economy has developed sufficiently to withstand the rigours of international competition. Perhaps the point here is not to be unduly prescriptive, but to recognise that different policy mixes seem to have worked equally well. It is worth noting, however, that both Singapore and South Korea have recognised the imperative to improve productivity to maintain comparative advantage – and public policy has been deliberately designed to move export-oriented industries up the value chain.

Nonetheless, there do seem to be some advantages associated with national ownership – including reinvestment in the domestic economy and ensuring that national businesses benefit from technology, skills and R&D gains across the value chain (Amsden 2007: 144).

Trade policy is critical in determining the effectiveness of industrial policy and some of the demands for market liberalisation can get in the way of development, impeding the process of industrialisation in developing countries. Examples of policy instruments whose use is now much more restricted are tariffs, subsidies, performance and local content requirements, export targets and incentives, reverse engineering and deliberately weak enforcement of intellectual property rights.

Tariffs in particular have been a key instrument in the process of industrial development and structural transformation. It is hard to imagine how an infant industry could actually take off and become competitive without tariff protection. The global trading regime needs to reflect the lessons of successful development and make provision both for a limited degree of infant industry protection and the phased elimination of tariffs as a country reaches industrialised status.

Conclusion

A sustainable growth model requires a revival of industrial policy for developing countries, but not just any industrial policy. There must be renewed acceptance of the need for industrial policy strategies and the use of a wide range of policy instruments. There must also be a revival of recently abolished trade policy instruments, a strategy for creating new dynamic comparative advantage and a balanced approach to foreign direct investment. Questions should be asked about how much any development model perpetuates existing production structures or natural comparative advantage, and how much it actually allows for the establishment of an independent strategy for industrial development by moving into higher value added industries.

Reduction and even elimination of tariffs across the board, as promoted in most trade agreements, goes against the need for protection of nascent industries. Building an industry without any tariff protection in a highly competitive international environment is beyond reach and hence tariff flexibility is required in order to build industries that can compete internationally.

The Global Jobs Pact – a prescription for recovery

Sharan Burrow

Growth and equity are not a trade off. On the contrary, if the world is to enjoy the 'strong, balanced, inclusive and sustainable growth' advocated variously by government leaders and the multilateral system, then income-led growth is essential. This requires employment-centred macroeconomic policy within the scaffolding afforded by the integrated approach of the Global Jobs Pact.

The ILO Global Jobs Pact was negotiated by governments, workers and employers as a crisis response but it is also the basis of a new development model. Income-led growth requires a social protection floor, a minimum wage and the distributive power of collective bargaining. These elements of wealth distribution are essential to both equity and the growth of demand. When you add to this job creation through both public and private investment, sustainable investment that encourages industrial development and a green economy, then the demand side of the equation is set to drive growth. Add to this the supply side of investment in skills and strong labour market institutions and economies can realise domestic demand, workers can have confidence in fundamental labour rights and societies can enjoy greater equity.

The ILO and the IMF recently met in an historic context in Oslo where the objective was to consider the now bitter unemployment crisis and capacities for joint action. Front and centre was the commitment to work on the 'social protection floor' with a view to the consideration of options for financing. Social dialogue was accepted as the basis for developing responses to the unemployment and social challenges in countries where joint activity is possible.

The promise of joint activity represents a powerful opportunity for a different approach, but even as we acknowledge and encourage the commitment to a new approach to macroeconomic policy, the promise of a social protection floor and the realisation that social dialogue is essential to success, sadly IMF officials in many countries in Europe are pushing the old agenda of 'labour market flexibility'. There is no recognition that income-led growth requires job security, collective bargaining, a minimum wage on which you can live and a social security net that cannot simply be cut by financial market whim and political acquiescence. This attempt to use the arguments concerning sovereign debt to push for deregulated labour markets does not help business; certainly is not acceptable to workers, their families or their unions; and is not a basis on which to build the social dialogue essential to constructing strong social and economic futures.

If you consider Romania before the crisis, the new Labour Code adopted and implemented in the early 2000s underpinned eight years of economic growth and the halving of unemployment to less than 5 per cent. This story is the same in many nations. There is no evidence anywhere that flexibility drives jobs and it certainly does not drive a fair share of productivity in wage growth. Rather we see an increase in precarious work and increasing anxiety and justified anger from working people in almost every country.

The Global Jobs Pact is not a menu of options – although there may be nations where some elements are already in place – but rather an integrated approach that is essential for driving sustainable growth, employment and workers' rights. What the neo-classical economists refuse to accept is that social protection and workers' rights are economic tools as well as fundamental elements of equity and social justice.

Unions are committed to social dialogue to drive development and fiscal consolidation over time, leveraged from increased employment, growth and income. We will reject austerity measures which put workers, jobs and job security at the core of some bond-market and/or orthodox IMF response to a crisis that began in an unregulated financial system. Inequality drove a stake into the heart of stability of the global economy and, unless it is corrected through greater equity, it will continue to do so.

The Global Jobs Pact is the basis of a new development model and unions are committed to seeing it implemented.

V Monetary and fiscal policy tools

Monetary and fiscal policy tools

Andrew Watt

Identifying the problems revealed by the crisis

Inadequate macroeconomic (monetary and fiscal) policies, both at national level and in terms of international policy coordination, played an important contributory role in the crisis. A controversial debate has since ensued about the relative weights to be attached to different causal mechanisms and, following on from this, about necessary reforms.

Under the dominance of neoliberalism and the so-called Washington Consensus, *monetary policy* was, across the world, entrusted with (more or less) sole responsibility for price stability, defined in terms of a low rate of consumer price inflation, usually over the medium term. To achieve this goal, monetary authorities were granted one instrument: the short-term policy rate of interest. This approach was – and widely still is – held to be optimal for the promotion of stable low-inflationary growth. This, in turn, is based on the belief that inflation is a monetary phenomenon, that money is 'neutral' and thus that there is no trade-off between inflation and output/employment in anything but the very short term. This position has been decisively weakened by the crisis.

Two specific, not mutually exclusive, criticisms have been offered. One is that the focus on consumer price inflation blinded central banks to asset price developments (and thus to the risk of a massive crisis when boom turns to bust). Rather, central banks should take the latter into account in setting interest rate policy and/or should deploy other measures to guard against destabilising shifts in asset prices. The second is that low inflation is not always the right guide for monetary policy in terms of stabilizing demand growth at a rate commensurate with maximising growth and employment opportunities. In other words, there are – or at times can be – policy trade-offs. This claim requires central banks to follow a broader mandate, for instance explicitly including growth and employment, and entails changes in the mandate, target variables and/or the policy tools of the central bank.

In the context of the euro area, one issue is the suitability of a 'one-size-fits-all' interest rate policy for a heterogeneous currency area (see the section on Europe above). The experience of the crisis has been that, for an extended period, the real-interest channel (the pro-cyclical impact of lower real interest rates in high-inflation and higher real interest rates in low-inflation countries) has dominated the trade channel (that is, competitiveness on goods markets). This led to the build-up of substantial competitiveness and trade imbalances within the euro area. This implies a need either for additional, country-specific monetary policy tools or, more plausibly, for national-level supplementary measures of dfcregulatory policy, fiscal policy and/or wage policy (see also 'policy mix' below).

Under the neoliberal aegis *fiscal policy* in many – but not all – countries ceased to be used as a means of macroeconomic stabilisation (counter-cyclical policy). Instead, the primary task of fiscal policy was seen as ensuring fiscal consolidation, often irrespective of the cyclical situation (for example, in many European countries during the mid-1990s when they were struggling to emerge from recession). This was driven by a belief that taxation had large distortionary effects on the economy and, specifically, reduced work incentives, while public spending was largely wasteful and/or also had distortionary and negative incentive effects. (It must be said that these more ideological motivations also led in some countries to massive tax cuts which, as for instance under George W. Bush, produced the opposite of fiscal consolidation, namely huge deficits.) More generally, elected politicians were not to be trusted with managing government budgets responsibly, being, it was claimed, incorrigibly self-serving and short-term in orientation.

According to this mantra, in the USA individual states were widely banned from borrowing at all (forcing them into pro-cyclical tightening in recessions and encouraging spending splurges during booms), while in Europe countries were subjected to the Stability and Growth Pact. While its form changed somewhat over the years, the essence of the SGP was to sharply limit deficits (arbitrarily to 3 per cent of GDP) and, more recently, to run close-to-balance or surplus budgets in the medium term, implying a reduction in government debt to zero. Partly as a result of this, fiscal policy in many (but not all) EU countries was frequently pro-cyclical. In other countries, pro-cyclical fiscal tightening was often imposed in the context of so-called stabilisation programmes mandated by the international financial institutions, the response of the IMF to the Asian crisis being a notorious case in point (Stiglitz 2002).

Meanwhile, countries across the world increasingly engaged in tax competition for the pool of tax revenues generated by mobile factors of production (financial capital, industrial capital, corporate profits, personal income and the wealth of 'high net worth' citizens). The impact of this was a secular fall in the tax rates on these factors and a concomitant rise in those on immobile factors (notably labour and consumption). This was one factor behind rising inequality.

Inadequate *macroeconomic policy coordination*, both at global level and also within the EU and euro area, was an important factor in the rise in current account imbalances. More generally, there is simply no institutional set-up at global level – and only weak and imperfect ones at European level – to coordinate balanced demand growth so as to achieve growth and employment objectives while maintaining stability. This coordination failure led to the pursuit of seemingly rational national development and growth strategies, varying according to countries' specific circumstances, that for a time were symbiotic, but over time proved unsustainable. As discussed in Chapter 3, the most important of these were mercantilist strategies (wage restraint, currency undervaluation, current account surpluses) in countries such as China, Japan and Germany, and, on the other hand, debt-led growth strategies (faster wage and price increases, asset-price booms, current account deficits) in countries such as the USA, the UK and Spain.

Under the neoliberal paradigm, these orthodox monetary and fiscal policy recommendations were coupled with various 'structural' policies (notably with regard to labour markets, the welfare state and wage-setting) that were also characterised by market fundamentalism. Institutions were to be abolished or reformed in order to approximate as closely as possible to a textbook 'perfect market'. Government intervention was to be minimised. This was the key to efficiency, equity and stability. Particularly important in the context of this section is the lack of an explicit '*policy mix*'. Instead, the mantra was 'policy assignment'. A case in point is wage-setting: wages are not considered, in this model, as a policy variable: they are best set in atomistic markets to ensure nominal and real flexibility at micro and macro level. Meanwhile, structural policies should aim at emulating market outcomes and – unless there are clear signs of market failure – focus on deregulation, liberalisation and privatisation. This is based on a belief that clear policy assignment without any coordination leads to optimal results: sustained non-inflationary growth at potential, unemployment at the NAIRU, the lowest unemployment can be forced down without igniting inflation. However, this flies in the face of considerable evidence that those countries that do make use of explicit forms of coordination between policymakers generate better outcomes (Traxler et al. 2001). This applies particularly to corporatist countries in which wage policy is set with explicit consideration of macroeconomic variables. By anchoring nominal price and wage expectations in this way, macroeconomic policy is free to target output and employment to a great extent. Moreover, the 'policy assignment' approach singularly failed to foresee – not to mention head off – the impending crisis.

Challenges that macro policy (along with other policy areas) must address

The immediate reaction to the crisis implied – although this was seldom made explicit – a rejection of the previous orthodoxy. Instead, governments resorted to the supposedly discredited old-fashioned Keynesian recipes, not least the extensive – if still inadequate – use of countercyclical fiscal policy. Monetary authorities, too, adopted large-scale unconventional measures.

Looking forward, in the short term the main challenges are to emerge from the economic crisis in such a way as to reduce unemployment from its current high level (before it becomes entrenched), move back towards full employment, raise living standards, consolidate public finances and overcome the competitive imbalances that have built up globally and within the euro area. This must be achieved in a way that avoids, as far as possible, leaving ordinary working people – who did not benefit from the previous excesses nor were the cause of the crisis – to pay the cost of the crisis. Currently, none of these goals seems assured. The risk of a double-dip recession persists and the consensus forecast is for an extended period of very sluggish growth, such that unemployment and pressures on fiscal budgets will remain high.

In the medium term, important issues include the establishment of economic governance mechanisms to avoid the widely feared decline in long-term growth potential and to ensure balanced growth in terms of distribution both between groups in society and between countries. Ways must be found to generate sufficient tax revenues to pay down debt and to finance necessary public services while investing in a green future.

In the longer term, the economic growth model must be rendered compatible with ecological constraints and, in particular, 'de-coupled' from carbon emissions.

Policy alternatives and recommendations

These goals cannot be achieved by macroeconomic policy and policy coordination alone, but they are certainly an important, indeed indispensable element. The basic alternative philosophy to the prevailing orthodoxy pre-crisis is that monetary, fiscal and wage policies must be aligned, over the medium term, so as to be mutually compatible and conducive to achieving, in a balanced way, society's goals. These include, notably: full employment, rising living standards, and economic stability – including price stability – social cohesion and sustainable growth. This requires explicit and institutionalised *policy coordination* – rather than an assignment of separate tasks – in order to ensure appropriate reactions, conducive to longer-term social goals, in a changing and highly uncertain environment (shocks) (Watt 2006 and 2007). This, in turn, has institutional requirements which will vary from country to country. Alongside national-level institution-building and policy reform, the crucial international spillovers, especially in Europe/the euro area, need to be addressed in the form of policy coordination mechanisms at appropriate (global, European, regional) levels.

Thus it is not easy or even possible to generalise a successful model for macroeconomic policy suitable for all countries, at least not one that is also politically feasible. For this reason, ideal-typical illustrations are given below of policy reform initiatives that can and should be taken, in pursuit of the above goals, depending on institutional preconditions.

Monetary policy

The policy remit of monetary authorities needs to be broadened to include more explicitly growth and employment objectives and also financial stability issues. The crisis has provided strong arguments – avoiding deflation/liquidity trap, facilitating adjustment – for a higher inflation target (Blanchard et al. 2010). A nominal GDP target might also be considered as a way of balancing growth and inflation concerns. Clearly, if central banks are to pursue multiple aims they need ways of balancing them and that implies multiple instruments. Low interest rates are important to maintain adequate growth of demand and promote investment, and also for distributional reasons. The risk that this might lead to asset-price bubbles and promote instability needs to be met with greater financial market regulation (see Chapter 6) and also by more finely tuned instruments at the disposal of the central bank itself: the short-term interest rate is a blunt instrument that must be complemented by more specific ones. The use of asset-based reserve requirements would free central banks to target stable growth and employment via lower interest rates, while guiding specific financial and asset (including housing) markets (Palley 2010). The use of a variable, countercyclical interest-rate tax (LIT REF Nauschnigg) can also be considered.

In the context of high fiscal deficits and government debt, bans on central banks monetising government debt should be reconsidered, at least during periods of crisis. These bans were imposed when the inflationary effects of allowing governments simply to 'print money' became apparent. However, such 'quantitative easing' strategies have proved useful in the context of the current crisis. It is vital that governments' fiscal constraints are eased to permit them to continue to finance growth-enhancing investment. What is required, therefore, is regulation that maximises the growth and stabilisation potential of coordinated support by central banks for fiscal authorities, while minimising the risk of inflation from fiscal incontinence on the part of governments which longer need fear market discipline. In other words, debt monetisation should be permitted subject to appropriate conditionality.

In terms of processes, central bank independence from short-term political interference is important, but at the same time central banks must be much more closely involved in dialogue with governments and other social actors. The creation of a social partner or civil society advisory council, as existed prior to EMU in a number of European countries, should be considered. One of the main goals of such dialogue is to enlist the support of other actors in order to achieve monetary stability in return for a greater growth and employment orientation on the part of monetary authorities (see also below).

Fiscal policy

The crisis has revealed the power of fiscal policy. Fiscal policy should be characterised by strong automatic stabilisers. Steps should be taken to strengthen them, while other policy reforms that have the (unintended) effect of weakening them should be reconsidered or the negative effect otherwise offset. Countries need strong fiscal frameworks that ensure robust counter-cyclicality in both directions: various 'buffer fund' or automatic rate-adjustment schemes, as used in Nordic countries, are a way forward. Fiscal policy should be broadly symmetrical and normally be 'neutral'; that can be interpreted to mean running an average deficit consistent with a constant debt-to-GDP ratio across the business cycle. (Within a monetary union, however, different rules may need to apply, given the loss of the monetary policy and exchange rate instruments.) This underpins investor and consumer confidence both in stable demand and in stable price developments. Strong frameworks should limit the scope for governments to unleash a 'political business cycle', while at the same time preserving democratic accountability and legitimacy for the tax and spending mix.

Fiscal credibility is important, but one-sided mechanisms such as the 'debt brake' which is now part of the German Constitution and the proposed stringent fiscal consolidation rules now being proposed in Europe are potentially dangerous. Fiscal consolidation must pay attention to aggregate demand and also equity issues. This implies a focus (especially in the current context) on revenue-side measures and in particular a financial transaction tax and taxes on higher income earners and wealth-holders). Crucially, the investment function of fiscal policy needs to be strengthened: in particular, fiscal rules should enhance, not limit public investment (for example, by removing potentially growth-enhancing capital projects from deficit calculations). International – and especially European – cooperation and coordination is necessary to reduce tax evasion and prevent harmful tax competition.

Specific issues arise in the context of European Monetary Union. Without going into detail, a common monetary policy implies the need for an even more active, symmetrical counter-cyclical fiscal policy at national level to counter the cumulative causation concerns detailed earlier. The SGP needs to be refocused more than has already occurred on the medium and longer term and on counter-cyclicality (achieving consolidation in good times). The automatic stabilisers should be strengthened using the so-called open method of coordination (Watt 2010). Fiscal policy needs to be considered to a greater extent than is currently the case a 'matter of common interest' (this requires addressing the democratic legitimacy gap at EU level). Positive and not just negative fiscal policy spillovers need to be taken into account. As discussed in Chapter 3, fiscal surveillance must be broadened to take into account the current account positions – both deficits and surpluses; this would also make fiscal policy surveillance more symmetrical and thus growth enhancing.

Longer-run sustainability concerns are not the key issue in this section, but what is certainly decisive is to raise in a sustained and predictable way the price of carbon. As regards fiscal policy, then, this implies the need for effective carbon taxation and/or an effective cap and trade system.

Economic governance

The crisis has revealed the vital importance of strengthening economic governance, globally and within EMU. In addition to the fiscal policy measures already mentioned, priorities include a system of pooled financial resources (limited fiscal federalism) that, in the event of crisis, supports countries facing fiscal crisis and speculative attacks, while providing for orderly default/restructuring channels and avoiding moral hazard issues (for example, euro bonds, European Monetary Fund and so on). A strong channel of communication between monetary and fiscal authorities is crucial.

Also, a long-standing demand of European trade unions – revealed as vital by the crisis – is the need for economic governance to be extended to wage and price setting. A key demand would be to strengthen corporatist wage-setting and coordination institutions in order to ensure balanced growth of nominal wage and capital incomes compatible with price stability and competitiveness, but avoiding mercantilist beggar-thy-neighbour tendencies. This would maximise overall growth potential by reducing the incentive to constrain domestic demand growth, permit solidaristic wage policies that help reduce inequality and, by adding an important instrument to the fight against inflation, allow more growth-oriented macroeconomic policies. This is particularly vital within EMU which lacks the instrument of exchange rate changes to restore internal balance.

This, in turn, requires effective collective bargaining systems, which have been disastrously weakened during the phase of neoliberal economic policy dominance. Instead, what is required is a return to policies in which governments explicitly strengthen the bargaining power and negotiating and problem-solving capacity of organised business and, in particular, labour interests. This would enable nominal wage increases to return to an orientation towards productivity plus (sustainable) inflation, stabilising both the real economy and nominal values and (at least) stabilising labour's share of national income. This would pave the way for a return to full employment via steady demand and output growth driven by investment and wage income rather than debt.

VI Financial regulation and taxation

The regulation of financial markets

Pierre Habbard, with David Coats and Andrew Watt

It has already been observed (see the introduction to this volume) that the global financial crisis invalidated the assumptions on which policy had been based for more than twenty years. A central element of the market fundamentalist faith was the belief that financial markets, if left to themselves, would allocate capital efficiently and produce optimal outcomes. Light touch regulation was always and everywhere the best option. More intrusive rules would lead to market inefficiencies, hold back growth rates and make the world less prosperous. Trade unions and some critical economists had been arguing for some time before the crisis that this was a recipe for speculative bubbles and economic instability.[16] There is little to be gained from being proved right given that the jobs and incomes of millions of ordinary citizens have been lost or put at risk, but that is precisely the situation in which trade unions find themselves today.

Action may have been taken to stabilise the financial system at great cost to taxpayers, but there is little willingness among those responsible for the crisis to recognise that there is a need for fundamental change. Bankers continue to argue that they know better than governments how to run their own industry; they refuse to accept that there is a case for self-restraint, much less restrictive legislation, in the payment of bonuses; and they continue to resist any decoupling of investment banking from narrow or retail banking. Moreover, while the momentum for reform appeared strong at the London G20 summit in 2009 those good intentions appear to have been dissipated by the complexities of implementation. Bankers are resisting radical action with all the vigour at their disposal – witness some of the comments emerging from the 2011 World Economic

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16. See, for example, Baker (2002), Stiglitz (2007) and Aglietta and Rebérioux (2004).

Forum in Davos that 'banker bashing' must end. Of course, there is much less resistance to the idea that higher capital requirements should be used to restrain reckless lending and the growth of asset price bubbles, but there is no certainty that these measures alone will be adequate to prevent another crisis or restore legitimacy to the banking system. This short paper maps the dimensions of the problem and proposes a more ambitious mix of potential policy solutions. Obviously, it is difficult to be comprehensive in a brief discussion and the intention here is to describe the outlines of a new regime.

The problem in outline

It would be wrong to say that this was a crisis made in America, but the regulatory failings emerged first on Wall Street and the consequences echoed in other financial centres across the globe. Neither central banks nor other regulatory authorities nor governments foresaw the unfortunate chain of events that led to the deepest global recession since the 1930s.

Against the background of misaligned exchange rates, global trade imbalances built up. These were reflected in an accumulation of huge dollar savings in surplus countries, notably China, which were largely invested in US treasuries. This in turn kept interest rates low, inflating asset prices, providing cheap finance for speculation and driving investors to take increasingly risky positions in search of higher yields.

Banks began to lend recklessly – particularly in the sub-prime mortgage market – and the securitisation of mortgage debt when combined with an accelerating pace of financial innovation led to the creation of a range of AAA-rated exotic derivatives. The inevitable result was an asset price bubble driving an unsustainable boom leading to an equally inevitable bust. Securities that were supposed to be as much of a safe haven as government debt proved to be nothing of the kind. Far from diversifying and minimising risks across the system the scale and pace of innovation created instruments that were of doubtful value. This proved to be a rather toxic brew and it exacerbated the depth of the recession.[17]

Some market actors realised that this process was too good to be true and saw a straightforward route to short the market by buying credit default swaps (essentially a form of insurance) that would pay out if the value of the insured securities fell (Lewis 2009). Once again, these arrangements accelerated the boom and amplified the bust.

Few institutions understood the risks they were taking; senior directors were often completely ignorant of the nature of the securities being traded; and, as the post-crisis period proved, were unable to describe the practical operation of a collateralised debt obligation (essentially a bundle of securitised mortgages that is created by slicing and dicing other asset-backed securities and then sold on to investors as a AAA security).

A Faustian pact bound the bankers and governments together: the banks were given light touch regulation and the government collected the corporate taxes generated by Big Finance to support a higher level of spending on public services. For most of the decade up to 2007 the system worked well. But, as Simon Johnson, former chief economist at the IMF, has suggested, the boom discouraged a close inspection of the flaws in the system. The ratings agencies were unable to play a neutral role and were infected by conflicts of interest: they simply could not afford to alienate the institutions whose securities they were rating. Bankers were also able to exercise undue influence over public policy, advising governments on the structure of financial regulation, using financial support for political parties to influence the agenda and placing individuals at the top of the public administration. Johnson identifies the confluence of campaign finance (in the USA), personal connection and ideology as a fundamental cause of the crisis (Johnson 2009).

The supposed diversification of risk proved to be nothing of the kind and the tower of financial innovation was built on sand. Moreover, the Basel 2 Accord, which determined how much capital banks should hold in relation to their liabilities, was pro-cyclical, demanding that less capital be held during a boom and more when balance sheets were already under pressure. The complexity and opacity of ‘innovative’ financial instruments meant that nobody knew who was holding losses: there was a complete breakdown of confidence in counterparties’ solidity. All of the factors were responsible initially for creating a credit crunch in which capital became unavailable (banks were unwilling to lend to each other,

17. A good narrative account of the crisis can be found in the report produced by the UK government in advance of the London Summit in 2009. See HM Government (2009). Another compelling account can be found in Turner (2009).

as well as to investors and retail customers) and the global economy was pushed into a recession from which recovery is not yet secure.

The current crisis reveals, among other things, the threat that the 'shareholder value' model of corporate governance can pose to market integrity in much the same way as the Enron episode did in 2001–2002. The banks that were hit by the crisis were ruled by 'imperial CEOs' and did not have proper risk management procedures in place. Departing directors and traders have benefited from grotesquely large compensation packages and golden parachutes – often with no sense of embarrassment. The failure, therefore, was as much a matter of governance as of financial market regulation. Indeed, it demonstrates that shareholders are often not the best judges of their long-term interests. They can hold directors to account, but investors rarely spot systemic risk. Action must be taken on both fronts if further crises are to be avoided in the future (the governance questions are dealt with in more detail in Chapter 8).

Simply expressed, policymakers must develop a new, internationally co-ordinated agenda for re-regulating the financial system, focused on the following flaws revealed by the global financial and economic crisis:

– *An unsustainable model of growth*, fuelling wage compression, predatory lending, debt-financed consumption and the transfer of market risks to workers (pensions, housing).
– *An uncontrolled 'structured finance' industry* in which credit risks were not spread but hidden: a system that lacked regulation, was riddled with conflicts of interest and, when coupled with rigid prudential and accounting rules, both accelerated the boom and led to a deep global recession.
– *Widespread institutionalised regulatory arbitrage* between jurisdictions and within financial institutions, which has helped to blur the lines between regulated and shadow banking, letting financial groups practice double accounting by using off-balance-sheet operations and encouraging irresponsible risk-taking and leverage investment strategies.
– *Corporate short-termism and 'shareholder value' governance* undermining market integrity and stakeholders' long-term interests. The crisis has exposed weak risk management by ineffective boards of directors and turned the spotlight on the money that has been wasted in past years in grotesquely large executive compensation, dividend payouts and share buy-back programmes.

Principles for financial market regulation

Developing a new regulatory architecture requires some clarity of thinking about the broad purpose of financial services. Just what are banks for? Answering this question would enable policymakers to create the right framework with the right incentives. Allocating capital to investment projects efficiently is obviously critical, but so is the public utility function of banks, providing current accounts and other financial products for households. This suggests that financial regulation should be focused on the following objectives:

- maintaining stability by ensuring the solvency of market actors;
- protecting investors against failures and fraud;
- ensuring that capital is allocated where it can be used most efficiently;
- implementing procedures that allow for the orderly winding up of failed institutions;
- limiting taxpayers' exposure to the risk that bail outs will be required in the future.

The agenda that flows from these fairly straightforward statements is potentially radical. For example, it demands much greater international cooperation to strengthen financial safeguards: by establishing early warning systems, prudential regulation, the public accountability of central banks and the role of regulatory authorities, as well as finance ministries. Similarly, one might say that finance should be reconfigured to reflect the fact that for most citizens banking is a public utility – or, in the language of the European Union, is a service of general interest. Households should be protected against predatory lending and there should be a wider range of providers in the sector (including community-based providers like mutuals or credit unions) Moreover, responsibility must be properly allocated throughout the investment chain: with specific reference to the role of credit rating agencies and the role of remuneration policies in encouraging short-termism or excessive risk taking.

An assessment of progress and some proposals for action

Some progress has been made through the G20, with the London and Pittsburgh summits setting the ground rules and making more specific recommendations. So, for example, G20 governments have committed themselves to: the Basel 3 framework with higher capital requirements and stronger counter-cyclical rules for banks (which would allow for lending in recessions); a new set of requirements to assess systemic risk, with a focus on systemically important institutions; the creation of proper exchanges for the trading of derivatives (improving transparency); and taking action on bankers' bonuses and remuneration packages with the banning of guaranteed payments and the introduction of 'claw back' provisions in the event of poor future performance.

All of these measures are welcome, but they may not be adequate to the scale of the task.

Policymakers must act now to deliver fair taxation (to ensure that the burden of fiscal consolidation is shared, as argued elsewhere in this volume), curb financial speculation, clamp down on tax havens and accelerate the financial market reforms that have been agreed. More specifically, G20 leaders must give priority to progressive taxation that taxes higher income groups and unproductive or speculative assets. A fairer distribution of the tax burden between labour and capital is urgently needed, not only to address growing concerns about social injustice, but also to ensure that employment is prioritised. Governments must protect and expand their tax revenue base to provide support for household demand and funding for quality public services and social protection. This requires a break with the policies of the past whereby direct taxation was cut while indirect taxation – inherently more regressive – was increased.

The five priority areas for both national and international policy action can be summarised as follows:

1. *The financial sector needs to be democratised and diversified*. There should be a wider range of providers in the sector than private banking, including cooperative banking, mutual insurance, public financial services and other community-based providers. The private banking system – where the risks are most concentrated – should be structured so as to protect retail and commercial banking from volatile and risky investment banking. The governance of banks themselves should be democratised to strengthen risk management processes. Banks must recognise their responsibilities to all their stakeholders: in other words, banks must become sustainable corporations too, as Sigurt Vitols argues later in this volume. Excessive

risk-taking and irresponsible remuneration should be curbed by regulating the pay of bankers, traders and other executives.

2. *Regulatory gaps must be plugged*. Derivatives markets must fall under publicly accountable supervisory authorities and all products must be traded on organised exchanges. Hedge funds and private equity houses should be subject to the same accountability and transparency requirements as more conventional asset managers. International cooperation should intensify regarding offshore financial centres that fuel tax and regulatory arbitrage, including an automatic information exchange system and an improvement in the capacity of the tax and supervisory authorities in developing countries
3. *Fair taxation is needed to strengthen financial stability and accountability*. Tax reforms are crucial to ensure that the burden of fiscal consolidation is shared. Moreover, policy needs to be internationally coordinated to avoid tax arbitrage and ensure that there is a level playing field to prevent excessive leverage. The case for a financial transactions tax is made elsewhere in this volume. This would put some sand in the wheels of the system, reduce the incentives for speculation, potentially reduce the pain of fiscal consolidation for ordinary citizens and allow for the provision of global public goods (environmental protection and development aid).
4. *Financial supervision must be 'hands-on' rather than 'light touch'*. Supervisory authorities should have the power to implement an orderly winding up of failed institutions before they reach crisis point (Lehman Brothers), so as limit taxpayers' exposure to the risk that bail outs will be required in the future. In particular, banks and other financial institutions should be subject to 'disciplining rules' whereby public authorities can intervene to prevent irresponsible risk taking (the right to remove directors or to suspend bankers' decisions regarding bonuses, and to enforce group restructuring if systemic risks are in play).
5. *There must be effective international supervision and global governance*. Global finance needs global regulators. Some progress have been achieved in the US (the Dodd-Frank Act) and, to a lesser extent, in Europe. It would be wrong to assume, however, that allowing policy to continue on its current trajectory will deliver international institutions with the legitimacy, powers and resources needed to prevent another global crisis of the magnitude of 2008. More ambition and radicalism are needed if public expectations are to be met and the proposals outlined here offer a positive point of departure for policymakers at global level.

Tax systems that work for distributive justice and public services

Pierre Habbard

Almost all governments have seen their revenues affected by the global financial crisis. Bailing out the banks in 2008 and running 'counter-cyclical' budget deficits to finance emergency stimulus packages in 2009 inevitably caused budget deficits to rise. Deficit reduction can have virtues if it is undertaken at the right point in the economic cycle and is designed to ensure a fair sharing of the burden across the income distribution. Unfortunately, the austerity measures being implemented today are hitting those on modest incomes and the poor.

Of course, deficit reduction does not just depend on spending cuts. Economic growth will generate higher revenues for government. And tax increases can be used to ensure a higher level of distributional fairness. Nevertheless, so far governments have been unwilling to countenance an open and honest discussion about tax policy. From a trade union standpoint workers are being asked to bear the costs of the crisis twice over: first through the initial financing of the bailouts and stimulus packages; and second through the reductions in public services, welfare and social security.

In the pre-crisis period – between 2000 and 2006 – the tax take as share of GDP remained stable across the OECD at 36 per cent. But the taxation mix was moving in a regressive rather than a progressive direction. Tax on capital gains and inheritance have been scaled down or even abolished and the top rates for personal and corporate income tax (CIT) have declined. The figures speak for themselves:

- Between 2000 and 2010, the average corporate tax rate across the OECD dropped 7.4 per cent, from 33.6 per cent to 26.2 per cent. The fall is more pronounced in the EU15 where (unweighted) average corporate tax rates dropped from 35.1 per cent to 26.9 per cent.

- Top personal income tax has been falling across the OECD. While a 70 per cent rate was not uncommon in the 1970s, it is now well below 50 per cent, with the exception of Sweden, Belgium, Denmark, the Netherlands and Austria.
- Taxation of dividends has followed suit, with the OECD average of top marginal tax rates falling from 50 per cent to 41.7 per cent between 2000 and 2010 (in the EU15, 51.8 per cent to 45.3 per cent) (source: OECD www.oecd.org/ctp/taxdatabase).

Meanwhile, the net tax burden on working families decreased very marginally by between 1 to 2 per cent between 2000 and 2009 (OECD 2009a). During that same period income inequality has risen sharply throughout the OECD.[18]

Most of the policy rhetoric of the past decade has been about reducing employers' social security contributions to encourage job creation. These measures were introduced on a wide scale in Germany, Japan and Mexico and targeted on particular groups of workers in Belgium, France and the Czech Republic (newly hired workers, the young or long-term unemployed, employees in small firms). No doubt, employers in these countries saw a significant reduction in their labour costs, but the OECD's research finds a very limited impact on employment levels in the long run and as employers adjust fully.[19] On the contrary, employers have either just reported an increase in profits or (where trade unions are effective) an increase in wages for the existing workforce. Not only that, but when sustained over time these reductions have led to a significant loss of revenue and a potential destabilisation of hitherto robust social security schemes.

The OECD stance on tax reform is emblematic of this shift in objectives from a concern about distributive justice to a focus on growth and competitiveness. In the 2009 edition of *Going for Growth* (OECD 2009b), tax systems are explicitly assigned the goals of increasing GDP growth and avoiding the distortion of business choices. 'Taxing consumption and property appears to have significantly less adverse effects on GDP than taxing income', it is argued. On the other hand, corporate income

18. OECD (2008); Jackson and O'Farrell in Chapter 7 of this volume.
19. OECD, *Employment Outlook* (2009).

taxes 'have a particularly negative impact on GDP per capita' and on the 'growth of the most dynamic and innovative firms'.

The economic theory underpinning this regressive approach is essentially market fundamentalist: deregulate labour markets, cut taxes, reduce bureaucracy, stop worrying about inequality and deal with the losers through the benefit system. The OECD may argue for this position, but it assumes that there is only 'one right way' to growth, employment and jobs. If we have learned nothing else from the experience of the last twenty years it is that there are many routes to prosperity. As Peter Hall and David Soskice have argued, there are several varieties of capitalism: they all seem to deliver similar levels of GDP per head but they achieve very different distributional outcomes (Hall and Soskice 2001). Instead of arguing for a 'one size fits all' policy, the OECD should recognise the fact of diversity, reinstate distributive justice as an objective of economic policy and recognise that a country with a very high number of working poor, crumbling public infrastructure and inadequate public services is unlikely to achieve high levels of sustainable growth.

The willingness of governments to pursue regressive tax reforms prior to the crisis contrasts with their inaction in dealing with the problems of tax evasion and avoidance. No precise estimate exists for the cost of tax evasion to governments' revenues: according to the few reliable estimates, tax evasion may cost 2–2.5 per cent of GDP on average. The difference between tax evasion (criminal conduct) and tax avoidance (stretching the rules to breaking point) can be very thin. Large corporations and wealthy individuals hire armies of lawyers and tax experts to conduct aggressive tax planning.

Tax evasion can hit government revenues domestically. In Greece, tax evasion with regard to VAT and income tax was widespread and a major contributor to the country's sovereign debt crisis in early 2010. International taxation represents an even greater challenge, however. Fraudsters have taken advantage of the low level of coordination between national jurisdictions to escape tax administrations whose jurisdictions are restricted to the national level. They can take advantage of tax havens and lightly regulated offshore financial centres, jurisdiction that offers opacity of banking services and that effectively do not cooperate with other jurisdictions regarding exchange of information. The US Senate Finance Committee quotes estimates of US$40–70 billion lost to international tax evasion alone. US$5–7 trillion are believed to be held in offshore financial centres. The British Virgin Islands have only 22,000 inhabitants but around 360,000 registered shell companies, and annual outward financial flows to China are estimated at USD9.4bn. Meanwhile, Brazil has an average trade deficit of US$4 billion per year with the Caribbean islands, and the Caymans are the fifth largest deposit banking centre in the world.

With the crisis, tax evasion issues have also been brought into the discussion on global financial stability. Integrated financial markets create numerous opportunities for escaping taxation, especially when these markets are not properly regulated, coordinated and supervised by public authorities. The combination of tax havens with the unregulated or lightly regulated 'shadow banking system' – structured products, hedge funds, debt securitisation and off-balance-sheet transactions, among other things – together with tax rules that favour debt over equity has offered formidable opportunities for tax arbitrage and tax evasion. Multinational companies and private pools of capital (hedge funds and private equity) have been suspected of practicing widespread 'double-dip' strategies whereby the interest expenses on a given debt are deducted from the company's or the fund's accounting twice, in two separate jurisdictions. More generally it appears that the use of off-balance-sheet vehicles and securitisation by global banks has gone beyond the theoretical justification of 'spreading the risk' across markets and asset classes: the real motive was tax evasion. This has, in turn, artificially reduced the cost of financing transactions that otherwise would not be viable, leading to mispricing of assets and hence of risks.

Tax competition between countries to attract FDI and, in turn, to raise their domestic firms' international competitiveness has proved to have destructive effects on the original purpose of taxation for public services and distributive justice. A fairer distribution of the tax burden between labour and capital is urgently needed. This is necessary not only to address the growing concerns about social injustice within our societies, but also to ensure that the crisis exit strategies fuel robust household (and solvent) demand and are responsive to growing unemployment problems in all OECD countries.

Much more needs to be done in the international arena. The G20 decision to tackle tax evasion and avoidance by accelerating the OECD's work on international cooperation on tax havens is a step forward. However, there is a need to go much further. The OECD's approach to information exchange between tax authorities is too limited, relying on requests for information rather than automatic exchange, and on bilateral rather than multilateral agreements. Transparency and disclosure of beneficial ownership – that is, access to the real identity of bank account holders, owners of shares and bonds other than securities – remain problematic for many jurisdictions across the OECD, including the USA.

Finally, we need to put an end to the multiple exemptions that benefit the financial sector. In reality, domestic tax bases have been shrinking, not expanding, because the current systems are designed for the real economy (corporate income tax, personal income tax, VAT, property and so on). They are not adapted to the growing complexity and size of the financial sector. Financial services are usually exempt from VAT, and yet it is in that sector that most revenues have been generated in the past decade. The tax dimension of derivatives markets has yet to be tackled seriously by regulators. Careful consideration should be given to the application of VAT to financial services. Importantly, governments should consider implementing a financial transaction tax to redress the current tax exemptions that benefit the shadow banking system, while providing a much needed new source of financing for global public goods, such as the Millennium Development Goals and climate change policies.

Box 2 **Taxing financial transactions**

The economic justification for an FTT starts with the acknowledgement of the harmful effects of short-term speculation, producing strong and persistent deviations of asset prices from their theoretical equilibrium levels. Such 'overshooting' in prices leads to speculative bubbles over the long term. The measured and controlled increase in transaction costs implied by an FTT would slow down trading activities so as to align capital flows with economic fundamentals and the real economy, while freeing up new sources of financing for global public goods. Since the original proposal by James Tobin, the idea of an FTT has been developed in many different ways, both by economists and civil society groups which have a strong focus on financing for development. Today, the issue is back on the agenda with the current global crisis and the G20 process in particular. Unlike in the pre-crisis literature, it has now gained considerable traction, both as a financial stability instrument and as a solution for financing development.

An FTT could be designed with different rates for each 'counterparty' (regulated banks, other financial institutions and private capital, and non-financial corporations and public institutions) and for different transactions ('traditional' foreign exchange markets, exchange-traded derivatives, over-the-counter (OTC) derivatives), assuming that some categories of counterparty (for example, hedge funds) or transaction (for example, certain derivative products) are more prone to speculative trading than others. Such a multi-tiered tax regime would help to identify the desirable level of reduction in trading activities, which should be large enough to wipe out short-term speculative trading, but not so large as to hamper normal functioning of markets. Given the change in scale in financing global public goods resulting from the OECD countries' resource gap, and new financial stability concerns associated with the shadow financial industry, it is important that an FTT cover exchange traded and over-the-counter (OTC) derivatives, where the overwhelming majority of trading is taking place.

The IMF has argued for the creation of a financial stability contribution levied on global banks' balance sheets as an alternative to an FTT, to which the Fund is opposed. The two instruments differ substantially and are not comparable. While the FTT would be no panacea for the much-needed re-regulation of financial markets, it would provide governments with a powerful regulatory tool that would not depend on the ability of the supervisory authorities to price or assess risk. It would help tackle volatility in asset prices and in downsizing the global banking industry, particularly at a time when the international financial supervisory framework is in tatters and will take a decade to reform. It would also free up new sources of financing for global public goods, including climate change and development, at a time when public services and welfare could be under threat if OECD fiscal consolidation is acted upon.

Source: TUAC (2010).

VII Fair and efficient labour markets and decent work policies

A model of fair and inclusive labour markets

Robert Kuttner

Introduction

In most of the world's wealthy nations, the experience of the past three decades has been one of steady dismantling of regulated labour markets and the shifting of risk from institutions back onto individuals. It is a reversal of the post-war vision of social democratic welfare states, in which a managed form of capitalism co-existed with a decent society, resulting in a more productive and secure economy. This was a virtuous circle, in which centre-left parties and trade unions, as guardians of an effective social compact, won the allegiance of workers and citizens. State policies were complementary.

For example, the plan of the two wartime Beveridge reports envisioned a comprehensive system of social protections to protect workers from disruptions in their working life, as well as a policy of full employment to ensure that every able worker could find a job and that workers would enjoy the fruits of their productivity. The Bretton Woods accord sought to create a global financial system biased towards full employment policies domestically, insulated from the deflationary drag of private speculative finance.

Meanwhile, many Third World countries have been enjoying rapid growth, on average, but of an unbalanced kind that increases income inequalities and denies both basic civic and labour rights to ordinary citizens. The growth is to be welcomed; the inequality and injustices are not. Although the reversal process began in the United States with an assault on unions and the welfare state beginning in the 1970s, closely followed by the policies of Thatcherite Britain, most of the OECD nations have experienced variations on the same theme. The mechanisms include efforts by industry to limit the proportion of workers covered by either regular labour contracts enforced by the state or by collective bargaining agreements; a shift to 'casualised' labour in the form of outsourcing, temporary and short-term contract workers, as well as use of the gray economy; a variety of strategies to weaken trade unions as social partners; and a reduction in the efficacy of other social protections that maintain labour bargaining power, such as unemployment benefits.

The consequence has been an increase in inequality and insecurity. This weakening of standard labour protections has occurred against a background of rising rates of unemployment and increased globalisation of commerce, not accompanied by globalisation of social standards. To some extent, the Nordic nations have been insulated from the worst of these trends because of the strong tradition of unions as social partners. But even in Scandinavia, income inequality has been increasing, unions have been on the defensive and social protections have been weakened. Multinational corporations, in several recent legal cases brought before the European Court of Justice, have been able to exploit the primacy in EU law in favour of free movement of persons, goods and capital to weaken Scandinavian collective bargaining.

If a trend is occurring nearly everywhere, there must be a common set of causes. In this case, the weakening of social protections for workers reflects an increase in the relative power of global capital, a weakening of the nation state that has been the traditional venue for the regulation of capital and a concomitant weakening of the power of democratic citizenship and trade unionism as countervailing forces. This has been most pronounced in the United States, where social protections never reached European levels, but other nations are following this path because of a common weakening of democratic counterweights and an increase in the power of capital to play off states and workers alike.

In many nations the response of trade unions has necessarily been defensive. Core workers protected by unions or by long-term employment contracts have been able to maintain many of their traditional benefits, but younger workers, women, part-time workers and immigrants have not enjoyed the same protections. This society of 'insiders and outsiders', as some have termed it, is not sustainable for progressivism in the long term, either politically or economically, because it is destructive of the social solidarity on which the labour movement depends. A labour movement built mainly on government employees and factory workers will become a minority movement.

The labour movement, like the rest of the progressive community, is caught in a vicious circle. This has both a political and a labour dimension. Politically, in many of our countries, nominally centre-left parties have embraced centre-right programmes of financial deregulation and labour market liberalisation. When a severe financial collapse appeared to have discredited the model of neoliberalism, however, voters did not turn to left-wing parties because so many of them had been complicit in the very policies that led to the collapse. That is why there is a need for a robust opposition economics programme, more progressive than that of many of the parties with which we are nominally allied.

Moreover, the less the labour movement and the welfare state are able to deliver, the more tempting it is for citizens to conclude that they might as well take their chances with the market and vote for parties that promise tax cuts, reduce public services and let the devil take the hindmost. The radical individualism preached by neoliberal parties and dogmas becomes internalised in the outlook of the citizenry.

Therefore, both for the sake of social justice and for its own survival, the labour movement and its progressive allies need a broader blueprint to restore fair and inclusive terms of employment, as well as a practical political strategy to make them a reality. Even the use of the phrase 'labour market', although modern-sounding, is somewhat self-defeating, for labour is more than a market and a long-standing goal of the labour movement has been to 'take wages out of competition' and to compel industry to compete on the basis of efficiency and productivity, not on the basis of compelling employees to work for the lowest market-clearing wage. If labour is just another market, we are in big trouble. It is a mark of the hegemony of the neoliberal paradigm that even trade unions speak of labour markets when they mean labour rights.

Some strategies

Our task is both intellectual and political. It is not difficult to design manifestoes. The challenge is to win over public opinion and to persuade our political allies that these policies are sound and necessary politics, as well as good economics.

Full employment and social investment

Restoring full employment has to be at the heart of a just system of working life. With full employment, workers have more bargaining power and the state does not spend scarce resources paying for idleness. Full employment ordinarily goes together with decent rates of economic growth, which make it politically easier to spend public money on social benefits. The vicious circle becomes a virtuous one.

As it happens, the current depression cries out for a serious programme of public investment. Technically, we are out of the recession, in the sense that GDP growth has turned positive. But it is possible to be out of recession and in a depression. The economic situation is reminiscent of the 1930s, when the aftermath of a financial collapse created a prolonged period of equilibrium well below full production or full employment. High unemployment, reduced consumer purchasing power, traumatised banks and business reluctance to invest all fed on each other, as they are doing today.

Some nations, such as Germany, have managed to reduce unemployment rates, thanks to very strong export economies and a deliberate policy of wage restraint for the sake of global competitiveness. But by definition, all nations cannot run a trade surplus. And as China becomes a more powerful force, its entire economic strategy is based on extremely low wages relative to worker productivity, coupled with a structural trade surplus whose reciprocal is trade deficits for many other nations which, in turn, lead to higher unemployment and pressure to reduce wages defensively.

The benefits of a massive public investment programme are multiple. Most of it would be spent domestically. Decent labour standards can be part of the rules. And the investments can make the economy more productive. To achieve this strategy, it is necessary to challenge the currently ascendant view that our economies need nothing so much as a good dose of austerity as a cure for large public deficits and national debts.

Work and life

With full employment, it also becomes easier to adjust working life to the other aspects of life, such as raising children and enjoying a productive and sometimes gradual retirement. A fair and inclusive programme for labour must include ample paid parental leave for both parents; opportunities for paid sabbaticals for retraining; and retirement at a suitable age, often with phased-in reduced working hours. As some workers voluntarily choose to work less than full-time, part-time workers need the same rights as full-time workers. Pension systems need to be re-socialised, so that they are not at the mercy of market forces. Otherwise, workers cannot count on secure incomes in retirement.

Today, some workers are putting in longer hours than they desire, while others cannot find work at all. A rebalancing is overdue. Society would be healthier and the economy more productive.

Decent wages and social income

The economy needs a floor under wage levels so that employment is sufficient to keep a family out of poverty. In some of our countries, this can be achieved by collective bargaining alone; in others, it requires statutory minimum wage regulation. Wage and salary income, nonetheless, needs to be complemented by other forms of social income, such as family allowances, subsidised early childhood education and child care, and comprehensive health coverage.

Active labour market policies and 'flexicurity'

In the period of neoliberal ascendancy, it became fashionable to blame slow growth in Europe on labour market 'rigidities', when in fact most of the causes were macroeconomic. Labour flexibility, in neoliberal terms, means making it easier to fire workers, reduce their benefits, outsource work and so on. The Scandinavian models of active labour market policies, which antedate the debate about rigidities by several decades, demonstrate that it is possible to have highly flexible labour markets while preserving employment security and enhancing productivity and competitiveness. The essence of the model is that workers who lose their jobs qualify for generous benefits while they are trained for other jobs, and that wage differentials among sectors are narrow, so that shifting sectors is more likely to produce an income gain than a loss. The model, however, requires either general full employment or heroic policies of subsidised work to bridge over periods of high joblessness. It also requires close alignment of wage increases with productivity growth. Comprehensive active labour market policies are vastly superior to a fragmented system whose elements include unemployment insurance, retraining programmes, public works jobs, vocational education and regional development policies, but not linked to form a coherent whole.

Strong, outward-looking trade unions

The resurgence of the labour movement will be built on its ability to organise new sectors, as well as to mobilise its traditional members. In some of our countries, the assault on unions is crude and direct, as in the United States and many third-world countries where the basic right to join or organise a union is routinely denied and workers are fired or arrested for attempting to unionise. In other nations, such as Denmark and Sweden, the process is more subtle, using devices such as rolling back the advantages of union-sponsored unemployment insurance plans.

One of the heartening counter-trends of recent years is the building of more robust union internationalism and solidarity, through global union federations and ad hoc collaborations aimed at organising multinational corporations worldwide, so that a given employer is not permitted to enjoy good labour relations in Europe while bashing unions elsewhere.

Fair trade

We now have global markets in capital, goods and labour. For more than a century, trade unions and other progressive movements battled to impose basic standards of decency on employers, often using the power of the democratic state. As commerce has become global, it has outrun the writ of the state. Corporate elites and their intellectual allies have celebrated this trend as a gain for ‘efficiency’, when in reality it is mainly a gain for a more primitive form of capitalism. Our task is to extend the balanced form of capitalism that we painstakingly built, nation by nation, to the global arena. If we fail, it is guaranteed that corporations will play off national labour forces against one another, and that standards and rights will fall everywhere.

Protecting hard won rights is not ‘protectionism’ in the sense of discriminating against imports. Just as we do not accept the goods of slave labour or prison labour as freely traded, democratic countries should not accept on equal terms the goods of societies that deny basic labour rights or that systematically exploit workers. The purpose of this approach is not to find a high-sounding rationale to keep out foreign goods, but to ensure that workers are paid fairly for their labour and then to welcome a world where imports and exports are traded freely. The dogma of liberal trade is used cynically to undermine labour rights everywhere. Fair trade can expand those rights, even as it increases trade.

Conclusion: Back to politics

The alert reader will notice that this program is not very different from other manifestos that progressives have written over the past half century, and that a decent society of this kind actually appeared to be in closer reach half a century ago than it does today.

The pieces of the model described in this chapter fit together logically. And when the model works, it becomes a majority programme. Despite claims about a new post-industrial economy requiring different forms of work organisation, there is nothing about the current state of capitalist production, whether in manufacturing or services, that demands a less egalitarian or less secure model. If anything, the move away from large, stable employers requires an increase in labour rights and protections as rights of citizenship. This recognition is the essence of Nordic success.

We have moved away from a system of labour rights and protections that serves the vast majority only because of a shift in power relations. Globalisation has facilitated that power shift but, as the architects of Bretton Woods might remind us, there is more than one form of globalisation.
Our historic task is to remind the citizenry that a more just economy is not only a possible economy, but one that is equally or more productive, as well as more attractive to most people. If too many of our political leaders have been captured by a small elite and have turned their backs on this model, then our challenge is to mobilise democratic majorities to elect different leaders.

Flexible vs. inclusive labour markets

David Coats

We have seen throughout this volume that the global financial crisis represented the failure of a paradigm. For our purposes, the next question must be whether the labour market policies associated with the finance-driven capitalism of the past twenty years has also been consigned to the dustbin of history. After all, the policy mix of weak employment regulation, low out-of-work benefits subject to job search obligations and time limits, low taxes and enfeebled unions are from the same stable as the efficient markets hypothesis and the belief that economies have a natural tendency to rebalance themselves in the absence of government intervention or the collective bargaining activities of trade unions.

This may be something of a caricature of the orthodoxy, but it is not too far from the truth and, despite the experience of the crisis, many policymakers continue to subscribe to the model. In the United Kingdom, for example, a country that already has one of the least regulated labour markets in the developed world, it is being seriously suggested that increasing the qualifying period for unfair dismissal protection from one year to two years will lead to rapid job creation. And this is despite the fact that such policies were implemented in the 1980s with no discernable impact on employment. The economist John Quiggin has suggested that pre-crisis thinking continues to exercise a strong hold on policymakers (Quiggin 2010). In his view, ideas which should really have died as a result of the crisis continue to influence decisions today. For example, the notion that minimum wages are bad for employment growth helps to explain why minimum wage reductions have been included in the austerity package in the Republic of Ireland, even though there is ample evidence to show that sensibly fixed minimum wages have no adverse impact on jobs and minimum wage cuts do not lead to a reduction in unemployment.[20] The purpose of this section is to demonstrate how we can move beyond the 'zombie economics' that continues to shape labour market policy in many countries, both within the OECD and beyond.

The OECD Jobs Study 1994

The best formal presentation of the orthodox approach to labour market policy is to be found in the OECD Jobs Study, published in 1994 (OECD 1994). This offered not just a prescription for job growth but a comprehensive approach to macroeconomic management. Although one might have expected a straightforward pro-market approach, the reality was slightly more complicated. For example, the OECD endorsed the notion of counter-cyclical fiscal policy and supported the essentially Keynesian idea that rising budget deficits in slumps should be offset by budget surpluses in booms. Similarly, some attention was paid to insights from endogenous growth theory, with a focus on investment in research and development, the diffusion of new technologies, the protection of intellectual property rights and continual skills upgrading. It was also suggested that a wider range of working patterns should be available to foster freely chosen part-time work and the inclusion of older workers in the labour market through a phased process of retirement. To that extent there were some elements of the policy menu that progressives would find little difficulty in supporting.

On the other hand, the recommendations with a specific labour market focus were rather more problematic. For example, it was suggested that minimum wages should be indexed to prices rather than earnings and that there should be variations by age and by region. Sectoral collective bargaining was said to be inflexible – a process of decentralisation should take place. And while employment protection legislation could not be dispensed with entirely, it was argued that it should be relatively easy to dismiss workers for economic reasons and that protection of permanent employment should be light, particularly in the early stages of an employment relationship. Active labour market policies were endorsed but it was suggested that unemployment compensation should

20. See, for example, Card and Krueger (1995) and the regular reports of the UK's Low Pay Commission, available at: www.lowpay.gov.uk.

be set below market levels to maintain incentives to seek paid employment. Benefit durations should be limited and there should be a much higher level of conditionality focused on the obligation to look for work.

The labour markets closest to the OECD's prescriptions were said to be the USA and the UK. But it was by no means clear at the time that these labour markets enjoyed long-term superior performance to other models, an uncomfortable fact that required some revision of the orthodoxy a decade later.

The OECD's Review and other critiques of the Jobs Study

We will deal with the Jobs Study review in a moment, but first perhaps it would be useful to record some of the other critiques of the orthodox prescriptions to prepare for that discussion. John Schmitt and Jonathan Wadsworth offered a fairly devastating analysis in 2005, demonstrating that the central predictions of the OECD's model were not borne out by the experience of either the UK or the USA in the 1990s (Schmitt and Wadsworth 2005). At the heart of the conventional argument is the belief that labour market flexibility should be associated with higher employment, lower unemployment and the successful integration of traditionally marginalised workers, including young workers and those with lower levels of formal education. The rationale for this argument is that flexible labour markets lower the relative costs of less highly skilled workers, pricing them back into jobs. Of course, the corollary is that if these effects cannot be detected then 'flexibility' is not delivering the results predicted by the theory. Schmitt and Wadsworth report the following findings:

– *Youth unemployment*: Over the course of the decade youth unemployment in the USA and UK was solidly in the middle of the OECD range. More interventionist countries (the Netherlands, Austria and Denmark) had lower youth unemployment rates.
– *The less educated*: Again, the USA and the UK sat in the middle of the OECD range. Seven countries had better performance than the USA and all had less flexible labour markets. The least educated workers were better off in Germany, Sweden, Switzerland, Japan and Portugal than they were in the USA. If anything, the data suggested that flexibility was associated with worse rather than better outcomes for these groups.

– *Regional unemployment*: A flexible labour market ought to equalise unemployment rates across regions. Over the period under review neither the USA nor the UK had a narrower distribution of regional unemployment than other comparable countries.
– *Long-term unemployment*: There was some support for the flexibility thesis here because the USA had the second lowest level of long-term unemployment and the UK was in the middle of the rankings. But a number of OECD economies did better than the UK, including Austria, Denmark, Norway and Sweden, all of which had less flexible labour markets on the OECD's definition.

An obvious criticism is that the less flexible countries with better performance were all small and therefore might be viewed as atypical. But Schmitt and Wadsworth advance the counter-argument that across the full range of measures the UK's performance was no better than those of France and Germany:

> Greater OECD style flexibility in the UK ... does not seem to have produced better relative outcomes for marginalised workers there than France and Germany achieved with their apparently more rigid labour markets. (Schmitt and Wadsworth 2005: 177)

And what of the argument that excessive regulation is the explanation for higher unemployment? Ronald Schettkat, in his comprehensive review of Dutch and German labour market performance, noted that, on the OECD's analysis, the Netherlands should have had consistently higher unemployment than Germany from the middle 1990s onwards simply because dismissal rules were stricter and benefits more generous (Schettkat 2005). Once again, this central prediction was confounded by the data – Dutch unemployment was consistently lower than German unemployment. The flexibility story had been found wanting on this dimension, too.

Allard and Lindert offered an altogether more orthodox assessment, endorsing the view that strong employment protection legislation increases unemployment and that active labour market policies have only a limited impact on the job prospects of the unemployed unless they are combined with other policies (see Thomas Carlen's contribution to this chapter on how a series of interlocking institutions make the Nordic model effective on this dimension) (Allard and Lindert 2004). Nonetheless, they also observed that corporatist wage bargaining can preserve jobs and reduce unemployment, whereas the OECD would, on their 1994 view, have seen such arrangements as an inflexibility.

As Rory O'Farrell and Andrew Jackson point out later in this chapter, the adoption of the OECD's 1994 prescriptions seems to have been associated with growing inequality. Indeed, the efforts of German governments to make their labour market more flexible confirm that this is the case. Structural change adversely affected wage growth at the bottom of the distribution and, while those workers covered by collective agreements fared reasonably, those on the periphery of the labour market did much worse (Dustmann et al. 2009). As a result Germany, hitherto a fairly egalitarian country, witnessed an increase in inequality comparable to that experienced in Anglo-Saxon countries in the 1980s (OECD 2008). Moreover, the Nordic experience demonstrated that a strongly redistributive welfare state, combined with effective trade unions, could deliver high employment and only a modest increase in wage inequality after taxes and transfers. Experience had demonstrated that there was more than one route to economic success and it could be combined with social justice.

When the OECD came to undertake their review of the Jobs Study in 2004 they could not ignore these rather uncomfortable facts that challenged the orthodoxy. Nonetheless, while some effort was made to accommodate these other successful experiences, the core of the earlier analysis was modified rather than abandoned (OECD 2006).[21] For example, it was accepted that high benefits were compatible with strong employment performance if the generosity of the state was matched with strong job search obligations on the unemployed. The analysis of the role of collective bargaining was also more nuanced, with coordination being emphasised as a necessary ingredient of flexibility. At least some progress was being made but there did seem to be a disconnection between the acceptance that countries pursuing unorthodox policies could be successful and a continued emphasis on labour market deregulation. Moreover, by giving equal weight to the success of the Anglo-Saxon and the Nordic model rather less attention was paid to the very different distributional outcomes. If, returning to the theme described in Chapter 1, growth has to be for something rather than an end in itself then equity

21. For a critical evaluation see Watt (2006b).

considerations cannot be ignored. Expressed bluntly, there can be little doubt that the poor in those countries pursuing 'unorthodox' policies have rather better life chances than the poor in either the USA or the UK.

Policies for an inclusive labour market

Perhaps the real importance of the Jobs Study review was the explicit (although grudging) recognition that more than one bundle of policies was consistent with good employment performance. Moreover, even though the general approach still emphasises the benefits of labour market deregulation, the simple recognition of other successful approaches opens up space for the discussion of alternative models. This is especially urgent in the post-crisis period if a return to the failed policies of the past is to be avoided.

What is needed more than anything else is a focus on the quality as well as the quantity of employment (Leschke and Watt 2008; Parent-Thirion et al. 2007). Decent work is more likely to be sustainable work. Jobs that offer development, progression and rising incomes are much more likely to break the low pay–no pay cycle in which many workers find themselves trapped. If policymakers are looking for an analytical lens that might help in constructing a new labour market model they could do worse than embrace the notion that the employment regime in its totality influences both the quantity and quality of employment (Gallie 2007). For these purposes the elements of an employment regime can be described as follows:

– the initial skills formation system;
– continuing vocational training;
– the balance of power between capital and labour;
– work integration policies – what happens in the workplace to minimise differences between groups of workers;
– employment integration policies – the instruments used to sustain a high employment rate and encourage the unemployed back into the labour market.

In his exhaustive study of employment regimes Duncan Gallie distinguishes between the Nordic (or inclusive), corporatist and liberal market models. He notes that job quality in the former is much higher than in either of the latter and that this is explained largely by how each element of the employment regime relates to the others. For example, in a liberal market economy such as the UK initial skills formation is more focused on general education. Most training takes place after labour market entry and employers offer rather narrow, job-specific programmes. In Germany, skills formation often happens before labour market entry and the culture of lifelong learning is not especially well developed. In Sweden, however, the training system gives people vocational skills and a sense of occupational identity before they enter the labour market and there is a strong culture of lifelong learning.

The inclusive model is characterised by strong trade unions, whose authority is not in question and who give equal priority to job quality and rising incomes. Because unions are strong both employers and policy-makers seem to give a higher priority to the quality of work as part of a wider discussion about the quality of life. In the corporatist model, unions are not as strong but are sustained by strong institutional guarantees of workplace representation. Unions may not lack all influence, but they are less able, perhaps, to shape either employer or government policies. And in the liberal market model, unions are both weak and conspicuous by their absence in the private sector.

The inclusive model is characterised by a strong commitment to equality (see Thomas Carlen's description of the Nordic model later in this chapter), minimising differences between workers and avoiding the creation of a two-tier labour market, with a secure core and an insecure periphery. The corporatist model offers protection to labour market insiders but leaves outsiders in a weak position. And in the liberal market model the imbalance of power between workers and their employer means that inequalities are compounded by unconstrained market outcomes.

So far as employment integration policies are concerned, in the inclusive model the combination of generous benefits and active job search, along with the provision of high quality training, helps to get people back into sustainable jobs. Corporatist models offer more generous benefits than the liberal market approach, but are less effective in implementing coherent activation policies. And the liberal market approach itself is characterised by less than generous benefits, time limits and the implementation of sanctions.

The value of this approach is that it can explain why the Nordic countries do so well and why, somewhat surprisingly, the labour market in

Germany looks more like the labour market in the UK than the labour market in Sweden. Of course, it is absurd to suggest that policies and institutions can simply be transplanted from one country to another, but the employment regimes story does enable us to develop a comprehensive approach to training, employment relations, collective bargaining, employment policy and the reform of the welfare state. The EU has developed the open method of coordination as a form of peer review and learning from best practice.[22] There is much to be said for this as an alternative to the 'one size fits all' solutions advocated in the past by the OECD. Moreover, it encourages policymakers to learn from each other and consider how successful policies in one country might be modified or adapted to meet the unique circumstances of another. And it is focused on the clear objective of both full and fulfilling employment, consistent with the notion that growth must be for a purpose and that purpose must be to expand the capabilities of all citizens to choose lives that they value.

22. And the OECD might be said to be an organisation that has adopted peer review as a foundational principle. The organisational mission is to enable member countries to learn from each other.

Narrowing income inequality

Andrew Jackson and Rory O'Farrell

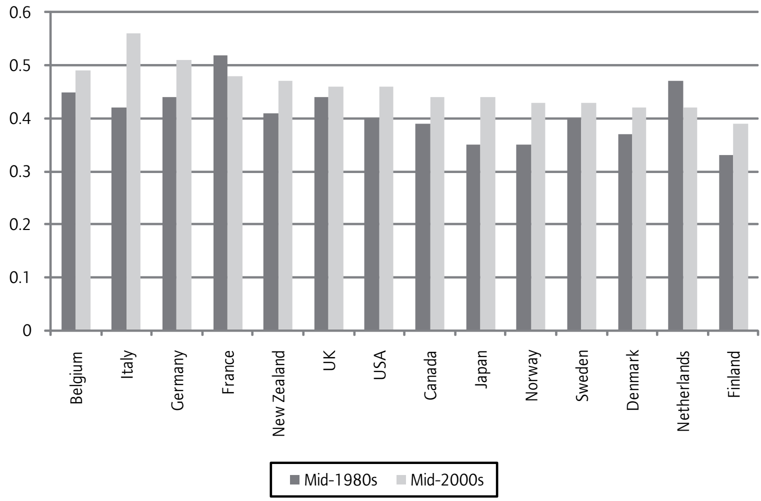
We noted in Chapter 1 that high income inequality is associated with worse life chances and lower life expectancy for those at the bottom of the distribution. Other analysts, such as Richard Wilkinson and Kate Pickett, have gone further and argued that income inequality undermines social trust, increases the rate of imprisonment, leads to poorer educational outcomes and helps to explain the rising tide of obesity in Anglo-Saxon countries in particular (Wilkinson and Pickett 2009).

In Denmark, the poorest 10 per cent earn a fifth of the richest 10 per cent. In the US, the poorest 10 per cent earn 16 times less than the richest 10 per cent (OECD 2008). The period leading up to the economic crisis showed a large increase in inequality. Before accounting for taxes and government transfers, Danish inequality in the mid 2000s was actually higher than the US inequality of the 1980s (Figure 2).

However, governments can and do act to reduce inequality. After accounting for taxes and transfers, inequality has actually decreased in several countries (Figure 3). For the US, inequality in the 2000s *after transfers* was actually higher than 1980s inequality *before transfers*, reflecting a large increase in inequality in the US. However, the Gini coefficient is just one way of measuring inequality. How has inequality changed using other measures?

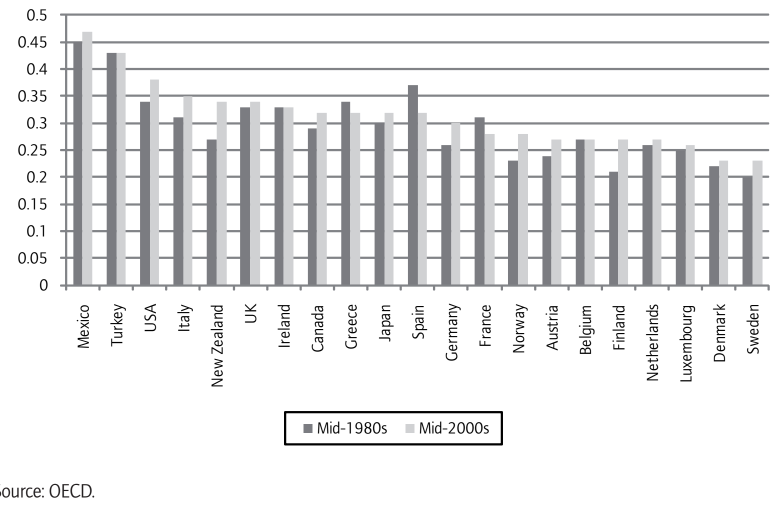
The wage structure in the US has been studied more closely than those of other countries. For this reason, and as the OECD's largest economy, the US serves as a useful benchmark for comparing trends in inequality across the OECD. Autor et al. examined US wage inequality and found that inequality increased during the 1980s but overall wage inequality actually *decreased* during the 1990s (Autor 2003). From the 1980s there was a steady increase in wage inequality at the top of the wage distribu-

Figure 2 **Gini coefficient, before tax and transfers**



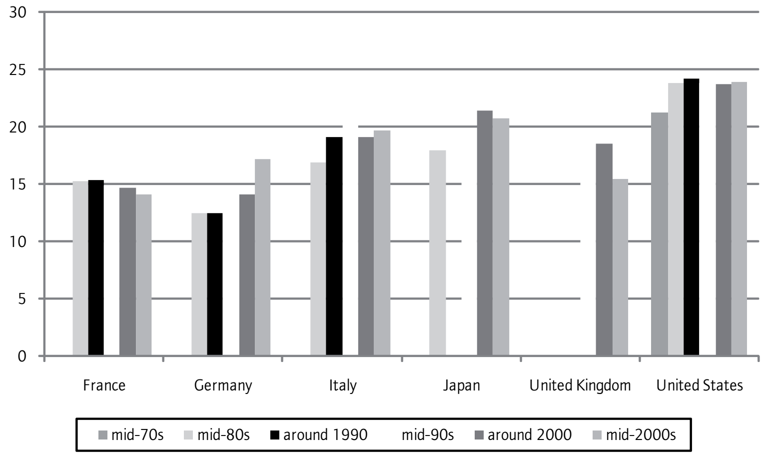
Source: OECD.

Figure 3 **Gini coefficient, after tax and transfers**



Source: OECD.

Figure 4 **Proportion of population in households with less than 60% of median income**



Source: OECD.

tion (the rich continued to get richer), and this pattern continued into the 1990s. During the 1980s, there was also increasing inequality at the bottom of the wage distribution, however during the 1990s there was greater equality at the bottom of the distribution: that is, low incomes and median incomes began to converge (Figure 4). This is why the 1990s showed greater overall wage equality.

Although not universal, the pattern of increasing inequality at the top of the wage distribution, and stable inequality at the bottom, is common across countries. Such a pattern has been found for Portugal, Denmark, the UK, Italy, Greece and Belgium.[23] For Sweden the wage compression that occurred during the 1960s and 1970s was reversed by the 1990s (Oyer 2008), but in Norway (Hunnes et al. 2008) and Finland (Uusitalo and Vartiainen 2008) the wage distribution was stable. The most striking difference with the US, however, is shown by Germany. In Germany,

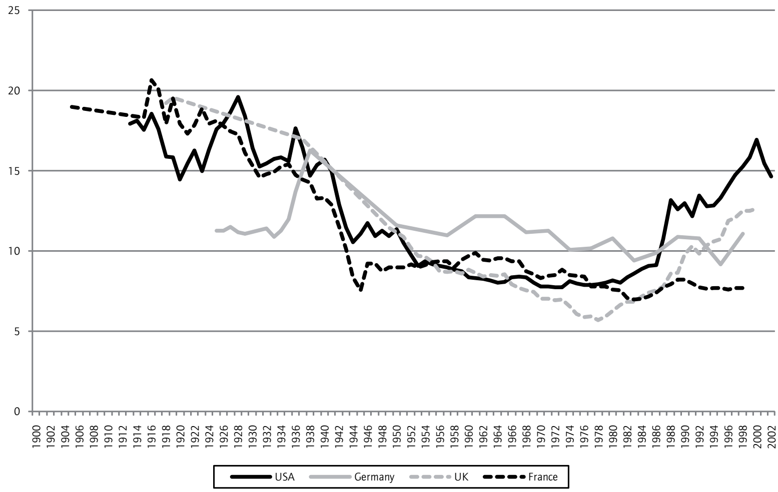
23. Machado and Mata (2005) (Portugal); Eriksson and Westergaard-Nielsen (2008) (Denmark); Goos and Manning (2007) (UK); Contini, Leombruni, Pacelli and Villosio (2008) (Italy); and Christopoulou, Jimeno and Lamo (2010) (Greece and Belgium).

wage inequality increased at the top of the wage distribution during the 1980s and 1990s, but also increased at the bottom during the 1990s (Dustmann, Ludsteck and Schonberg 2009). This pattern in inequality at the bottom of the distribution is the opposite of what happened in the US. Although increasing inequality at the top of the wage distribution is common to most countries, it is important to note that the magnitude and timing of such changes has varied greatly.

There are two main problems with the above income studies, which rely on survey data. One is that most of these surveys only began in the 1970s, limiting comparability with data before this time. The other problem is 'top-coding' or censoring of data for those with the highest wages. This problem can be overcome through the use of administrative data (such as for tax collection). Using such data, Piketty and Saez (2003) show that after the Second World War, the *income* share of the top 10 per cent of earners in the US remained stable at 30 per cent until the 1970s, before starting their upward trend. Interestingly, wage income has become more important than *capital* income for top earners (in 1916, 0.01 per cent of earners received only 5.6 per cent of their income from wages, but by 1998 this was 44.8 per cent). Also, post-war *wealth* inequality in the US has remained stable. Looking at top wage shares for 20 countries,[24] Piketty (2005) finds that top *capital* income shares were hit by major shocks between 1914 and 1945, and were largely unable to recover after the Second World War, due to estate and inheritance taxes. Top *income* shares have remained stable in Continental Europe, but returned to interwar levels in the US, with the UK and other Anglo-Saxon countries somewhere in between (Figure 5). However, the increased importance of wages in top income shares appears to be a US phenomenon. Evidence from Sweden (Roine and Waldenstrom 2008) shows that the treatment of capital gains which stem from compensation (for example, stock options for CEOs) affects the relative importance of capital and wage income for top income earners, and this could explain the importance of wage income and why the US has a higher labour share of income (Figure 6). Also, although inequality decreased after the Second World War in countries such as France due to declines in capital income for top income earners (Piketty 2003), capital's share of income has in-

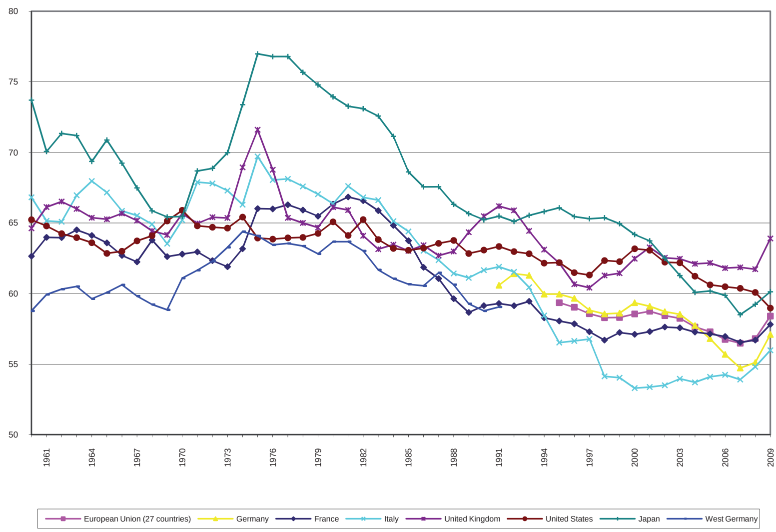
24. Countries reported on are Argentina, Australia, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, India, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the UK and the US.

Figure 5 **Income shares of 1%**



Source: Atkinson and Piketty (2007).

Figure 6 **Labour share of income**



Source: AMECO.

creased, showing the importance of wealth concentration in determining concentration of capital income.

Although the US is considered a less equal society than European societies, this is not necessarily true for all measures of inequality. Dell points out that, after the Second World War, German top incomes were more concentrated within the top decile than other industrial countries (unlike in the US, in Germany top income shares quickly returned to pre-Second World War levels), so the German super-rich were richer than the US super-rich until the 1990s (Dell 2005). This is explained by the relatively low inheritance tax in Germany in comparison to other countries.

Goos and Manning suggest that there has been a polarisation of the workforce, with a hollowing out of middle-paid jobs (Goos and Manning 2007). This is suggested as the reason why wages for top earners have increased, but those on bottom and middle incomes have converged. This could be due to computerisation eliminating middle paying jobs of those who perform routine tasks, such as clerical work (Autor et al. 2003). Goos et al. studied 16 European countries and found for all countries, apart from Portugal, that middle paying jobs have shown the largest decreases in employment (Goos, Manning and Salomons 2009). This was also found for Germany by Spitz-Oener (2006) and for the UK by Goos and Manning. However, the polarisation hypothesis of Goos and Manning also suggests increased demand and so higher wages for those doing low paid jobs, but no evidence of this is found. Lemieux finds evidence in favour of polarisation for the US (Lemieux 2006).

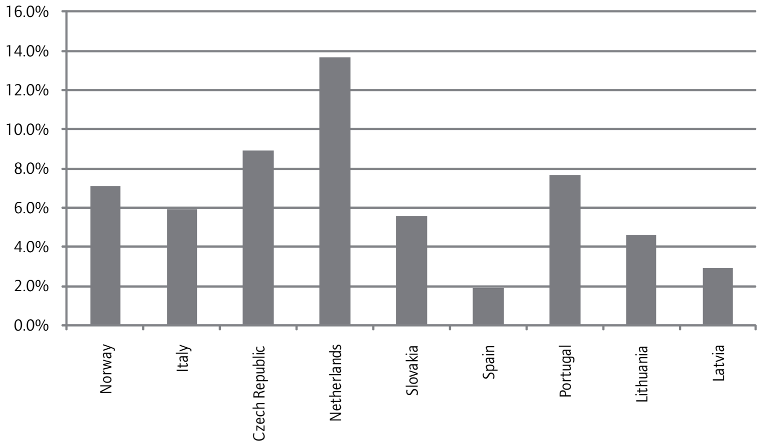
The dominant explanation for rising inequality is skill biased technical change (SBTC). This occurs as new technologies, such as computers, improve the productivity of highly skilled workers, but not that of the lesser skilled. Although early versions of the theory predicted that SBTC would increase inequality throughout the wage distribution, the refined SBTC hypothesis of Autor et al. – that computerisation reduces demand for workers performing routine tasks – predicts increasing inequality at the top of the wage distribution, but makes no predictions about the bottom of the distribution. A consensus is emerging that institutional factors, such as the minimum wage and unionisation, caused changes in inequality in the bottom of the US wage distribution. Also, cross-country differences in top income shares (those of the top 10 per cent) lead Piketty and Saez to conclude that SBTC is an unlikely explanation for top wage growth in the US, as most developed countries have had access to the same technology as the US (Piketty and Saez 2003). This leaves SBTC as a candidate for changes in inequality between the 50th and 90th percentile. However, the data do present some puzzles for the refined SBTC hypothesis. Even before the refined hypothesis was published, Card and DiNardo presented US evidence that the mean salary offer for recent graduates with ‘high tech’ degrees (such as engineering) actually declined relative to that of social science graduates (Card and DiNardo 2002). Also, Lemieux finds that incomes rose for those in high skilled jobs, with one crucial exception. Workers in jobs most closely associated with the computer revolution, such as computer programmers, suffered negative relative wage changes, despite a tripling of the number of those employed as computer programmers. Finally, countries such as Finland, which are technologically advanced, have not shown an increase in inequality.

Difference of supply of skilled workers can also explain a proportion of the rise in inequality. In the US there was an increase in educational attainment for those age groups born up to the early 1950s (those who would have reached college age during the Vietnam War), followed by stagnation (Card and Lemieux 2001). If technical change was occurring at a constant rate, then the slowing of educational attainment could explain increases for the highly educated. However, Simón (2010) shows that differences in education can explain as little as 2 per cent of within-country inequality (Figure 7). This is probably an overestimate since those with greater innate ability are also more likely to pursue higher education.

Decomposing changes in Germany, Dustmann et al. find that changes in the composition of the workforce explains only up to 50 per cent of the rise in inequality for the top half of the wage distribution and 15 per cent for the bottom half (Simón 2010). In comparison, deunionisation explains 28 per cent of the rise in inequality at the bottom of the wage distribution, but only 11 per cent at the top.

What, then, should be done? An obvious conclusion is that full employment matters more than anything else. High employment and low unemployment in decent and secure jobs at relatively equal hourly wages is the best route to greater equality (Pontusson 2005; Freeman 2007). Policies in the form of legislated minimum employment standards, such as exist in the European Union, are needed to ensure that part-time work

Figure 7 **Percentage of inequality explained by differences in education**



Source: Simón (2010).

and temporary work are the result of a worker choice for time flexibility as opposed to an employer low wage strategy. Basic employment standards as set out in ILO conventions and standards must be made effective by systematic monitoring and reporting on compliance.

Increasing union density has a 'sword of justice' effect and is especially important for those in the middle of the income distribution. High union density compresses pay gaps based on skills and education, and narrows differentials based on age, gender and race, which can and do arise from discrimination (Aidt and Tzannatos 2003; Freeman 1998 and 2007).[25] As conceded in the revised OECD *Jobs Study*, these equalizing impacts of unions on earnings do not come at the price of jobs or economic performance, at least when accompanied by complementary active labour market and macroeconomic policies (Auer 2000; Baker, Glyn, Howell and Schmitt 2002; OECD, Employment Outlook 2006; Freeman 2007).

Even in countries with high levels of collective bargaining, there will be a need to narrow income gaps through a progressive system of taxes and

25. See also OECD Employment Outlook 2006, 59–108.

income transfers, operating mainly at the level of the household rather than of individual income. Both the transfer and tax side are important to achieving greater equality, although the evidence suggests that the greatest impact comes from a high level of equalizing transfers in relation to GDP, even if this is paid for through a relatively flat or non-progressive tax system (Smeeding 2002; Pontusson 2005). Growing pay gaps between the middle and the very top of the earnings spectrum in many countries can be countered by setting norms through legislation, such as limits on the amount of compensation which can be offset for corporate tax purposes, and limits on options payouts. However, progressive tax measures are likely to be more effective.

Increasing the supply of skilled workers can help to reduce the skilled wage premium. This can be achieved by investing in education. Improving equality of opportunity by means of government funded education can also improve equality of outcome, by reducing wage premia. The incidence of low paid work can also be countered effectively by training and active labour market policies to raise skills and by shifting some usually low paid jobs (such as caring jobs, mainly held by women) from the private to the public sector. Employers can also be encouraged to pursue competitive strategies based on productivity-enhancing investments in skills as opposed to low wages (Westergaard-Neilson 2008; Auer 2000). It should be noted that a high wage floor set by collective bargaining or statutory minimum wages will itself push employers to adopt productivity-enhancing strategies.

The most important income transfers among the working-age population are unemployment benefits which should maintain incomes at decent levels during periods of involuntary unemployment and active job search or training; universal as well as household income-based transfers to low income families, especially those with children; and adequate income support for persons with disabilities and others who are unable to access decent employment on a regular basis. High equality countries have relatively generous systems of income transfers, although the overall cost of transfers to working-age households may not be high if unemployment is low and the incidence of decent work is high. The evidence shows that generous unemployment benefits do not create work disincentives when twinned with active labour market policies.[26]

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26. OECD Employment Outlook 2006; Baker et al. (2002).

The rise of precarious work[27]

Jim Baker

Introduction

The 1980s marked the beginning of the end of the post-War consensus that sought to combine social and economic progress. In that decade began a monumental change in the global economy, along with the refashioning of the global trade and investment regime to accommodate the expanded reach and mobility of capital; something that became known as 'financialisation'. The impact on non-financial corporations was a growing trend to divert productive investment, previously financed out of retained profits, into share buybacks and dividends ('shareholder value'). Non-financial corporations henceforth competed not only in product markets, but also in financial markets. And they were under pressure to 'deliver' equivalent returns to those found in those markets.

In addition to relocation to low-wage countries, there were two ways to achieve this pressure for increased returns: either increased leverage or increased outsourcing and a growing reliance on precarious work. This phenomenon mirrors the perceptible, documented reduction in productive investment relative to cash flow. Analysts persistently called on non-financial companies to reduce both capital investment and payroll, or face the consequences.

As part of that shift in the economy and in order to accommodate or facilitate global economic integration, there was pressure to establish 'flex-

27. The contents of this section come largely from the discussions and exchanges in the Work Relationships Group (WRG) of CGU. The members of the WRG reviewed the draft. This chapter incorporates specific suggestions from Peter Rossman (IUF), Jenny Holdcroft (IMF), Fons Vannieuwenhuyse (ICEM) and Dwight Justice (ITUC).

ible labour markets' that would quickly adapt to global economic and employment shifts. Where policymakers responded to these pressures from employers, reinforced by the IMF, the World Bank and the OECD, labour markets began to revert to being markets just like any other, as they had been many generations before. Security of employment diminished, as did ties between workers and their enterprises.
The move to 'flexibility' often came in the form of the avoidance of regular employment relationships and the obligations that national labour law imposed on the employers of regular employees. The means by which this was done included the use of other enterprises through the contracting out of 'non-core' activities and the use of temporary work agencies or other forms of labour intermediaries. These commercial relationships spawned the increased use of what were considered 'atypical' work relationships, such as temporary work, causal labour, part-time work and 'contract manufacturing' (where no workers have permanent jobs). Not all of these relationships under which work was performed take place within a legal framework: some intermediaries are not legitimate enterprises and employers resort to disguising what the law would recognise as an employment relationship by treating the workers as self-employed. The relationships under which work was performed were becoming more varied but, whatever the form, these relationships were increasingly precarious.

It is difficult to come by reliable global figures, in part because 'precarious work' covers so many areas that it can be measured by its parts better than as a whole, but also because, in much of the world, statistics in this area are not gathered or are not viable. The International Chemical, Energy, and Mine Workers, as well as the International Metalworkers' Federation, conducted surveys – the first published in 2007 and the second in 2009 – of their affiliates on contract and agency labour (ICEM) and precarious work (IMF). Results showed a significant growth of such work, as well as a number of specific concerns. It is significant that both the IMF and the ICEM received unusually high response rates and that the perception of an increase in contract and agency labour and precarious work was clear across all continents. Around 90 per cent of respondents indicated that CAL or precarious work had increased over the previous five years.[28]

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28. A copy of the summary of the report can be found at: http://cal.icem.org/images/documents/CALoverviewofresultssurvey.pdf

A report published in May 2010 by Hartmut Seifert, and supported by the Japan Institute for Labour Policy and Training, compared the growth of 'atypical' work in Japan and Germany. That trend, based on official, government figures, is illustrated by Figures 8 and 9:

Figure 8 **Trends in atypical employment in Japan and Germany, 1991–2007 (%)**

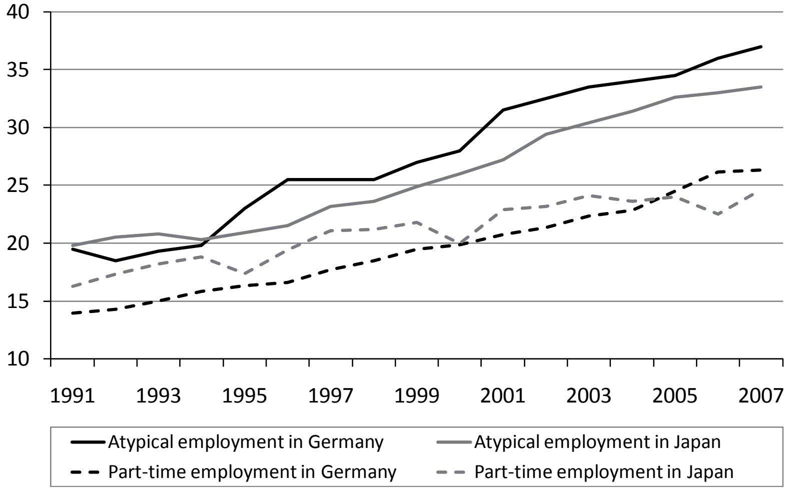
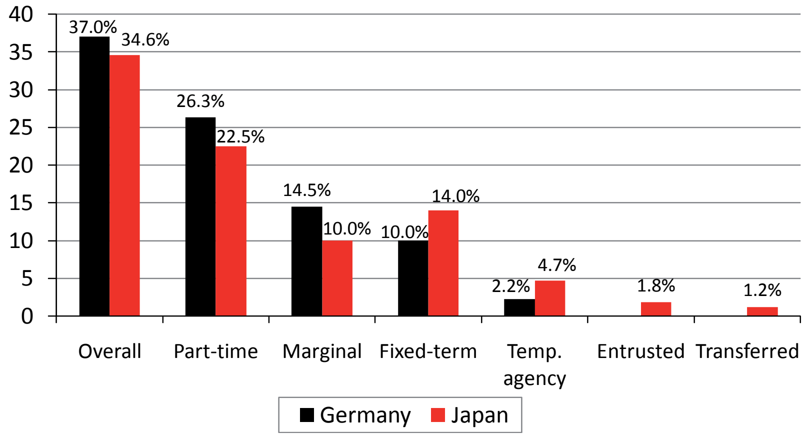


Figure 9 **Atypical employment in Japan and Germany, 2007 (%)**



Precarious work and the crisis

Against this background of growing insecurity of employment, deterioration of the labour market and various forms of precarious work, the crisis struck. During its initial stages, employment was reduced rapidly and such changes were often made with very little cost to employers. They did not have to negotiate social plans with trade unions and/or governments for many temporary workers, particularly those supplied by agencies with a 'triangular' employment relationship. Employing workers became a commercial transaction and one that was often more easily and cheaply terminated than contracts for goods and services. This undoubtedly accelerated and contributed to the fall in employment in the crisis. Opportunities for migrant workers, often performing work on a precarious and unprotected basis, were greatly affected.

Precarious work and recovery

Prior to the crisis, precarious work in the form of temporary work and indirect employment gave companies possibilities for cheap and relatively painless (for them) 'adjustment'. During the crisis, many of the initial layoffs were temporary workers whose status made them relatively costless and easy to dismiss.

There is a serious danger and already indications that a 'recovered' economy will feature more, rather than less, precarious work. The uncertainty of the recovery may make even more tempting the engagement of 'disposable workers', just in case there is another downturn.

One of the reasons why the recovery has not yet come is the continued reduction in investment, even as profits have returned to pre-crisis levels for many companies. The companies are sitting on piles of cash, and using low and even negative interest rates to boost dividends.

Before, during and presumably after the crisis, many employers have, in effect, shifted the risk from themselves to workers in a whole range of areas. Various forms of precarious contracts or other arrangements reduce obligations and responsibilities for the enterprise and shift them to individual workers who are forced to find their way on their own or, in exceptional cases, with help from the state. In those cases, the costs are shifted to taxpayers and, with the reductions in taxes for higher income categories and corporations in many countries, it means a double sacrifice for working people. It means shifting risks and costs to workers, individually and collectively.

Legal context, rights and social protection

Labour law is based on the underlying notion that a worker and an employer are parties of unequal power. That is the difference between commercial arrangements which are considered to be between equals. The recognition of an employment relationship is the basis for the application of labour law. Labour law, which includes laws protecting wages, working time and health and safety, is the most important way in which society protects working people. The employment relationship also has an important role in terms of the way that most countries provide social protection, such as retirement provisions, medical care and unemployment compensation.

The erosion of the employment relationship and its replacement by other, often triangular relationships, creates imbalances in power and changes attitudes about work and employment. The labour of a human being becomes, in effect, a 'commodity' to be bought and sold on the market. And the instability and insecurity in workers' lives also contributes to the growing instability and volatility of economies.

Job insecurity causes tensions in families and stress on and off the job. Several studies of the health effects of precarious work show large increases in stress-related illnesses, with both psychological and physiological effects. For example, the Centre for Addiction and Mental Health (CAMH) in Toronto, as part of a larger project for the WHO, states that

> there is consistent evidence suggesting that workers who have jobs with high demands, low control and few rewards are at greater risk of developing anxiety disorders, depression or substance abuse. In fact, temporary workers are three to four times more likely to develop some form of mental illness. Work-related stress among this group of workers is also linked with a 50 per cent increased risk of heart disease. Not surprisingly, mortality is also higher among temporary workers compared to permanent workers.

Precarious forms of work can also have very specific effects on rights, in particular the rights to organise and bargain. The legal and institutional framework that underlies collective bargaining and trade union recognition is based, one way or another, on the employment relationship. For instance, if one cannot identify the employer, it is difficult to determine how one might form a union and how bargaining might be conducted. In some countries, whole categories of workers are simply excluded from the rights to organise and bargain. The decisions of the ILO Committee on Freedom of Association on Korea, for example, clearly demonstrate the connection between precarious work and the loss of trade union rights.[29] The government has yet to respond to this decision or subsequent decisions and requests from the ILO.

However, even if workers are direct employees of an enterprise, but with short-term (fixed-term) employment contracts, it is easy for fear to 'crowd out' workers' recognition of their own interests. The threat that another contract may not be forthcoming is bound to concentrate minds and the workers with weak ties to a workplace or enterprise may not feel they will be around long enough to benefit from union organisation.

Workers performing work on a precarious basis may also find themselves ineligible for certain social protections, for example, health care coverage or occupational pensions. Training opportunities may also be limited. Just as a temporary worker is reluctant to 'invest' in the company, the company may be reluctant to invest in the worker.

Not surprisingly, health and safety performance suffers where precarious work becomes prevalent. In part this is a consequence of lack of training, but it also reflects the confusion about roles and responsibilities – particularly the role and responsibility of the employer. Using workers on atypical contracts may reduce immediate labour costs, but productivity may suffer and the social costs (as a result of increased illness and accident rates) may be very high indeed.

Precarious work and society

The crisis has helped to generate an understanding of some developments that considerably pre-date the crisis. In fact, they reveal weaknesses that

29. One of the most significant cases can be found at http://webfusion.ilo.org/public/db/standards/normes/libsynd/index.cfm?hdroff=1.

contributed to the crisis. The abuses, instability and costs of the financial crisis were imposed on societies that were becoming increasingly fragile. Gaps in income had grown rapidly and, for many years, they were largely accepted without becoming serious issues. They were simply the price that allegedly had to be paid for globalisation, which had its good parts and its bad parts. Inequality is on the increase in most countries. This has been established by the OECD in its publication *Growing Unequal,* as well as the ILO study *World of Work Report 2008: Income inequalities in the age of financial globalisation*. Although it is far from the only explanation, precarious work is one of the reasons that income disparities and economic injustice are growing.

Precarious work is also part of that shift in attitudes. It is not just something that generates income and social protection gaps, but also one of the most visible signs of the weakening of the fabric of our societies. It is part of a growing sense of unfairness or injustice. This new fragility and insecurity undermines stability but also democracy and the institutions that are necessary to sustain it. Society has an interest in stable work relationships and in social justice. That is the reason for recognising the specific features of employment relationships and distinguishing them from other commercial relationships.

It is difficult to imagine that the serious economic, social and environmental problems that are facing society can be addressed with weakened institutions, including social institutions such as trade unions and employers' associations, an alienated and atomised workforce and persistent incoherence in thought, policymaking and administration.

An alternative vision

Economic and social policy

- Economic policy needs to focus on full, productive and freely chosen employment. That means the creation of good jobs based on recognised employment relationships. The crisis only underlines what has been a long-standing problem, the lack of good quality jobs.
- Social protection systems should be comprehensive and adequate in order to cushion the blow of employment shifts and reduce the dependence on and effects of precarious work.

- Education and training do not guarantee an end to precarious work, but they help to provide a solid basis for greater security. Quality public services are necessary to deliver social services that work and to address some of the failures of the labour market.
- Policy should be based on tripartite consultation and represent consensus rather than be imposed in the interest of special interests.

Rights and governance

- Governments should make sure that labour law is actually protecting the people that need protection and should update the criteria used to determine the existence of an employment relationship. The ILO Employment Relationship Recommendation 198, adopted in 2006, provides a basis for doing this.
- Many workers slip out of legal protection for reasons of poor governance, including weak labour inspection. As in so many other areas, the protection of law depends on properly functioning governments and quality public services.
- The use of temporary contracts and temporary work agency workers should be limited in time so as to not be excessive.
- Temporary workers should be covered by the collective bargaining agreement of the user enterprise.
- Measures should be taken to ensure that all workers can freely exercise freedom of association and the right to collective bargaining with the real employers, who today often sit at the apex of a pyramid of precarious employment relationships.

International Labour Standards: safeguards for an open world economy

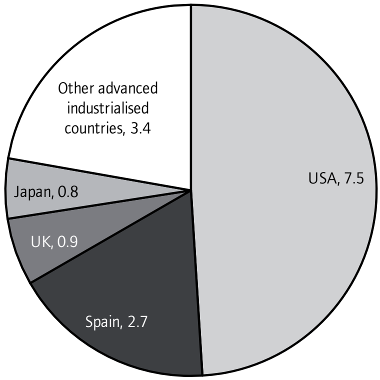
Frank Hoffer

In recent decades, labour markets in many countries have been deregulated and trade union strength has declined. Trade liberalisation and deregulated financial, product and labour markets have created a mutually reinforcing trend towards weaker regulation. Lower labour market protection and increased precarious employment have resulted in a declining wage share and growing inequality. The lack of wage-based aggregate demand that followed from these dysfunctional wage developments translated into massive export surpluses in some countries and debt-financed consumption in others. The crisis has proved both trends to be unsustainable.

The crisis has shown not only that 'employer friendly' labour market regimes are not also employment friendly, but also that they are dangerously pro-cyclical. In the US and Spain, countries with underdeveloped labour market protection and massive precarious employment, respectively, the economic downturn rapidly translated into massive employment and wage losses. These two countries represent two-thirds of all the crisis-related unemployment in the advanced countries.

Well-designed labour legislation has the twofold function of protecting workers against the abuse of market power, hazardous working conditions and arbitrary employers, and of acting as an automatic stabiliser against the volatility of under-regulated labour markets. However, in recent decades there has been a regulatory 'race to the bottom'. Deregulatory 'success' in one country created pressure to emulate it in neighbouring countries. True, not all countries deregulated to the same extent and some countries continued to pursue a high protection/high productivity path, but no country remained unaffected by the general tendency towards lower levels of protection. While individual countries have demonstrated that they retain some regulatory room for manoeuvre, under

Figure 10 **Increases in unemployment in the advanced industrialised countries**



Note: Change in number of unemployed in advanced industrialised countries: 15.3 million.
Source: IMF (2010).

the current globalisation regime all have felt the pressure to reduce labour costs by weakening labour market protections. This demonstrates the need for coordinated action to reverse the overall trend.

During the three decades that prepared the ground for the Great Recession, mainstream opinion in policymaking circles ignored or forgot what was common sense 90 years ago when the ILO was founded. At that time, everyone agreed on two fundamental necessities for a modern market economy: the need to limit the power of private ownership through protective labour legislation at the national level; and the need to coordinate this regulation internationally in order to avoid a race to the bottom. The ILO Constitution captures this thinking in a single sentence:

> The failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries. (Preamble)

In recent decades, multinational companies and financial institutions have undermined the capacity of democratic societies to ensure the sovereignty of the people and the law over the 'logic of the market'. Profit seeking at the expense of the public good becomes an option when irresponsible business practices become possible. Sustainable enterprises based on the principles of collective bargaining, fair wages, non-discrimination, taxation and respect for labour standards are out-competed by those who do not hesitate to employ children, ignore minimum wages, evade taxation, circumvent labour legislation, under-invest in health and safety and environmental protection and abuse the open global economy to demand ever more preferable conditions for investment and externalise as many costs as possible to society.

Universally applicable national labour legislation is necessary to avoid unfair competition. This makes it possible to steer the economy by means of a growth model based on innovation and product competition instead of exploitation. International Labour Standards (ILS) complement and reinforce action at national level. They are based on the understanding that, in a global economy, national regulation must be harmonised and coordinated through an international labour standard setting process. They are safeguards against social dumping and can generate the mutual trust among nations that is a precondition for a stable open economy. Open markets can be maintained only when regulatory arbitrage is limited. If countries strive for export surpluses by keeping wage growth systematically below productivity growth, they either trigger a global downward spiral or force other countries to take protective counter-measures.

In order to avoid such a situation, governments need a mechanism that credibly ensures a regulatory floor applicable in all countries. This does not imply the establishment of absolute common standards, but it does involve a commitment to a similar approach to labour protection in each country. Many labour standards do not entail substantial costs and can be applied in all countries, independently of the level of development; such labour standards include the right to organise, the right to non-discrimination, the right to consultation with workers and employers, the right of workers to refuse to work under hazardous conditions, the right to the safe handling of health threatening chemicals and pesticides and the right of workers' organisations to have access enterprises. Other standards, such as maternity protection, protection against excessive working hours and minimum annual vacations are essential for workers' health and should not be undercut under any circumstances. Moreover, many standards provide for flexibility in recognition of different levels of development. For example, coverage of a limited number of contingencies for a certain percentage of the population is sufficient for ratification of the minimum social security convention.

Use existing tools but make them more efficient and relevant

In 2009, ILO member states identified a set of labour standards for recovery as part of the Global Jobs Pact (GJP). They reiterated the importance of the core labour standards as human rights, but also recognised that, for a regulatory response to the crisis, a much more comprehensive labour standards package was required.

The standards identified in the GJP can be grouped into four areas:

1. *empowering workers* to represent their interests;
2. *economic policy and governance* of the labour market;
3. *protecting* employees in the workplace;
4. *guaranteeing* minimum income levels for wages and social transfers.

Here are some of the key labour standards in each of those groups:

Empowering workers

Full respect of freedom of association and collective bargaining is a basic necessity to enable workers to protect themselves.[30] Denying the fundamental right to organise and bargain collectively constitutes unfair competition. That is why the Social Justice Declaration emphasises that:

> the violation of fundamental principles and rights at work cannot be invoked or otherwise used as a legitimate comparative advantage.

Labour rights become meaningful only if workers cannot be intimidated and if they can organise to access these rights. Therefore, Convention 154 requires of governments that:

> Collective bargaining should be made possible for all employers and all groups of workers ... (and) bodies and procedures for the settlement of la-

30. ILO Conventions 87 and 98.

> bour disputes should be so conceived as to contribute to the promotion of collective bargaining. (Article 5)

However, millions of workers, in particular in SMEs, are often not covered by collective bargaining, and individual bargaining power is minimal in a deep crisis of the kind we are experiencing at present. Collective bargaining needs to be supplemented by an active employment policy and statutory labour market regulation that provide legal protection against employers' arbitrariness.

Employment policy and governance of the labour market

In recent decades, the objective of full employment and raising living standards has largely been abandoned by policymakers. Instead, policy has focused on low inflation, flexibilisation and the liberalisation of capital, goods and labour markets. The underlying assumption has been that shifting policies from 'outcomes for people' towards the creation of efficient institutions would ultimately produce better results. This has proven wrong and costly. Convention 122 calls upon governments:

> With a view to stimulating economic growth and development, raising standards of living, meeting manpower requirements and overcoming unemployment and underemployment, each Member shall declare and pursue, as a major goal, an active policy designed to promote full, productive and freely chosen employment. (Article 1)

The quality of labour market regulation depends as much on the design of laws as on their enforcement. In particular in the world of work, with its uneven balance of power, effective labour inspection is essential. Convention 81 obliges member states to establish a sufficiently resourced and qualified labour inspectorate

> to secure the enforcement of the legal provisions relating to conditions of work and the protection of workers ... such as provisions relating to hours, wages, safety, health and welfare, the employment of children and young persons, and other connected matters. (Article 3)

Protecting workers

During any crisis, termination of employment without consultation about alternative solutions or without adequate compensation is widespread.[31] Convention 158 calls for a proper procedure for all contract terminations and provides protection against dismissal without reason:

> The employment of a worker shall not be terminated unless there is a valid reason for such termination connected with the capacity or conduct of the worker or based on the operational requirements of the undertaking, establishment or service. (Article 4)

Union membership or activities, as well as non-work related criteria such as gender, ethnicity or political views, are explicitly excluded as valid reasons. In case of termination for economic reasons the employer shall:

> provide the workers' representatives concerned in good time with relevant information including the reasons for the terminations contemplated, the number and categories of workers likely to be affected and the period over which the terminations are intended. (Article 13)

During a crisis, the number of insolvencies grows and, unfortunately, in many cases workers lose their jobs *and* suffer from unpaid wages and benefits, including paid vacation. Convention 173 ensures that workers' claims are at least given priority in the case of insolvency:

> In the event of an employer's insolvency, workers' claims arising out of their employment shall be protected by a privilege so that they are paid out of the assets of the insolvent employer before non-privileged creditors can be paid their share. (Article 5)

Guaranteeing minimum levels of income and working time

To avoid a downward spiral in wages and working conditions the ILO standards suggest a number of minimum requirements:

> The working hours of persons employed in any public or private industrial undertaking or in any branch thereof ... shall not exceed eight in the day and forty-eight in the week. (Convention 1, Article 2)

31. ILO Conventions 158 and 173.

Some 91 years after Convention 1, this remains a dream for millions of workers. In particular during crises, employers often extend working time without increasing wages. Legal regulation of maximum working hours is the most efficient way of protecting workers against excessive working hours that endanger their health and deprive them of a life beyond work.

Governments can and must play a vital part in preventing downward pressure on wages. Convention 94 therefore states that public contracts:

> shall include clauses ensuring to the workers concerned wages (including allowances), hours of work and other conditions of labour which are not less favourable than those established for work of the same character in the trade or industry concerned in the district where the work is carried on:
> (a) by collective agreement ...; or
> (b) by arbitration award; or
> (c) by national laws or regulations. (Article 2)

All workers have the right to and need at least a minimum living wage. The ILO Convention 131 on minimum wage fixing does not call for the same global minimum wage, but it calls on all governments to establish a minimum wage that takes into consideration:

> the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits, and the relative living standards of other social groups. (Article 3)

Establishing a minimum wage fixing mechanism in line with the Convention contributes to the creation of an anti-deflationary global wage floor that takes full consideration of different levels of development, while ensuring that all workers enjoy the right to a living minimum wage.

The progressive expansion of social security, as outlined in Convention 102, and the ILO concept of a social protection floor are key for income support and for automatic stabilisation of the economy, as social transfers and in particular unemployment benefits help to maintain income levels during an economic downturn and provide families with basic socio-economic security.

International Labour Standards are a potentially strong means of improving global governance and creating the trust among nations needed to ensure that all countries apply labour standards – adapted to their level of development – that avoid a race to the bottom. Obviously, additional standards are necessary to deal with new developments in the global economy, such as cross-country teleworking, global supply chains, cross-border collective bargaining, social security for informal economy workers and so on. However, universal ratification of existing ILO Standards would be a major contribution to coordinated global governance. By ratifying an international standard, governments make a commitment to the international community to apply certain labour standards and to maintain this level for the foreseeable future (denunciation is permissible at the earliest ten years after ratification). A serious approach to ratification and implementation of labour standards would help to ensure a level playing field and increase the willingness of all countries to keep their borders open for goods and services from other nations.

This crisis must be the moment when governments come together and strengthen their commitment to labour standards in order to maintain and strengthen an open and fair globalisation.

The current ILO mechanisms are clearly insufficient to achieve widespread ratification and enforcement of international labour standards. Nearly all governments voted for the adoption of most conventions at international labour conferences. But very often they have not followed up with ratification.

Governments should consider a new ILO declaration with the sole objective of increasing the commitment and capacity to ratify and implement existing labour standards. The current supervisory mechanism has proven insufficient to achieve the high levels of ratification that many member states regard as desirable. Such an endeavour will involve a difficult negotiation process, but given the importance of universal labour standards to maintain support for open economies, there seems to be no attractive alternative. Here is a proposal to start the debate:

Box 3 **Promotion of Labour Standards Declaration**

Recognizing that the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries;

recognizing that the universal application of labour standards is an important condition for a sustainable, open and rules-based global economy;

recognizing that after more than 90 years of existence, the existing body of international labour standards has not received a sufficient level of ratification and lacks rigorous implementation;

Member States agree to renew their efforts to achieve the constitutional objective of universal ratification of labour standards.

In order to build a common regulatory floor of social and labour rights this Declaration calls on all member states to commit themselves to the following supportive measures and targets to achieve this objective:

1. Member States will bring all non-ratified up-to-date ILO conventions before their national parliaments for the enactment of legislation or other action. For the purpose of this Declaration, this will also apply to conventions which have already been brought before the parliament in the past.

The twelve conventions identified as core and priority conventions in the Social Justice Declaration will be submitted within a 12 month period after adoption of the Declaration. Within the next 24 months, the conventions identified by the Governing Body (March 2009) as highly relevant for crisis response and recovery will then be submitted. Finally, all up-to-date conventions need to be submitted within a five-year period following the adoption of this Declaration.

2. Member States (except Least Developed Countries) who fail to submit the instruments within the established deadlines will support promoting efforts through an annual contribution of 0.000001 per cent of

32. ILO Conventions 94, 95, 97. 102, 131, 143, 158 and 173.

their GDP per non-submitted convention to a Global Labour Standards Promotion Fund under the auspices of the ILO.

3. In order to promote the ratification and implementation of up-to-date conventions Member States – except the LDCs – will make an annual contribution to the fund of 5 per cent of their current membership fees. This contribution will be made over a period of 10 years following the adoption of this Declaration.

4. Member States can request financial and technical assistance from the fund to ratify and implement ILO conventions.

5. Twenty per cent of the fund will be reserved for employers' and workers' organisations to request financial assistance to organise national awareness-raising and information activities to promote ratification and implementation of ILS.

6. Member States (except Least Developed Countries) that, according to the assessment of the ILO's Committee of Experts, fail to fully implement a ratified convention will make a contribution as indicated in Article 2. The Committee of Experts will assess in the following cycle of reports whether the convention is fully applied. Otherwise, the contribution is to be maintained. Governments can challenge decisions of the Committee of Experts at the International Court of Justice.

7. The ILO office will make this follow-up mechanism the priority of its technical assistance work and actively support and encourage efforts by governments, workers' and employers' organisations to improve ratification and implementation of International Labour Standards.

8. The ILO will provide interim reports about the implementation of this Declaration three years and six years after its adoption. A final report will be provided after 10 years.

9. The ILO will provide a Decent Work certificate for meeting the minimum DW regulatory requirements to Member States that have ratified and, according to the assessment of the Committee of Experts, implemented the core conventions and at least three-quarters of the other up-to-date conventions. The DW certificate requires revalidation by the ILO every five years.

10. After at least 50 per cent of the Member States have completed the abovementioned follow-up mechanism Member States will review at the International Labour Conference whether those conventions that have not achieved at least 20 new ratifications or have been ratified by at least 25 per cent of all Member States are still relevant.

11. Members agree to undertake the necessary constitutional amendments to ensure that the non-payment of the contributions described in Article 2 and 6 by Member States will have the same effect on their voting rights at the ILO as the non-payment of membership contributions.

Adapting the Nordic model

Thomas Carlen

Up until the 1990s, the Nordic model was generally believed to have performed well. It generated high quality employment, sustainable growth, strong welfare states and the most egalitarian distribution of incomes in the developed world.[33] But after 1991, the Nordic countries fell into a deep economic crisis. International opinion began to take a rather different view: the Nordic welfare model was neither competitive nor sustainable in a global economy. Organisations such as the OECD therefore recommended increased flexibility and competition in product and labour markets. The trade union goals that had served the Nordic countries well over the preceding four decades – such as employment protection, real wage increases in line with productivity and generous unemployment benefits – were all considered to be agents of job destruction.

Today, this picture has changed considerably, with the Nordic countries once again at the top of international rankings of economic and social development. Even if many economists still believe in deregulation, increased flexibility and less generous benefits, the Nordic experience shows that there is an alternative. It is possible to have high employment rates, competitive businesses, strong unions, effective welfare states and widespread income equality.

Nordic performance in the crisis

During the initial phase of the current global financial crisis, the Nordics, with the exception of Norway, were hit harder by the drop in global

33. The Nordic countries are Sweden, Denmark, Norway, Finland and Iceland. Even though there are important differences between these countries, the similarities are striking.

demand than the OECD countries, on average. This is simply a result of being small open economies, exposed to international competition but making progress through a high degree of specialisation in areas of comparative advantage (Gylfason et al. 2010). The Nordics appear to be emerging from the crisis faster than many other OECD countries.

In terms of GDP, Nordic growth rates have been slightly higher during the past decade (2000 to 2009) than the OECD average: 1.9 per cent compared to 1.7 per cent. One explanation for this is favourable development of productivity. Within the industrial sectors which operate on international markets productivity levels and growth are among the highest in the world, especially in Sweden and Finland.

The Nordics have been positioned on top of the global competitiveness rankings for a long time. In the latest Global Competitiveness Report from the World Economic Forum, Sweden is in second place and Finland and Denmark are among the top ten, with Norway close behind. This shows that countries with regulated labour markets, high taxes, strong trade unions and generous welfare schemes can be among the most competitive economies in the world. If high taxes are used to provide a world class education and an efficient social safety net, then competitiveness will be strengthened, not undermined.

The Nordic countries have also achieved sustained high employment rates (Table 4). In 2008, the year before the crisis hit the labour markets, employment rates ranged from 71.3 per cent in Finland through 75.7 per

Table 4 **Employment rates in 2008 (% of population in each category)**

Country	Total 15–64 yrs	Men 15–64 yrs	Women 15–64 yrs	Younger 15–24 yrs	Older 55–64 yrs	Shorter education* 25–64 yrs
Denmark	78.1	81.9	74.3	67.0	57.0	69.4
Finland	71.3	73.4	69.0	46.4	56.4	59.3
Norway	78.1	80.6	75.4	58.0	69.3	66.0
Sweden	75.7	78.1	73.2	45.9	70.3	66.2

Note: *Less than upper secondary education.
Source: OECD.

cent in Sweden to 78.1 per cent in Denmark and Norway. The OECD average was 66.5 per cent. Since then, employment rates have gone down in the Nordic countries, as well as in the rest of the OECD. Even though some groups continue to do better than others, employment rates are above the OECD average for all groups of workers.

To summarise: the Nordics are successful in combining economic efficiency and growth with limited industrial conflict, high employment rates, a fair distribution of income, social cohesion and a high level of social mobility (Andersen et al. 2007). Nevertheless, the Nordic model faces important challenges, such as relatively low employment rates for certain groups, for example immigrants, disabled workers and high school dropouts. Another challenge is to raise productivity growth in the service sector, where many of the new jobs are being created, to secure real wage increases and higher living standards in the future.

Pillars of the Nordic model

The Nordic model is traditionally built on seven pillars. They are vital for its performance, efficiency and legitimacy. The pillars are:

1. *High trade union density* with a strong labour movement is one of the features of the Nordic model. Despite a fall, unionisation rates are still high, currently around 70 per cent in the Nordic countries. An important explanation of this is that the unemployment insurance funds are organised by the trade unions (the Ghent system), with the exception of Norway where trade union density is lower than in the neighbouring countries, at slightly over 50 per cent.

2. *Widespread collective agreements* establishing universal labour standards reduce the need for state regulation of the labour market – the government intervenes only when absolutely necessary. Indeed, collective agreements tailored to the needs of a sector or business offer more flexibility than legislation. Nonetheless, the government plays an important supportive role by establishing some minimum standards, supporting a generous welfare state and providing institutions for tripartite consultation.

3. The *solidarity wage policy* essentially means an equal wage for equal work. Rather different arrangements exist across the Nordic countries to

secure this goal, but the principle is universally respected. In the Swedish case, central collective agreements or coordinated sectoral agreements fix wages at a common level across an industry. Firms competing in international markets are driven to focus on productivity, innovation and high performance to generate profits. Competitive businesses generate tax revenues that contribute to funding the generous welfare state. But the system also implies that low productivity businesses faced with international competition will find it hard to survive unless they improve their performance, invest in technologies or improve their human capital. Inevitably firms that fail to adapt will see a reduction in their workforce (Bergström 2009). In other words, the system is deliberately designed to secure a shift in employment from low productivity to high productivity enterprises. The system has an additional element of flexibility through bargaining at company level to ensure that the central collective agreement is a floor, not a ceiling and guarantee that workers continue to see wages move in line with firm level productivity.

4. As a result of restructuring, the workforce faces the risk of unemployment. The purpose of *active labour market policy* is to help those who lose their jobs back into employment. This includes targeted education, practical training and subsidised employment. The policy is aimed at facilitating structural adjustments and enhancing relocation abilities, reducing adjustment costs and maintaining the unemployed person's contact with the labour market.

5. *Generous unemployment benefits* are necessary to facilitate labour transition from jobs that are being lost to jobs that are being created. It both makes the transition possible and legitimises structural change in the eyes of the affected workers. Generous unemployment benefits also contribute to the maintenance of narrow income gaps and a low risk of poverty. In return, the right to unemployment benefits is matched by a mutual obligation on job seekers to diligently look for work. This benefit conditionality is the lynchpin of the system. Of course, generous unemployment benefits also work as an important automatic stabiliser during a recession.

6. The *Nordic welfare states* are based on universal income security and public services, to a large extent financed by taxes. One guideline in welfare politics is the 'employment principle', as opposed to the 'benefit principle', which basically means that unemployed people are expected to look hard for work, and even move to get a job, but in return they get

extensive help with job search and the support of well-financed active labour market programmes. The welfare system contributes to security in transition, mobility and moderate indirect labour costs. The welfare system also contributes to the maintenance of narrow income gaps and a high level of social mobility.

7. Without extensive *public investment in human capital*, the Nordic model could not survive the globalised world, with its continuous structural change. No Nordic country has embraced the notion that low wage competition is a viable strategy. Instead, investment in education and skills is vital and a key factor in higher productivity. A well-educated labour force, one of the attributes of the Nordic model, facilitates adjustment to changing circumstances by making it easier to upgrade skills through additional training (Gylfason et al. 2010). This is also the best way to avoid poverty (Sapir 2005).

Security in transition

The basis of the model is a combination of collective risk sharing at national level and openness to globalisation and competition (Andersen et al. 2007). Collective risk sharing makes globalisation acceptable to citizens by allowing both companies and workers to benefit from structural change, new markets, productivity growth and continued real wage increases. Therefore, protectionism has little support in the Nordic countries. The positive attitudes towards globalisation are reflected in the Eurobarometer surveys, where Nordic countries, compared to the EU27 average, are significantly more positive towards globalisation and its opportunities for economic growth.[34]

Nordic labour markets are flexible and dynamic. The Danish flexicurity system, with its balance between flexibility and security, is well known. But the other Nordic countries have similar arrangements and employment protection legislation which is not particularly strict (Sapir 2005; Gylfason et al. 2010). The model encourages rationalisation and efficiency, but demands public investment in education and active labour mar-

34. In the 2010 spring survey, 82 per cent of Swedes, 87 per cent of Danes and 71 per cent of Finns entirely agreed that globalisation is an opportunity for economic growth, compared to the EU27 average of 56 per cent. See also Sapir (2005).

ket policy in return. One might go so far as to say that the Nordic model is designed to accommodate the 'creative destruction' that Schumpeter described as the fundamental dynamic of capitalism.[35] Because the Nordic model is focused on managing labour transitions, 'security' lies in the notion of employability rather than in the protection of existing jobs. The model is designed to facilitate restructuring and the welfare state and social partners ensure that there are measures available to support displaced workers in finding new jobs. The widespread feeling of trust, and a sense of fairness when it comes to welfare ambitions is the foundation for a well functioning combination of flexibility and security.

In André Sapir's analysis of various European social models, the Nordic model is the only one that delivers both efficiency, in terms of high employment rates, and equity, in terms of low risk of poverty.[36] In the long run, however, a social and economic system also needs to be sustainable and robust. Models that are not efficient are simply not sustainable in the face of growing strains on public finances coming from globalisation, technological change and population ageing. The level of government debt as a share of GDP is relatively low in the Nordic countries, even after two years of economic crisis, compared to other countries. Another sign of sustainability is the public perception of globalisation.

What can be learned from the Nordic model?

The success of the Nordic countries indicates that well-regulated labour markets and egalitarian economies with sophisticated and extensive welfare systems and collective agreements are able to assert themselves well in a world of global competition. Nevertheless, the Nordic model is not without flaws and problems, and politicians and social partners are facing important challenges that call for continued adjustments.

Can the Nordic model be copied or exported? The successful performance and adjustments of the Nordic model cannot be attributed to single

35. Schumpeter, *Capitalism, socialism and democracy* (1942). The Rehn-Meidner model, an important contribution to the Nordic model developed by the economists Gösta Rehn and Rudolf Meidner at LO Sweden in the early 1950s, can be seen as an example of 'creative destruction'.
36. Sapir (2005). In this report, the Nordic model is taken to encompass the EU member states Sweden, Denmark, Finland but also the Netherlands.

factors or particular policy choices. It is a model that has been evolving for more than one hundred years, beginning with the formation of trade unions in the late nineteenth century, the election of social democratic governments in the 1930s and the expansion of welfare states in the 1970s. The development of the Nordic model is strongly associated with the strength of the social democratic labour movement, even though many welfare reforms were underpinned by broad social and political compromises. It reflects the institutionalised interplay between employers' organisations, trade unions and governments. This has allowed for the development of gradualist policies that are coherent, balanced and inclusive. Most importantly, perhaps, this has also allowed the construction of sustainable coalitions for economic and labour market reform, providing the legitimacy and support needed to undertake painful adjustments (Dølvik 2007).

Therefore, it would be very difficult to simply export the Nordic model in its entirety to countries with very different histories, traditions and institutions. But, as David Coats argues earlier in this chapter, an understanding of the Nordic employment regime does allow policymakers elsewhere to consider how they can create more inclusive labour markets. Inevitably, the practical application will be different, but policymakers have no choice but to look at the initial skills formation system, lifelong learning, the balance of power between capital and labour, the extent to which unjustifiable differences between groups of workers are eliminated, the generosity of out-of-work benefits and the effectiveness of active labour market programmes in getting the unemployed into sustainable, high quality work. In other words, there is no reason why other countries cannot look to the Nordic model for inspiration, even if they devise policy solutions that look rather different. In the EU, in particular, member states are supposed to apply the open method of coordination to labour market policy, learning from each other's successes and failures. This general approach has much to commend it and is also reflected in the work of the OECD. It means that it is possible to escape the perils of the *pensée unique* and creates welcome space for the consideration of policy alternatives. An eclectic approach to mutual learning is going to be essential in building the post-crisis economic model. That is why the success of the Nordic model remains important as both developed and developing countries consider how policy should develop over the next decade.

Putting work/family reconciliation policies on the agenda of a post-neoliberal era

Claire Courteille

Introduction

Over the past three decades, female participation in labour markets has increased virtually everywhere. In developing countries in particular, women, often perceived as a cheaper and more docile labour force, have taken up paid employment in huge numbers in export industries. This situation, however, should not hide the fact that, on average, the rate of unemployment amongst women is higher than among men and that, overall, women are overrepresented in precarious forms of work, with fewer rights and less access to social protection.

The ILO estimates female labour market participation worldwide at about 52 per cent, in contrast to male participation estimated at 77 per cent. Significant differences exist between regions: while female participation is close to 75 per cent in the Nordic countries, in the Arab world only 23 per cent of women are engaged in paid work. Available data also point to a narrower gender gap in the employment rate for the younger generation. For example, in the EU in 2007 the gap was estimated at 6 points for 15–24 years old as opposed to almost 18 points for those aged 54–65.[37]

All data across countries seem to indicate that the increase in the rate of female employment is a persistent trend. Many trade unions have declared the traditional household model of a male bread winner and a female care giver outdated. Double income households have indeed become commonplace in many countries. Another equally persistent

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37. Eurostat, *Statistics in Focus*, 99/2008.

trend, both in developing and industrialised countries, is the growth of female-headed households.

Although female engagement in paid work is a positive development, it puts great strain on working women who have to combine family responsibilities and professional obligations. As they work outside the home, women have less time to spend on domestic tasks and care work which continues to fall on their shoulders. In addition, family structures have changed, offsetting the traditional reliance on female extended family members taking on care obligations. This trend, more pronounced in developing countries, has further increased the pressure on working women.

The crisis of care

The market fundamentalist agenda has failed to provide an adequate response to the care needs of working women. The market has proved unable to match supply and demand, creating huge care deficits in virtually all countries. In the poorest parts of the world, the deficit is often made up by workers in the informal economy who have limited rights and access to social protection. Richer countries have sometimes implemented measures to facilitate the combination of work and family responsibilities, but generally on the incorrect assumption that women are the primary caregivers and men the primary breadwinners. As a result, very few policies have been successful in promoting a fair distribution of paid and unpaid work among men and women within the household.

The lack of adequate public intervention has several implications:

First, the market approach has contributed to widening inequalities. While high income families can afford good quality private care services, for lower income families the lack of collective support has had adverse consequences for families' well-being and decent-work objectives. The conflict between work and family restricts the options of those worse off, forcing them to choose between employment and care, or to combine them, all of which requires painful trade-offs in terms of quality of employment and/or quality of care and long-term consequences for escaping poverty.

Second, the privatisation of the provision of care has contributed significantly to the feminisation of migration. Over recent decades, millions of women in developing countries have left their own children behind to take care of other people's children. In some cases, rich countries have actively promoted such migration flows as a way to address their care deficits. In other cases, when governments were reluctant to open up legal channels, the needs were met by women migrants in irregular situations, who are particularly vulnerable to all kinds of abuse. This export of care labour deprives millions of children of their mothers, raising questions about the impact on their psychological development.

Third, the market approach has pushed women into precarious jobs. In order to be able to combine work and family many women had no option but to accept poorly paid, insecure, part-time, home-based or informal work. This has confined them to low skilled, low paid jobs with little prospect of advancement.

Fourth, the privatisation of the provision of care and indeed the whole neoliberal agenda has further eroded the notion of collective answers to collective problems. But developing work/family policies and programmes is not just an issue concerning the welfare of individual workers and their families; it affects the economic and social development of society as a whole.

The only way to care is to share

Trade unions need to underline government's responsibility to provide care for working families as a way to facilitate all workers' access to decent work. In a post-crisis model, reconciliation measures – such as flexible time arrangements, a compressed working week, reduced working hours and overtime, extended maternity, paternity and parental leaves, teleworking or homeworking – should be extended to all workers. The same regulations and supervision of the terms of employment and social protection rights should be granted to all, including part-time and home-based workers. Public support to care institutions – such as crèches, pre-schools, after-school or out-of-school care facilities, homes for the elderly, the disabled or the sick – should be increased substantially. Providing good quality collective solutions has a cost which ought to be socialised. Women can no longer assume this burden alone.

It is interesting to note that the job-creation potential of such social infrastructure is consistently overlooked. This could probably be addressed if more women were involved in the economic decision-making process. However, some studies have found that 10 jobs can be created in the care economy for each additional 100 women at work.[38]

ILO Convention 156 and its accompanying Recommendation 165 on workers with family responsibilities provide useful guidelines. These instruments seek to promote policies reducing the work/family conflict and combating labour market discrimination. Only 40 countries have ratified the Convention to date.

But trade unions should also actively promote men's participation in family responsibilities, which remains generally at low levels. The principle of men and women's having co-responsibilities for the care of family members should underpin the new generation of reconciliation policies. Making women's and men's engagement in care giving equal implies that men and women be granted equal entitlement to work/family measures. It also implies breaking down the gender norms of care and employment.

Making the 'other economy' visible

However, these fundamental changes are not likely to happen unless visibility in macroeconomic aggregates is given to unpaid care work. Taking account of the 'other economy' where the care of human beings takes place is a long-standing call of the feminist movement. The fact is that unpaid care work contributes to economic growth by supplying human resources and maintaining the social framework. But it is excluded as a matter of principle from the UN System of National Accounts and GDP calculations. UNDP, which has on several occasions recognised that mainstream macroeconomics is based on a partial understanding of how the economy works, has estimated that unpaid work produces an output equivalent to at least half of GDP.

It is ludicrous to maintain a system of GDP calculation which includes financial speculation, whose impact on welfare is close to zero, and exclude care work, whose contribution is enormous.

38. Esping-Andersen, quoted in Party of European Socialists (2006).

Work, paid and unpaid, constitutes a fundamental element of analysis and of public policy because it is one of the major factors affecting women's integration in the labour market. Taking account of the unpaid work performed by care givers is essential to better reflect economic reality and to lead to less arbitrary decision-making in the labour market and welfare reforms. It is also essential if we are to build societies that measure progress by more than simply increases in measured GDP. Recognising the role of care in a balanced and sustainable economy is an obvious indicator to be included on the dashboard described in Chapter 1.

Skills: beyond the supply side

Roland Schneider

Recent OECD reports, as well as other studies, strongly recommend the implementation of education policies and practices to boost the supply of skills so that employers' demands are met. Unfortunately, reality is not in line with the general rhetoric on education and training. In striking contrast to the predictions of the economics of education, high educational achievement does not necessarily translate into strong growth, the transition towards a knowledge-economy based on high skilled and highly paid jobs cannot be taken for granted and, last but not least, employers and governments alike fail to invest sufficiently in workforce development.

A financing gap in education and training does not allow for spending cuts

As the editorial of the OECD's *Education at a Glance 2010* points out, education is a large item of public expenditure in most countries. However, the data available on education spending highlight once more that governments have failed to act in line with the education mantra. The increase in spending on educational institutions between 1995 and 2007 in more than half of the 27 OECD and partner countries for which data are available did not keep up with growth in national income. Expenditure for all levels of education combined increased at a faster rate than GDP in only 10 of the 27 countries. The increase exceeded more than 0.8 percentage points over the period in Chile (5.1 per cent to 6.4 per cent), Denmark (6.2 per cent to 7.1 per cent), the United States (6.6 per cent to 7.6 per cent) and the partner country Brazil (3.7 per cent to 5.2 per cent). The OECD countries spend on average 6.2 per cent of their GDP on educational institutions.

Against the background of a prevailing financing gap in education, it is important that the education sector has benefited in a number of countries from the implementation of fiscal stimulus packages that provided additional funds for investment in infrastructure, including educational buildings, as well as in training. However, more needs to be done. Contrary to calls for 'exit strategies', the persistence of high youth unemployment requires that appropriate education budgets are maintained. Despite public budget constraints caused by the global financial and economic crisis it is essential to avoid that budget consolidation adversely affects education. Education spending must not be slashed; on the contrary, it must be maintained and increased relative to GDP. Students cannot acquire world class skills in ill-equipped, broken and battered schools, staffed with poorly paid teachers. The challenge of making public finances sustainable must not be taken as an excuse to cut education spending.

Budget cuts in education would have large adverse consequences on institutions, staff and quality of educational provision through reductions in teaching and support staff, reduced availability of teaching and learning materials, larger class sizes, suspended construction and lower maintenance of educational buildings. Moreover, it would – as the issues paper *Tackling the effects of the economic crisis on education* prepared for the 2010 OECD Education Ministerial Meeting rightly pointed out – 'disproportionately harm those who are most vulnerable' and thus create new barriers for students struggling not to fall behind, as well as for those who are in desperate need of improving their education, such as the unskilled and the excluded.

Financialisation – a threat to company investment in workforce development

It is puzzling that, in striking contrast to public debates on the ever-growing importance of education and training, corporate strategies of investment in workforce development and the use of skills have not taken centre-stage. Disturbing signals such as cuts in corporate training budgets in an effort to maximises short-term shareholder value have hardly been noticed by policymakers and the broader public alike. According to a survey carried out in more than 27 European countries and published in spring 2010, enterprise spending on CVT courses per employee decreased significantly from 1999 to 2005 (CEDEFOP 2010).

Overall, enterprises in Europe invested less in CVT courses in 2005 than in 1999. In most northern, western and southern European countries, total monetary expenditure as a proportion of labour costs was lower in 2005 than in 1999, and the decrease is fairly substantial in Italy, the Netherlands, Finland and Sweden. At EU level, small enterprises spend 0.7 per cent of total labour costs on CVT courses, compared to 0.8 per cent in medium-sized enterprises and 1.0 per cent in large ones; analysis shows that this applies to most countries. However, the situation in Denmark is noteworthy as small enterprises spend 0.9 per cent of total labour costs on CVT courses, large enterprises 2.0 per cent and medium-sized enterprises as much as 2.4 per cent. Overall enterprise spending on CVT courses per employee over time decreased significantly. At the level of the European Union, spending per employee across all enterprises decreased by more than a quarter from 1999 to 2005.

Of course, it is debatable whether lower spending is a general indication of worsening CVT provision, as it does not consider its efficiency and effectiveness. However, taking into account indicators on the incidence, participation and intensity of CVT besides decreasing expenditure implies a general worsening of the provision of CVT in Europe, especially in western and northern Europe. This development is a clear signal of the need for national and international policies to intensify efforts aiming at the promotion of vocational education and training.

Polarisation of labour markets: the bumpy road towards a high-skill, high-wage economy

Although it is often claimed that research has confirmed a long-term trend toward jobs requiring more education and cognitive skills, the direction and rate of change, as well as the assumed level and kinds of skills in demand, are controversial. There is no clear cut evidence suggesting that the declining share of employment in manufacturing and the rising shares of various service industries lead straightforwardly to higher skill requirements and 'better' jobs in terms of wages and working conditions.

There is, however, increasing evidence indicating that expanding job opportunities in both high-skill, high-wage occupations and low-skill, low wage occupations, together with contracting opportunities in middle-wage, middle-skill jobs, have lead to a polarisation of labour markets in advanced economies. The polarisation of employment, the widening gap between ‘good’ and ‘bad’ jobs, has been mirrored by wage growth: rising wages for highly skilled workers, falling wages for low- and unskilled workers. Long-term occupational employment projections suggest that the polarisation of employment is not going to go away.

Policies focusing on the supply of skills are important but not sufficient

Unsurprisingly, a great deal of recent research challenges the faith in the benefits of a supply push effect with regard to skills. Publicly-funded activities to boost the stocks of qualifications cannot be relied on to push an economy onto a new, higher skilled, higher value added path. There is no robust evidence suggesting that the economy with the biggest stockpile of skills ultimately outperforms all others in the global race of innovation and competition. A recent white paper of the UK Department for Business, Innovation and Skills noted in this respect that ‘there is no automatic relationship between skills and productivity. Critically important is how businesses actually use the skills of their workforce; and how they use them in combination with other drivers of productivity, such as investment, innovation and enterprise’ (DBIS 2009: 20). In other words, ‘skill policy based on a demand-led and market-driven’ approach is not going to work.

Unfortunately, issues of skill utilisation have hardly been dealt with in the process of designing, implementing and pursuing skills policy. There are several reasons for that. One is that a narrow skills supply strategy goes well together with the policy prescriptions of the neoliberal growth model. Another is related to efforts to avoid any interference in areas of alleged managerial prerogative or any regulation regarding the demand for skills. Moreover, current skills policy most often neglects the workplace and industrial relations context in which skills are acquired and mobilised. Hence, issues such as the redesign of jobs and work systems, which are vital for the ability of employers to make effective use of the skills available and to use the skills of the workforce in order to improve productivity as well as working conditions, have not been brought centre-stage in debates and policymaking.

There is a strong case to revisit the skill-policy agenda and to reprioritise a range of issues of particular importance. A change in education and training policy is required in order to address the need for the effective utilisation of skills at work and to link skills policy to a broader agenda of innovation, business performance and economic and social development. The problem with many advanced countries is not that there are too few well qualified workers but too few employers who want to employ them. Hence, promising policy approaches need to take into account the full range of contextual factors that shape the conditions of both the formation and use of skills, in particular business settings and competitive strategies pursued by them, institutions and policy frameworks for education and training, modes of engaging trade unions and employers in the process of designing and implementing training policies and the governance of VET institutions, the type and level of skills formation (apprenticeships or workplace- or school-based) and, last but not least, the structure of jobs (low-road respectively high-road approaches).

It is essential that skills policy does not rely any longer on stand-alone training measures but is integrated with measures for promoting regional socio-economic development, as well as business performance. A new approach to developing, utilising and retaining a highly skilled workforce should be based on what is increasingly becoming known as the 'skill ecosystem approach', based on clusters of all levels of competencies in a particular region or industry and shaped by interlocking networks of companies, markets and institutions (Payne).

A broad-based skills policy must also confront the prospect of increasing labour market polarisation, characterised by high-skilled, high-wage employment at one end of the labour market and low-wage, low-skilled employment at the other. The latter is a prevailing feature of 'low-road firms', pursuing competitive strategies focusing on price and cost. Jobs in these firms are typically organised around very narrow sets of tasks, often highly routinised, within a prescribed division of labour. The training process in low-road firms is mainly short-term training provided by the employer for rather narrow and specific tasks in that firm. Public policies must confront low-road strategies; training and innovation strategies need to be put in place 'closing off the low road' and making it more difficult for firms to pursue low-road strategies. At the same time, policies must make it easier for firms to adopt high-road strategies and to provide high-skilled jobs offering different and frequently changing kinds of tasks and thus higher levels of autonomy, discretion and commitment (Wright and Rogers). Last but not least, training and innovation policies must also confront the emerging risk of a high-skilled but low wage economy, driven by global skills and sourcing strategies of companies, as well as by the rise of digital Taylorism, for example, through the standardisation of knowledge work.

Trade unions and the skills agenda

In recent years, education, training and learning have become increasingly important items on the agenda of trade unions across OECD member countries. Unions have spread the learning message in a broad variety of actions, predominantly social dialogue and collective bargaining with employers, formal representation in the governance of VET systems and organisational innovation.

Regrettably, economic research on skills as well as national skill strategies have often failed to pay sufficient attention to the industrial relations context of the formation of skills and their use as well as to the role of trade unions as advocates of training and as stakeholders in the process of governing VET systems. The fact that union involvement as stakeholders within VET systems has increased in the recent past is not without reason. Unions can effectively balance the influence of employers by representing students' and employees' interests regarding the design and implementation of curricula and the acquisition of both transferable and firm-specific skills. The role of unions is particularly important with regard to making lifelong learning a reality for all. Available evidence in this respect suggests a positive impact of collective bargaining on CVT participation.

The third European survey on continuous vocational training (CVTS 3) revealed that national, sectoral or company-specific agreements between trade unions or works councils and employers contribute to fostering lifelong learning. In all countries surveyed and for all size classes of enterprises, employees in enterprises providing training that have a works council or a joint agreement on CVT generally have a higher rate of access to training than their colleagues in enterprises that do not. A similar pattern emerged when, instead of the access rate, hours spent in training per employee were analysed; employees generally undertook more training hours in training enterprises with a works council or covered by an agreement between the social partners including CVT, compared to enterprises not covered by an agreement or without a works council (CEDEFOP 2010: 55 ff).

Regrettably, in many countries unions are currently without any statutory right to bargain with employers on training. However, where such a right exists or where trade unions are recognised by employers, age-, skill- and gender-specific inequalities regarding access to further training are much less pronounced than in other instances. Broadly speaking, trade unions have identified a number of key priorities regarding vocational training and lifelong learning:

- Equal access to training for all those who want or must develop their skills and aptitudes.
- Recognition and validation of aptitudes and skills irrespective of how they were acquired and their recognition in the company.
- The financing of training and employers' responsibility in this area.
- The anticipation of future skills needs.
- Removing the barrier between vocational education and training and higher education.
- The participation of both trade unions and employers in policies promoting vocational training and lifelong learning.

Moving ahead: key elements of effective vocational education and training policies

Skills policy must be based on realistic expectations. What is needed is an open and honest debate about what education and training policy can contribute to improving economic performance and delivering social justice and inclusion. Previous OECD work on skills and training issues – in particular *Learning for Jobs*, the OECD policy review of vocational education and training (VET), designed and conducted to help countries make their VET systems more responsive to the needs of employers – has not focused sufficiently on the broad range of characteristics and issues of VET systems. Focusing narrowly on the supply of skills, the work has been based on the assumption that skills, once created, are almost automatically utilised to their full potential. Moreover, it has neglected the workplace and industrial relations context in which skills are mobilised and increasingly created (OECD 2010b).

In order to be effective, vocational education and training policy must:

- aim to increase the training opportunities available, in particular workplace-based training;

- take into account the workplace and industrial relations context in which skills are created and mobilised;
- ensure union involvement in the design and implementation of training policy as well as in the assessment and subsequent revision of curricula;
- recognise the positive impact of collective bargaining on participation in training and further training;
- avoid promoting exclusively core technological underpinnings, such as science, technology, engineering and mathematics, allegedly required by an advanced economy;
- tackle underinvestment in training by employers through the implementation of train-or-pay levy/grant schemes and thus encourage employers to increase their levels of investment and commitment to skills, development and training;
- raise employer ambitions through policies addressing the demand side weakness regarding high-level skills by promoting the implementation of high performance workplaces, as well as the transition towards the production of high quality goods and services;
- strengthen the ability of vocational education and training systems to support a transition towards green growth and a low carbon economy;
- introduce workplace training entitlements for employees as a means by which the take-up of skills training and subsequent occupational mobility can be raised.

VIII A sustainable model of growth

The sustainable company: a key element of the new growth model?

Sigurt Vitols

Introduction

that the corporate sector accounts for the bulk of production and employment, an important prerequisite for achieving a new model of growth is to reorient companies' strategies and operations. In recent decades, companies (particularly those listed on stock markets) have been increasingly influenced by the 'shareholder value' conception of the firm. This puts shareholders at the top of the hierarchy of all those that are dependent on and/or have relationships with the firm. As a consequence, companies have become more oriented toward short-term performance (for listed companies, short-term share price changes on the stock market). In order to implement a new growth model it will be necessary to counteract this trend and to replace the dominance of shareholder value with a focus on sustainable employment and production for the long term.

The 'sustainable company' draws on an alternative conception of the firm, the so-called 'stakeholder' model. According to this model, the company is dependent on and should serve the interests of a plurality of groups or 'stakeholders'. In contrast to the shareholder value model, in which shareholders are clearly top dog, the stakeholder conception is much more pluralist. One useful approach is to analyse stakeholders in terms of the extent to which they invest their specific capital in and are dependent on the firm for their welfare.[39] According to this alternative conception, workers (particularly skilled workers who have made a large investment in firm-specific skills and knowledge) have clearly made a

39. I am grateful to Pierre Habbard of the Trade Union Advisory Committee (TUAC) of the OECD for this insight.

greater investment in and are more dependent upon their company than shareholders in a large listed company with dispersed ownership. In this type of company a shareholder may be one of the thousands or even tens of thousands of institutional investors holding a very small fraction of the firms' capital, generally for a very short period of time.[40] According to the stakeholder conception, workers clearly are more essential stakeholders than shareholders in this case.

What is the sustainable company?

What does the sustainable company look like? Even though full-blown examples of the sustainable company may still be rare, we know from best practice that key elements of the sustainable company include the following:

– A multi-dimensional concept of *sustainability and stakeholder value* as the central guiding principle of the company accepted by the key stakeholders.
– An *externally verifiable reporting system* adequate to measure progress on the achievement of multi-dimensional sustainability goals.
– The formulation of concrete *sustainability goals and a detailed strategy* for achieving these goals.
– The *alignment of incentives within the company* to support the achievement of these goals. Central here is tying a portion of top management pay to the achievement of sustainability goals.
– The *involvement of stakeholders and, in particular, employees* in all of the above processes. This can occur through a number of mechanisms, including board-level employee representation (BLER), European Works Councils (EWCs), collective bargaining (for example, increasing frequency of international framework agreements) and the founding of stakeholder advisory boards at companies.

Worker participation is not only possible but also needed to make sustainability 'real' with regard to each of these elements, which are discussed in more detail in the remainder of this section.

40. As an example, the largest pension fund in the US (CALPERS) holds the shares of more than 14,000 companies. The average period for which institutional investors hold listed stocks has decreased to less than one year.

Sustainability as the central guiding principle

In many non-Anglo-Saxon countries, company law emphasises the responsibility of companies to a plurality of stakeholders: not only shareholders, but employees, debtors and others dependent upon the company as well. Since the early 1990s, however, the concept of shareholder value as the central guiding principle for companies has spread beyond the Anglo-Saxon countries to Europe and Asia. Supporters of this concept claim that maximising shareholder value is in the interests of all stakeholders. Critics point to the conflicts of interest that arise between shareholders and other stakeholders when a critical mass of shareholders pursue investment strategies designed for short-term capital gains, either by boosting the share price in the short term or by extracting cash from the firm. The problem of externalities, of which pollution is a classic example, involves boosting the profits of shareholders by shifting costs to other stakeholders.

The concept of sustainability, which involves generating value for key stakeholders, offers an alternative principle for the company, building on the older concept of the company as a community of interests, and ties it into the interests of society and the environment as a whole.

Sustainability reporting systems

A second key element of the sustainable company is a well-functioning sustainability reporting system. These systems have undergone intensive development over the past decade, and vary widely in terms of content and processes. However, a consensus on ‘best practice’ in sustainability reporting systems appears to be emerging in a number of dimensions:

1. *Widespread use*: The first ‘best practice’, of course, is that a large number of companies should be reporting on sustainability and making their reports accessible. Although most large listed companies in Europe do some form of sustainability reporting, such reporting is much rarer among non-listed or small and medium-sized companies and across most of the world beyond Europe.

2. *Multidimensional sustainability definition and indicators*. A second criterion of best practice is a broad definition of sustainability and the inclusion of indicators covering the different relevant areas of the sustainable

company. Best practice here is currently defined by the Global Reporting Initiative (GRI), which is a multi-stakeholder non-profit organisation with the ambition of creating comprehensive standards for sustainability reporting. Trade unions, in particular through the Trade Union Advisory Committee to the OECD, are one of the key parties involved in the development of reporting standards. The latest comprehensive revision of the standards was completed in October 2006 and the 'third generation' (G3) of standards issued. Indicators are defined and operationalised for the areas 'economic', 'environmental' and 'social', with the latter being further broken down into the subcategories of 'labour practices and decent work', 'human rights', 'society' and 'product responsibility'.

3. *External verification/assurance*. It is increasingly being recognised that the credibility of sustainability reporting systems depends on verification of the quantitative and qualitative data they produce through external agents, for example, through a formalised audit process. It is also important to involve stakeholders in the verification process, for example, as best practice in the case of international framework agreements (IFAs) indicates.

Company sustainability goals and strategy

Although crucial, the development of an adequate sustainability reporting system is only the first step in the establishment of the sustainable company. A next crucial step is the adoption of concrete sustainability goals, as well as a strategy for attaining these goals.

An examination of recent sustainability reports indicates that only a minority of companies has actually adopted concrete sustainability goals, and the strategies for attaining these goals are often not clear in the reports. A recent survey of US companies by SSOE, Inc. (a private engineering and architecture consulting firm) indicated that 45 per cent of the firms surveyed had adopted sustainability goals.[41] Most prevalent among these concrete goals are (1) the reduction of energy consumption and (2) improved recycling practices. The most common source of the formulation of these goals was an internal task force or committee (45 per cent of the companies surveyed).

41. SSOE 2008 White Paper on Sustainability, available online at http://www.ssoe.com/sWhitePaper.pdf

Another recent study with a different sample (FT500 – the 500 largest global listed corporations) came to a somewhat more critical conclusion regarding goal-setting.[42] Only about two-thirds (335) of these companies had CSR reports including data on environmental emissions. Of these, only 37 per cent set SMART (Specific, Measurable, Achievable, Realistic, and Time-Specific) objectives with regard to climate change. Another 14 per cent of the reporting companies preferred broad objectives and 49 per cent of the reporting companies reported no goals whatsoever.

Aligning company incentives with sustainability goals

A key element of the shareholder value approach which has been brought into the discussion on corporate governance reform is the aligning of management interests with the interests of shareholders through the redesign of management remuneration systems. In particular, stock options and other stock-related incentives (for example, virtual stock options, grants of stock on the achievement of particular conditions, incentives for the relative performance of a company's stock against a benchmark index) have been increasingly used in order to achieve this goal. The increasing power of short-term oriented investors in conjunction with the relatively short-term realisation periods of many stock-related forms of management compensation have raised the question of the extent to which these practices really lead to long-term value creation. Furthermore, the granting of significant stock-related remuneration creates a great incentive for top managers to misreport company finances in order to boost share prices (for example, the Enron scandals around the year 2000) or to corrupt the integrity of company board practices (for example, back-dated options scandals).

The way forward

In extending the sustainable company from a few isolated cases of partial implementation of a few elements to a broad-based full implementation in support of the new growth model, a number of key changes need to take place. These include the following:

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42. The Corporate Climate Communications Report 2007: A study of climate change disclosures by the Global FT500, Corporate Register.com, February 2008.

– the need for binding legislation creating a supporting framework for the sustainable company;
– transforming capital markets from short-term financially-oriented to long-term sustainability-oriented investment orientations;
– an extended role for trade unions, including expanded expert capacities on sustainability and on working with other stakeholders (for example, NGOs).

The need for binding legislation

A key issue in the development of the sustainable company is the degree to which a binding legislative framework is necessary. The argument made by a portion of the sustainability community that sustainability is in the (enlightened) self-interest of companies and thus can, for the most part, be supported by voluntary initiatives, is not plausible. Binding legislation is needed in the following areas:

– A clear statement in company law that the primary purpose and responsibility of the company is not only to the shareholders to increase shareholder value, but that the company is a social entity obligated to pay attention to the interests of and increase the welfare of a broad range of stakeholder groups.
– A legislative mandate on companies to extend their reporting beyond financial matters to include the whole range of sustainability indicators. Such a mandate already exists in a few countries, but generally extends only to a few indicators (for example, employment levels or environmental impact).
– In countries where permissible topics of negotiation in collective bargaining or workers' participation are spelled out in detail in law, this catalogue of bargaining issues should be clearly extended to include sustainability issues. For example, in countries with two-tier board systems, a catalogue of mandatory items to be discussed and approved by the supervisory board (including sustainability goals and strategies) should be embedded in law.

Sustainability-friendly capital markets

One of the main pillars of the stakeholder model of capitalism (along with worker voice) is 'patient' capital, which traditionally has been provided by large, long-term owners, such as families, the state and (in countries such as Germany) banks. In recent decades, however, the magnitude of patient capital from these traditional sources has been decreasing. An important supportive element for the sustainable company, however, is that capital markets should not penalise – and in the ideal case even reward – companies which transparently and systematically implement sustainability policies.

A list of measures that could help create a more sustainability-friendly capital market environment for companies includes the following:

– Mandatory reporting requirements for institutional investors (including hedge funds and private equity funds) on the companies they invest in and the extent to which these companies have sustainability policies. (Reporting requirements should also be extended to the corporate governance of institutional investors, such as management remuneration and so on).
– Constraints on the short-term behaviour of investors, such as differentiated voting rights, dividend policies and taxation rates for investors based on their length of investment (for example, dividends only after a one-year holding period, or double dividends for at least a one-year holding period, and so forth).
– Encouraging more ‘patient’ capital, such as employee shareholding, and ensuring that employee shareholders have a voice in corporate governance (for example, in France, where employee shareholders can elect a representative to the board when they hold at least 3 per cent of shares).
– Strengthening the weight of various sustainability elements, such as workers’ rights, in the major socially responsible investment indexes.

Extending the role of trade unions

Important dimensions of sustainability, such as employment conditions and occupational health and safety, have long been core concerns of trade unions. Other dimensions, such as the finances of the firm, have also been longstanding concerns of works councils and employee board-level representatives, which exist in many European countries, particularly in large companies. Nevertheless, many elements of the multi-dimensional concept of sustainability stretch beyond the traditional core concerns of trade unions. In this respect, the sustainable company represents a challenge to current trade union capacities to take positions on these issues and to advise trade union and/or works council representatives on a decentralised level. Taking an active role in the sustainable company would thus require trade unions to build up their expertise in new areas, either through further training and education for their officials and members, or by hiring experts or consultants for advice on specific issues. The negotiation of framework agreements on sustainability also represents an extension of trade union capacities to a new area, and will certainly involve an accumulation of learning experiences.

Conclusion

The road ahead to implement the 'sustainable company' concept as part of the new growth model will be neither easy nor quick. The current crisis in the shareholder value model of the firm has not automatically led to an alternative. The blueprints presented here are by no means final nor worked out in all details, and need to be modified and filled out in the future. Nevertheless, as this chapter has outlined, there are steps that can be taken right now, and in fact some actors have already started this journey. Some actions can be taken in terms of better practice at the company level, whereas other measures need to be taken in the legislative arena at the national and supra-national levels. The sustainable company can contribute to the establishment of a new growth model.

The case for a modern industrial policy

Tim Page

The economic crisis brought into the open a concern that many had felt for some years, especially in the Anglo-Saxon liberal market economies, namely that too much reliance was being placed on financial services and that banks were increasingly taking risks in the ways they made their profits. Those arguing the case for more traditional manufacturing were not doing so from a position of nostalgia, but from a belief that, while longer term, sustainable (in both senses of the word) industries may not produce bumper profits in a short space of time, they can provide steady growth, wealth creation and jobs over the longer term.

One silver lining arising from the downturn, therefore, is a renewed interest in manufacturing. Exactly what different countries will manufacture will depend on the individual strengths that provide, in economic jargon, their comparative advantage. From a UK point of view, the focus should be on high skill, high value manufacturing, which provides quality jobs for workers. This applies to Western Europe and the United States as well. The so-called BRIC countries – Brazil, Russia, India and China – are developing fast and will increasingly want to expand into these areas too. For developing countries in Latin America, Africa and some parts of Asia, the focus is likely to be on more labour-intensive, rather than capital-intensive, industries. Economic history tells us, however, that those regions will move towards higher skill manufacturing eventually.

So far, so good. But other factors also impinge on this debate. The threat of climate change cannot be ignored. This means that the demand for greener manufactured products will only become greater. Furthermore, the entry of large countries such as China, India and Brazil into the developed world economy has led many to ask, aloud, whether smaller countries such as the UK can possibly compete. With universal belief in the virtues of open markets and free competition, but recognition that there are barriers to entry in the case of many industries, this poses another question: what role for governments in helping to bring about an industrial renaissance? Or, to put it another way, do we not need a modern industrial strategy?

The economic orthodoxy does not favour industrial policy: in its view, it undermines the operation of the hidden hand of the market. The optimum orthodox solution is that businesses will develop in those sectors that offer the greatest returns – that is, the highest profits – and those sectors will be economically, socially and culturally the most desirable ones.

That reads well on the pages of an economic textbook. But it ignores the lessons of economic history. In a thought-provoking paper, Justin Lin, Senior Vice President of the World Bank, and Celestin Monga, his economic advisor, have stated:

> Historical evidence shows that all countries that have successfully transformed from agrarian economies to modern advanced economies – including those old industrial powers in Western Europe and North America, as well as the newly industrialised economies in East Asia – had governments that played a proactive role in assisting individual firms in overcoming the coordination and externality problems in the process of their structural transformation. In fact, the governments in high-income countries today continue to play that role. (Lin and Monga 2010)

These two economists from the World Bank – not an organisation on the left of the political spectrum – argue the case for industrial strategy and set out a way to make it work.

This section argues, then, in favour of modern industrial strategies, partly as a response to the economic downturn, but partly because the twin challenges of globalisation and climate change would have pushed us in this direction even if the downturn had not happened. The next question is: what should those industrial strategies look like?

As noted above, there is a broad consensus that competition must be maintained. Protectionism is a zero-sum game that simply encourages companies to put up more and more barriers. Innovation is undermined and productivity growth consequently falls. There is a limit to the role of government, but that is not the same thing as government having no role at all. All governments will wish to increase the wealth and well-being of their citizens. They should not be in government if they do not. This means that the development of national economies is a political issue. The problem with the hidden hand argument is that it suggests that governments have no reason to care which industries do and which do not develop in their countries. But they have every reason to care.

Lin and Monga argue that successful industrial policies are those that target mature industries not too far advanced compared to countries' own levels of per capita income. Pioneer countries have played the role, often unwillingly, of an 'economic compass' for those trying to catch up:

> Going back to the sixteenth century, the Netherlands played that role for Britain, which in turn served as a model and target to the US, to Germany and France in the late nineteenth and early twentieth centuries and to Japan in the mid twentieth century. Likewise, Japan was imitated by Korea, Taiwan-China, Hong Kong-China, and Singapore in the 1960s and 1970s. Mauritius picked Hong Kong-China as its 'compass' in its catch up strategy in the 1970s. China chose Korea, Taiwan-China and Hong Kong-China in the 1980s. (Lin and Monga 2010)

For developing countries, identifying a 'compass' economy may not be too difficult. For a country such as the UK, with an already developed economy, the situation is different. We might aspire to the manufacturing sector of Germany or the green manufacturing progress of much of Scandinavia. For trade unions the country either is or could become world class over the coming decades. The issue is less a need to catch up with the per capita income of other countries and more to learn from their industrial strategies.

So what role for government? Most obviously, governments need to provide horizontal support to industry. Investing in skills, which benefits all industries, is one example of this horizontal support. Decent transport links and other modern infrastructure, such as high speed broadband, are also important. Access to finance is essential and a green investment bank (currently under discussion in some countries) is an institution that cannot come soon enough.

But there are other innovative industrial policies around the world from which policymakers can learn. One possible model is the Fonds Strategique D'Investissiment (FSI). This has two shareholders, the Caisses des Depots and the French Government. The FSI invests in the capital structures of private companies, acting as a minority shareholder. It seeks to be a long-term investor, investing for up to 8–10 years, possibly longer. It invests an amount of money that gives it presence and allows it a say in governance, through seats on boards. Rather than offering subsidies, it associates itself with entrepreneurial risk. The FSI has 20 billion euros at its disposal: 6 billion euros in cash and 14 billion euros in equity stakes in companies.

The FSI invests in companies of strategic interest to France. It allows the government to nudge those industries where France can become and remain a world leader. It recognises that the job of wealth creation should be left to companies – the FSI is very much a minority player in the companies in which it invests – but it also recognises that wealth creation is not only of interest to companies. Furthermore, while a 20 billion euro budget may look huge, the FSI is not spending this money, but investing it. It should expect a return on its investment, just like any other shareholder. Indeed, it should expect to make a profit. This imposes important discipline on the FSI. Critics of industrial policy in the UK argue that, in the 1970s – the decade for which industrial policy is most (in)famous – the government did not 'pick winners', but propped up losers. The FSI should be no more expected to invest in an obviously failing company than any other shareholder should be.

Where governments have an interest in industry, they should say so. There is nothing wrong with this. On the contrary, businesses that engage with government often say that they mainly want a straight answer. If they do not get everything they want, but know what the government's priorities are, they can act accordingly. France is also the land of '*grands projets*'. Historically, governments have targeted a number of ambitions, whether the TGV or the A380, and private companies have known that various government strategies – for example, skills development or industrial infrastructure – will be designed to meet these ambitions. They can then invest in the areas that they know will grow. In the UK, the Defence Industrial Strategy worked in the same way. Companies knew about major defence procurement decisions, running into billions of pounds, years in advance, so they knew where to target their own development if they wanted to bid for those contracts. Defence procurement is subject to different rules to other government purchasing, but the principle of knowing government ambitions works in the same way.

In conclusion, there is a danger that, after a period, the world economy will return to the values that led us to the economic downturn. Central among these was the short-termism that led to so many banks and financial institutions behaving in the way they did. To avert this danger, this chapter recommends:

- that governments around the world adopt a long-termist approach to their economic futures;
- that strategic industrial policies be welcomed as a central part of building the post-crisis economic world order;
- that governments should target the development of industries that are not too far advanced compared to their own levels of per capita income;
- that industrial strategies should follow targets set by governments regarding the contribution of key industrial sectors to economic growth, wealth creation, job creation and industrial sustainability;
- that world trade and competition rules reject protectionism, but recognise the legitimate role of governments in building strategic industries, and especially in the 'greening' of traditional industries.

Quality public services for fair and sustainable growth

Sébastien Dupuch

Introduction

The reduction of the role of the state and of public authorities in general in economic activity is one of the pillars of the Washington Consensus that has dominated the development of recent economic policies. In the effort to meet targets intended to redress public deficits, governments have embarked on policies to reduce their expenditure and liberalise markets.

This trend is attributable also to various forms of dissatisfaction with the precepts governing public sector management. Public services have been accused of being both costly and inefficient; it has been argued that their 'modernisation' requires partial or total subjection to the play of competition or, at least, acceptance of managerial practices characteristic of the private sector.

And yet the impact of these policies has been mixed, to say the least. Some privatisations in some countries have worked moderately well – nobody is suggesting in the UK, for example, that the state should be in the business of making steel, aircraft or operating telecommunications services. But equally, it is difficult to argue that the privatisation of natural monopolies (most specifically, energy and water) have had a beneficial impact on consumers. Liberalisation policies have not proved particularly positive. Nor is there strong evidence to suggest that a market-based approach to health care delivers superior results – the US continues to spend the highest percentage of GDP on health care in the OECD, but many people remain uninsured (although this will change when President Obama's health care plan becomes operational) and health outcomes for the poorest groups in society are worse than in comparable countries.

We have already seen that governments emphasised the positive role played by the public sector in minimising the effects of the crisis. In that sense it seems that there had been a resurgence of the rather old idea that only the government could act to stabilise an inherently unstable capitalist economy. But austerity policies are now back in vogue and there is a real risk that the drive for fiscal consolidation will damage the provision of public services to the detriment of all but the richest in society.

What do we mean by the public sector and public services?

The state has four critical roles to play in an advanced capitalist economy. It undertakes a *protective* and a *regulatory* function insofar as it compensates for market weakness or failure and guarantees the security of transactions. The state is a *producer* insofar as it is responsible for public investment; and it is an *actor and operator* insofar as it conducts and implements the major forms of public policy.

In the broad sense, the term 'public service' refers to claims of rights by citizens to services that have been authorised through a democratic process and are provided on a non-discriminatory basis. However, within the European Union this notion of public service is subject to significant differences between countries, as regards both the nature and extent of public service provision and also the mode of organisation and intervention of the public authorities in sectors such as health or education. The EU distinguishes between 'services of general interest' (SGI), that are defined by the member states, and 'services of general economic interest' (SGEI), which are subject to European competition rules.

In order to restrict the scope of our considerations here, it will be appropriate to establish the following distinctions:

– activities belonging to the public sector in the context of the state's regulatory functions (police, defence, justice, public finances, general and local government, and so on);
– social protection (insurance against sickness, unemployment, old age and so on);
– non-market public services (health, education, roads, sewage, culture and so on); and
– those which relate to market activities that have been taken over

by the public sector because they meet essential needs or interests not easily compatible with the operation of markets. This applies to, among other things, infrastructure such as toll motorways, railways, ports, local public transport, energy production and distribution, water supply, the post office and telecommunications.

Apart from the difficulties involved in agreeing upon a common definition, data to facilitate comparison of the size of public services in Europe are scarce. Some indicators have nonetheless been published recently in a study carried out by CEEP.[43] This publication provides a picture of SGI in the European economy. Their share in EU27 GDP was estimated at 26 per cent in 2006, and accounted for 30 per cent of employment. However, the study does not provide insight into the development of SGI over time, information which would be a prerequisite for measuring the extent of the movement towards the liberalisation of public services. Nor does it enable a distinction to be made between activities supplied in the context of public ownership, those open to or shared with the private sector, and those supplied exclusively by private firms.

The outcome of liberalisation policies

While neoliberal economists have long decried the low productivity of public services and developed arguments in favour of opening them up to the private sector, it is important to stress that the results of the policies conducted to liberalise public services have been patchy (Drevet 2010).

Accused of being costly and of poor quality, public services are unable – so it is claimed – to generate the incentives that would be required to make them more efficient and innovative. The private sector, subject to the dictates of a cumbersome bureaucracy, is blamed for its inability to incorporate technological progress. The introduction of the principles of competition was intended to keep down costs, encourage innovation and improve the quality of services supplied.

As a result of privatisation, these services do perhaps weigh less heavily on the public purse. However, major investment remains in the hands of

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43. *Mapping the public services*, CEEP (2010), available at: http://www.ceep.eu/index.php?option=com_content&view=article&id=44&Itemid=58

the public authorities. Many types of activity require the kind of large-scale investment that private companies are not in a position to make. A private firm that pays dividends to its shareholders will seek to maximise its profits and adapt its tariff systems accordingly rather than to invest in generally costly infrastructure. A British example is illuminating. The railways were privatised in the 1990s, leading rapidly to increased delays, slower journeys and more accidents. Railtrack, the private company responsible for managing the infrastructure, failed to make the necessary investment. Only the public authorities are in a position to guarantee the public interest by undertaking the type of investment that will pay off in the long term. Privatisation has frequently meant that those segments likely to reap healthy profits were placed in the private sector, while the public sector retained responsibility for infrastructure.

A Eurobarometer survey conducted in January 2009 on consumer satisfaction in the wake of a change in service suppliers revealed a high level of dissatisfaction, particularly in the fields of insurance and energy. Even in telecommunications, often seen as a success story, significant problems remain, often to the detriment of poorer households in particular (Crozet 2007). For example, the Commission has several times intervened to decree a reduction in the cost of international telephone calls.

In the case of so-called natural monopolies, the consequence of privatisation has been to create an oligopolistic market with a somewhat ineffective regulatory regime. In gas and electricity supply, privatisation has entailed rapid price increases for both households and businesses. In Sweden, the opening up of the post office to competition in 1993 led to major increases in postal rates for individuals.

Liberalisation, finally, can exacerbate inequalities, insofar as the purpose of public services is to guarantee equal access for all citizens to essential goods and services. It is frequently the case that the advantages accrue to the biggest customers alone. This is what happened in France in 2005, for example, with the privatisation of the authority responsible for checking the roadworthiness of heavy goods vehicles. The transfer of this entity to private ownership led to cost increases of around 20 per cent for 90 per cent of road haulage operators – small businesses – whereas the remaining 10 per cent – the major groups – benefited from the reform since they were in a position to submit tenders and in this way force the private control centres to reduce their costs ('one man's price cut is another man's price rise').

Public services: an essential component of growth, investment and employment

Arguments favouring the maintenance of public services have long relied on the idea of natural monopoly. Founded on sound theoretical arguments, this notion suggests that, in sectors supplying essential goods or services, and whose operations are characterised by major economies of scale, a form of monopoly organisation is in the best interests of the population at large, being more effective than a competitive mode of organisation from an economic standpoint. In practice, natural monopolies have now been dismantled by the separation of infrastructure and operations in sectors such as energy or transport, thus giving rise to submarkets in which competition comes into play.

The presence of negative or positive externalities generated by private agents also justifies the existence of public services, whether it is a matter of dealing with the consequences of the activities of one agent for those of another (protection of the environment, for example) or of fostering the advantages for the population at large of the supply of all collective goods by the public authorities. In accepting responsibility for the production of these goods and services, the state enables everyone to take advantage of them at lower cost.

The public production of specific goods such as education, health care or transport also has cumulative effects on growth. Similarly, research, innovation, expertise and engineering conducted or acquired in the public sector contribute to the development of private activities. When public research is focussed on technological innovation, it alone is able to finance the long-term research whose fruits are not immediate. The quality of public services, their respective areas of competence, their infrastructure and local availability are, furthermore, assets that represent incentives for private firms to set up their operations and develop their competitiveness.

An OECD study has also shown that public investment can influence growth by improving the general conditions (this applies, for example, to the development of infrastructure) in which private agents carry out their activity (Bassinini and Scarpetta 2001). It also exerts a major leverage effect for private investment, typically for industrial projects that can prove profitable only in the very long term or which are on too large a scale or too risk-laden to be taken on by the private sector (Pollin and

Baker 2009). These findings are highly relevant in the context of sustainable development policies: for example, energy-saving measures and the development of new forms of energy, electrical cars or the extension of digital coverage.

Conclusion

Within the framework of a new growth model, it is important to reaffirm the essential role of public services as a means of guaranteeing fundamental rights, social cohesion and solidarity, and of bringing about a reduction in inequalities and the satisfaction of the needs and expectations of the population as a whole. At a time when austerity plans are gaining an increasing hold at European level, it is essential that public accounting should provide honest information about how such programmes affect growth, the development of wealth and employment or efforts to reduce inequalities.

In Europe the implementation of a regulatory framework with a clear definition of the cover to be provided by public services is required in order to guarantee access to essential services and to satisfy needs in the most appropriate manner possible, while also encouraging effective use of land and of common resources.

For the provision of high-quality public services, with guaranteed access for all and opportunities for greater participation by citizens and users, the following guidelines may prove helpful:

– Undertake a serious assessment of liberalisation and privatisation policies that have reduced the scope of public services.
– Privatisation should take place only where there is clear evidence that competition would be both genuine and beneficial. In some cases it may be necessary to take certain services back into public ownership/control. On the local level, this has already happened in the case of public transport, access to some forms of energy, water distribution and waste management.
– Create a European framework for public services in order to better link up networks, guarantee their mission as contributors to the public interest and include within their remit concerns of a social nature, as well as enhanced democratisation and user control.
– Strengthen the public sector by devising appropriate industrial pol-

icies. Today the EU, for example, has no adequate overview of its own industrial fabric. The aims and means of an ambitious industrial policy should be to:

- develop quality infrastructure (transport, water, electricity, communications and so on);
- encourage the creation and development of new industrial sectors by means of public investment programmes, investment subsidies or grants for setting up new firms;
- gear public scientific research budgets towards areas regarded as priorities, particularly so as to move in the direction of sustainable development;
- devise trading rules and mechanisms specifically intended to avoid situations of unfair competition;
- encourage environmental protection and international labour standards.

Green growth and the need for a paradigm shift: challenges for achieving social justice in a resource-limited world

Anabella Rosemberg and Lora Verheecke

Introduction

At the Earth Summit held in Rio de Janeiro in 1992, it appeared that a global consensus had been reached that there was an inevitable connection between social justice, environmental protection and economic security. Sustainability was the watchword and there seemed to be a high level of political commitment to that goal. However today, almost twenty years later, very little progress seems to have been made. The limits of our current economic system have been revealed by the continuing evidence of climate change driven by human activity; income inequalities have grown; much of the developing world continues to struggle (as we saw in Chapter 3); and the global recession has revealed the fragility of finance-driven capitalism.

Perhaps the banking crisis has created a further opportunity to make a reality of sustainability by rethinking the fundamentals of our economic system. This paper sets out a trade union response to the policy imperative and attempts to explain how the requirement to deal with climate change can be managed equitably.

More growth but greener? Ecological modernisation theory

The two central concepts here are green growth and the green economy. Both have emerged in recent times as a potential route out of the crisis. Nonetheless, they are hardly new and draw upon an older assessment of the capacity of the economic system to capture the environmental impacts of production and consumption. Expressed more technically, this represents no more that an effort to 'internalise the externalities'.

These fairly orthodox notions are at the heart of ecological modernisation theory. The central assumption here is that the appropriate response to the environmental challenge is not to abandon the objective of growth altogether. There is no necessary connection between continued growth and environmental devastation. According to this theory, the current environmental crisis is the result of institutional and market failures (Stern 2007). Reforming institutions and markets is the key to environmental improvement as 'existing political, economic and social institutions can internalise the care for the environment' (Hajer 1995). Markets can be 'greened' if a price can be attached to the impact of economic activity (externalities) on the environment. Two straightforward examples of ecological modernisation measures are the promotion of clean energy sources or improved material efficiency.

This theory has several advantages. A greener economy is a better alternative than business-as-usual growth. It can revitalise the economy in periods of economic decline through the mobilisation of new investment, job creation in emerging sectors or innovation processes. Green growth can also encourage investment in environmental innovations. Ecological modernists believe that resource efficiency can drive cheaper production and economic growth through reduced natural resource consumption (Jackson 2010).

From a trade union perspective, a greener economy represents an opportunity to build a progressive agenda for sustainability. In other words, there is a chance to transform traditional sectors – by improving resource productivity, for example – and to create high quality jobs in new sectors. Moreover, by putting employment questions back into the sustainability discussion, trade unions are making clear that the notion of sustainability has a number of dimensions. Low environmental impact has to be linked to high quality work. And, of course, this approach to growth adds a new dimension to business competitiveness, which for the past 40 years has demanded little more than the deregulation of labour markets.

Is green growth enough?

Despite the widespread agreement on the ecological modernisation agenda, that approach is not entirely unproblematic. How, for example, can the integrity of policies be guaranteed? It is fairly easy to envisage a situation in which more renewable energy is available but an increase in energy consumption means that the environmental benefits of renewables are blunted by a continuing rise in the use of fossil fuels. In principle, the energy mix may be more sustainable, but overall energy consumption most certainly is not.

The second drawback, closer to traditional union concerns, is the theory's reliance on the market as a tool for changing production and consumption. Ecological modernisers argue that the market is 'a more efficient and effective mechanism for coordinating the tackling of environmental problems than the state' (Mol 1995: 46–47). Practical experience tells us that this may not be true. Price signals do not always help market actors to behave in a more environmentally friendly manner. This is clear in the case of rising energy prices for households. Facing a potential increase in their bills, tenants have an incentive to insulate their houses in order to reduce their expenses. However, owners, who are in charge of the investment, do not see the interest of investment in insulation as they will not experience a direct benefit. In this case, only regulation and not just price increases can address the situation. Furthermore, price signals on energy can have a negative distributional impact on the poorest or more vulnerable consumers, who sometimes find that 40–50 per cent of their incomes is used to finance energy use.

Theories of green growth have often ignored 'issues of social justice and the processes of social inclusion and exclusion' that run through the modernisation they are advocating (Swyngedouw and Cook 2009: 12). There may be understandable resistance from citizens to the need for 'green growth' or a 'green economy' if the costs seem to outweigh the benefits or if the burdens of adjustment are unfairly shared. These are core trade union concerns. No green transition or paradigm shift will be possible unless workers' legitimate concerns are properly reflected in the process. Losers must be compensated and helped to adapt.

Radical critics of the green growth approach claim that the paradigm shift required by the environmental crisis cannot be met by either green growth or a greener economy. In their view, growth is the problem, not the solution; we will all have to be satisfied with less in the future. In reality, of course, two arguments are being confused here: the first about the sustainability of our current economic model; and the second about the appropriate measure of growth. We have already seen (Chapter 1) that a new approach is needed to measure the outputs of economic activity, including environmental impact and the need for 'a dashboard of economic and social indicators' has been endorsed. But to call for a new approach to measurement is not the same thing as a demand for a no-growth economy. Indeed, if economic activity were reduced to a steady state level where there was no further depletion of natural resources the poor would suffer the most, particularly in developing countries (Fitoussi 2010: 63). That is why a just transition is a prerequisite for the paradigm shift.

Beyond growth

Although there is no clear alternative to the growth paradigm, a number of ideas – of which 'just transition' is one – have arisen in recent years with a long-term vision and a similar aim: achieving wealth and an equitable share of natural resources through other means. These ideas include the concept of 'prosperity without growth' and 'greenhouse development rights'.

Prosperity without growth: Tim Jackson, a member of the UK's Sustainable Development Commission recently produced a report (*Prosperity without growth*) which had a wide public impact. Central to his approach is the desire to ensure that people have a decent life and the ability to flourish as a result of a change in behaviours and lifestyles (Druckman, A. and Jackson 2010). Key measures to achieve this new societal paradigm include, among other things, substantial long-term sustainable investments which create decent jobs, reform of financial markets, a better work–life balance through a reduction of working hours and a decrease in consumption levels. Those key measures are fairly close to past and current trade union proposals. However, there is a salient issue that is not addressed in this new approach: development. Jackson acknowledges that '*Prosperity without growth* is conceivable only in the richer nations' (Jackson 2009). In other words, this is a model that might be of relevance to OECD economies – although the barriers to implementation are formidable – but it says little of relevance to the developing world, where environmentally sustainable growth should be just as much of a priority. In other words, more policy instruments are needed.

Greenhouse development rights: Some intriguing possibilities are thrown up by the 'greenhouse development rights' framework. This was developed to offer some policy guidance to both developed and developing nations, although once again it is not entirely unproblematic.

Rather than conceiving the transition towards a more sustainable society as a single function of the GDP of nations, this framework suggests a change in our thinking: it bases the share of the effort for reducing emissions on two concepts: the Responsibility Capacity Index (for nation-states) and the development threshold (for individuals). The 'development threshold' is a level of welfare below which people are not expected to share the costs of the climate transition. People above the threshold must assume the costs of curbing the emissions associated with their own consumption, as well as the costs of ensuring that, as those below the threshold rise towards it, they do so along sustainable, low-emission paths. The development threshold is currently set at $20 per person per day.

The 'Responsibility Capacity Index' indicates how the share of the effort between countries should be based on their national cumulative emissions since 1990, excluding emissions that correspond to consumption below the development threshold. Similarly, capacity is the sum of all individual income, excluding income below the threshold. This index determines the level of actions that nations have to undertake to 'help to launch a global transition to a low carbon economy' and to help 'the poor adapt to the inevitable changes that await them'.

How would this thinking contribute to a paradigm shift? First, it introduces the social justice dimension into the environmental protection debate. The responsibility to 'pay' for climate change falls on the richer social classes within countries. The framework is also ambitious. 'It requires powerful countries to accept large obligations, and to commit to making large international financial and technology transfers' (Baer 2008: 16–25).

Introducing this thinking among the solutions to climate change would avoid putting excessive pressure on the poorest sectors of countries to contribute to climate solutions, in both developing and developed countries.

Just transition: Although there is a general consensus around the idea that social justice cannot be achieved without environmental protection, the means by which a 'win–win' approach could become reality are still unclear. How can environmentally-friendly policies become supportive of the livelihoods of workers and communities which make a living out of the degradation of the environment? How can we deal with the impacts of the transformation of our economies? Those issues are at the origins of the 'Just Transition' framework, developed by the trade union movement as a tool for ensuring that ambitious environmental actions integrate social and societal needs.

Just Transition refers to the need for long-term sustainable investments which could create decent jobs and transform those in traditional sectors; pro-active training and skills development policies, social dialogue with unions, employers and other stakeholders, research and early assessment of social and employment impacts of environmental policies, the development of social protection schemes and the need to develop local economic diversification plans (Rosemberg 2010).

How could a 'Just Transition' framework contribute to a paradigm shift? First, it would eliminate the apparent contradiction between the protection of livelihoods and the protection of the environment. Second, it has the advantage of highlighting the importance of anticipating and planning industrial and development policies and allowing for a reflection in the mid and long run. Ultimately, as a 'transitional tool', it makes the shift towards a different economic model possible.

Conclusion

Several groups in society acknowledge the need for a paradigm shift if we are to achieve social and environmental goals. Nonetheless, this thinking is still divided into 'silos'.[44]

If some opportunities for jobs and growth emerge from the ecological modernisation theory, it is important to consider what will be and who will pay for the consequences of the growth paradigm for our societies and our natural resources. New ideas linking both dimensions are emerging, but are still incomplete.

44. An 'information silo', for example, is a management system incapable of operating reciprocally with other, related management systems.

Although the trade union movement has advanced significantly in its understanding and actions on environmental issues, proposals such as those included in the concept of Just Transition have still not reached consensus outside the labour movement. Environmental degradation and the current economic crisis have opened a critical space for trade unions to raise their voice and offer a more comprehensive alternative framework.

There is a need to scale up our efforts in this exercise, as the consequences of the current economic model are already generating irreversible changes in the natural resource base of our planet, which in turn weaken even further the prospects of achieving decent work and sustainability.

Green jobs and the green transition

Béla Galgóczi

Introduction

What kind of economy will emerge from the crisis and what foundations will future growth have? The next big restructuring wave will be the transformation towards a low-carbon economy, also referred to as the 'green transition' or even the 'third industrial revolution' (Jänicke and Klaus 2009).

The International Panel for Climate Change (IPCC 2007) and the Stern Review (Stern 2006) provide convincing evidence that the world is already experiencing global warming and that the human impact on climate greatly exceeds the impact of natural factors since the onset of the industrial era. As a result, deep and significant cuts in anthropogenic greenhouse gas (GHG) emissions are urgently needed if we are to avoid dramatic, irreversible and self-reinforcing changes in the world's climate.

The G8 group of nations agreed in 2009 that the increase in global temperatures should be no more than 2°C above pre-industrial levels. To achieve that, global emissions will have to be cut to half their 1990 levels by 2050. For industrialised countries this would mean an 80 per cent cut in their emissions by that date.

There is a broad consensus that these targets should be applied and that future economic growth must be decoupled from energy and resource use. In order to manage this objective, the entire spectrum of economic activity must be transformed. Even though the applied policy tools are still unclear and the timeline is uncertain, we must take the target of 80 per cent emissions cuts by 2050 as a basic framework for future economic activity in industrialised countries. Implementing these climate targets will induce a restructuring process that will thoroughly transform industrial jobs, in both quantitative and qualitative terms.

This section attempts to take stock of the expected consequences of this transformation on European industrial jobs and to map the challenges trade unions are facing. We provide a brief overview of European climate policy targets in light of the EU 2020 Strategy and show that neither the necessary economic tools nor the implementation mechanisms are yet clear. We take account of the available literature and initiatives of the European Commission in mapping future employment impacts, and also address a number of open questions. Employment forecasts for particular industries will also be presented, although emphasising the uncertainty of such forecasts and focusing on the main trends and challenges.

The final goal of this section is to call the attention of policymakers to the fact that economic policy tools and a roadmap for achieving climate targets must be clearly defined with accompanying policies to guarantee a just sharing of the burden in the transformation process.

Broad climate policy targets and past achievements

The European Union is committed to a 20 per cent cut in GHG emissions, rising to 30 per cent if the rest of the world promises significant cuts. Japan's new government has promised a reduction of 25 per cent on the basis of 1990, but has revealed little about how it might manage that. The US offers a 17 per cent cut on 2005 emissions by 2020, which is around 4 per cent below 1990 levels, far below the 25–40 per cent cut that is expected of developed countries. The 80 per cent emissions cut for industrialised economies means a cut to two tonnes of CO2 equivalent per head per year. In 2008, emissions in the US were at around 24 tonnes per head, while in Europe they were ten.

According to the road map drawn up at the UNFCCC conference in Bali, developing countries are not required to come up with numerical targets for cuts, but they are required to propose 'nationally appropriate mitigation and adaptation actions'. China has offered a 40–45 per cent cut in the carbon intensity of its economy by 2020, but its absolute emissions would still grow. Achieving a globally applied and binding strategy for mitigating the effects of climate change poses an unprecedented governance challenge. This was illustrated clearly by the failure of the Copenhagen COP-15 Summit in December 2009.

Past performance at global level is fairly alarming. CO2 emissions from developed countries did not decrease in the period 1990–2008, while those of developing countries increased substantially. The overall global balance is a 41 per cent increase in emissions between 1990 and 2008 (IGBP 2008).

European policy framework and performance since 1990

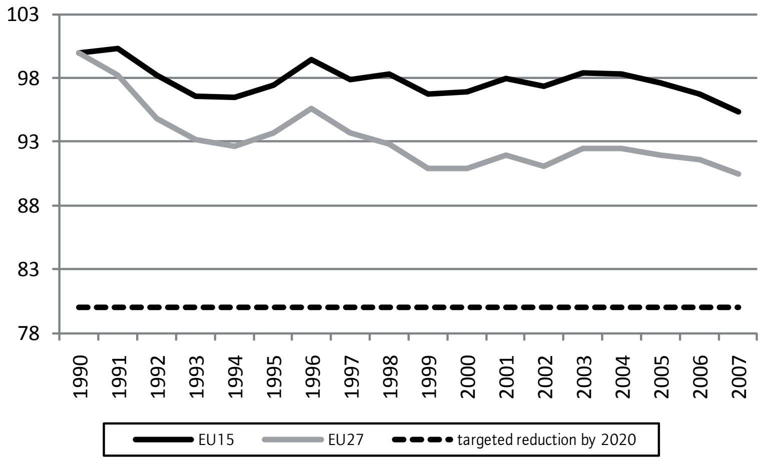
With all the uncertainties besetting implementation at the global level, it is imperative that Europe remain committed to its targets and apply the necessary policy measures to accomplish its promised goals.

The EU 2020 Strategy, with its triple priorities 'smart, sustainable and inclusive growth', has formulated its headline targets as: a 20 per cent reduction of GHG emissions (if possible, 30 per cent); increasing the share of renewable energy to 20 per cent of all energy generation; and a 20 per cent increase in energy efficiency. It has devoted one of its 'flagship initiatives' to a 'resource-efficient Europe'.

Regarding the performance of the EU, it is still one of the few regions that has achieved a reduction in greenhouse gas emissions in comparison to 1990. However, the rate of reduction is too low and the EU is still lagging behind the proportional fulfilment of its 2020 targets, with EU15 GHG emissions down by 6.5 per cent during the period 1990–2008 and EU27 emissions down by 11.3 per cent (Figure 11).

A breakdown of the data shows that a significant proportion of the cut in emissions was achieved during the first decade of the observation period, as in 1999 GHG emissions were 9.1 per cent below the reference level of 1990 in the EU27 and 5.3 per cent below this level in the EU15. The period 2000–2007 saw no more than a marginal decrease in emissions (0.4 per cent in the EU27 and 1.4 per cent in the EU15). The single crisis year of 2008 contributed a larger decrease than the preceding eight years put together, amounting to 1.8 per cent in both the EU27 and the EU15. The good performance during the 1990s was attributable mainly to the collapse of the traditional industrial base of the Central and Eastern Eu-

Figure 11 **Greenhouse gas emissions in % of emissions in the base year 1990**



Source: EEA dataservice.

ropean (CEE) countries and of eastern Germany during the initial phase of the post-1989 transformation. The wider post-unification recession in Germany in the early 1990s also contributed to emission reductions of the EU15. Out of the EU27's total 11.3 per cent reduction in emissions between 1990 and 2008, 7.3 per cent had already been achieved in 1994 (at the lowest point of the transformation crisis in the CEE), showing clearly that the bulk of the emission cuts was attributable to output contraction and economic crisis and not based on the sustainable implementation of measures aimed at achieving policy targets.

Even if Europe is performing better than the rest of the world, it is not on a sustainable track towards fulfilment of the ambitious 2050 targets. The target of an 80 per cent cut in emissions for the industrialised economies by 2050 means a cut in emissions to 2 tonnes of CO2 equivalent per head per year. In 2008, however, emissions in Europe were 10 tonnes, with an extra 4 tonnes CO2 equivalent of imports. There is thus a very long way to go to meet this long-term objective.

Implementation and economic instruments

Implementation is, however, the cornerstone of achieving climate policy targets. What we have now at the European level are mostly declarative objectives without a concrete roadmap and instruments of implementation.

The central issue is to get the 'carbon price' right. Economic policy instruments that determine the effective carbon price include 'cap and trade' policies (such as emissions trading), a variety of carbon-related taxes and the direct involvement of the state through redistribution mechanisms (for example, levies on carbon-based energy generation and use, with subsidies for environmental innovation). These instruments alone would not be sufficient to translate policy targets into business reality, however. What is needed is a coordinated policy mix of these instruments with a clear implementation agenda at the European level and this remains largely absent.

The European Emissions Trading System (ETS) clearly demonstrates the uncertainties and distortions of the policy instruments that have been – partially – implemented. The Commission is currently finalising the design of the third trading phase of the ETS, which will begin in January 2013 and last until 2020. The Commission's stated objective is to increase the share of emission permits that are auctioned rather than allocated for free to installations covered by the ETS. A key concern will be the potentially negative impact of the next phase of the ETS on the competitiveness of affected businesses. The potential exposure level of industries or sectors to the ETS depends on the CO2 intensity of production, the opportunities to abate carbon within the sector and the ability to pass along carbon cost increases in terms of output prices.

Opinions vary in the literature concerning the possible effects of the future ETS regime. A study by CEP, for example, argues that most industrial sectors entitled to free emission permits would not face an increased risk of closure if they had to pay for permits (Centre for Economic Performance 2010). Another study by the ZEW Institute points to the longer term uncertainty about carbon leakage and firms' pass-through capacity with regard to carbon costs (Oberndorfer et al. 2010).

There is thus a substantial uncertainty about the third phase of ETS, with a barely calculable increase in ETS costs driven by an assumed increase in the price of allowances. According to a study by the WWA consultancy group commissioned by the EIUG and the TUC, the forecast increase in the total energy bill – taking electricity, gas and emissions reductions schemes together – is projected to be between 18 per cent and as much as 141 per cent by 2020, an incredibly wide spread (EIUG-TUC 2010).

While economic actors are becoming aware that the costs of using environmental resources will impinge more and more on their operations, in the absence of a concrete policy framework they are unable to plan the necessary adjustments.

Employment effects

If we look at the possible social consequences of the implementation of climate mitigation policies, where the assigned economic instruments are actually applied (not the case up to now), we can identify two major impacts. The first is the effect on employment, the second is the manner in which higher carbon prices affect different income groups and thereby influence social equality.

There is a broad consensus in the literature that, although climate policies would not have a major aggregate impact on the number of jobs, a massive redistribution of jobs is to be expected:

– new jobs will be created;
– existing jobs will be transformed ('greened' jobs in existing industries);
– some jobs will disappear.

There will also be enormous differences by region, branch and labour market segment.

There is also a clear consensus in the literature that jobs identified as 'green jobs' will be net beneficiaries of the process, although the contours of this category are not clearly defined ('green jobs' include jobs that help to preserve or restore environmental quality, jobs that reduce energy, materials and water consumption and jobs that contribute to decarbonising the economy and minimising all forms of waste and pollution). High energy intensity and carbon emission activities are, on the other hand, expected to suffer a decline and substantial losses of employment.

Positive employment effects

In general, there is too much focus on the positive side of the green restructuring process on employment ('green jobs'): the employment risks and negative impacts on potentially shrinking activities have been paid insufficient attention so far. This is exemplified by the Commission Communication 'Seven measures for 2 million new EU jobs' (European Commission 2009a) that calculates the employment creation effects of the measures of the European Energy Efficiency Action Plan. The 'Employment in Europe 2009' report takes a more nuanced approach but also puts green job creation in the foreground (European Commission 2009b). A study by the UNEP and ILO takes into account the job creation potential of the green economy branch by branch (UNEP 2009), but makes an important distinction, pointing out that jobs which are 'green' in terms of the end product are not always green in terms of production processes because of the environmental damage caused by inappropriate practices (for example, in the recycling industry). The report also addresses the issue of job quality in the context of green jobs. A discussion paper by the King Baudouin Foundation goes further, addressing the implications of individual climate change mitigation measures for social justice and employment (Schiellerup et al. 2009).

According to the forecasts presented in the study prepared by Syndex, the 1.4 million jobs in the European energy sector (as of 2005) are likely to increase by a further 760,000 by 2020 (Syndex 2009). The Commission reckons on 2.3–2.8 million jobs in the renewable energy sector in Europe by 2020. The UNEP–ILO study on green jobs calculates on the basis of a potential 20 million new jobs in the renewable energy sector worldwide by 2030. However, the Syndex study warns that the net job generation effect will be lower, as jobs in traditional forms of energy generation will be downscaled (for example, by 80,000 in coal mining and 20,000 in related power plants).

There are two areas in which job creation effects will undoubtedly appear, although they cannot be regarded as long-term and sustainable forms of employment creation. First, the retrofitting and insulation of buildings has a tremendous potential for job creation in the construction industry, which has suffered particularly in the crisis. The Commission's 'Employment in Europe' report reckons that the Directive on the energy performance of buildings will create between 280,000 and 450,000 new jobs in the medium term. New jobs are linked to activities in the retrofitting of buildings and energy management, including related services. This very useful and important measure (often an element of green stimulus packages) might be threatened by the new wave of austerity measures, however.

Second, the new green industry might become an export engine, providing the rest of the world with much needed green technology and equipment (the demand to become an export leader in green technology is made mainly in Germany, but is also found at the European level). Developing green technology indeed has great future job creation potential and exports might also play a key role, assuming that Europe can acquire a comparative advantage in this field. Not all European countries are expected to benefit from such a development, however.

Employment risks

Manufacturing industry as a whole is responsible for one-third of global energy use and for 36 per cent of global CO2 emissions (International Energy Agency Tracking Industrial Energy Efficiency and CO2 Emissions 2007).

Within manufacturing, the steel industry accounts for 30 per cent of industrial CO2 emissions and employs 550,000 people in Europe, even after the elimination of excess capacities over decades of restructuring. Although the steel industry is among the most energy intensive industrial activities, the lifecycle CO2 footprint of its products has decreased dramatically and its energy efficiency has improved greatly. The industry's contribution to further emissions reductions is expected to occur through further energy efficiency improvements, not through further downsizing.

It is important to recognise that many energy intensive products have a low lifecycle carbon footprint, mainly due to their durability and recyclability. Energy intensive sectors, such as steel, chemicals and ceramics, provide many of the materials and products that are essential for the transition to a low carbon economy.

The post-2012 ETS regime will be crucial for these industries in Europe. Under current circumstances, future employment effects are not foreseeable.

Transportation is a particularly critical industry with a view to both its climatic effects and its key role in the European economy. While efforts are being made to reduce the footprint of cars, public transport systems offer lower emissions and more green jobs. Even so, employment in railway transport has fallen in the past few decades: for example, in the short period of time between 2000 and 2004 the number of jobs was cut by 14 per cent.

The automobile industry and its supply industries employ 12 million people in Europe, making it the backbone of European manufacturing industry: 2.3 million employees are directly involved in the production of vehicles, while supply industries account for 10 million (ACEA 2010). Only some 250,000 jobs are directly involved in the manufacture of fuel-efficient, low-pollution and low-emissions cars and thus can be considered green jobs. The automobile industry faces particularly strong challenges in the coming period in the course of the transformation to a low carbon economy.

Meeting the long-term CO2 emission target per of 95g/km per vehicle produced by 2020 will be a huge challenge in itself, but the role of individual road transport within the EU's broad transport concept adds a further constraint, although no details are known yet.

Under these circumstances it is extremely difficult to forecast the likely development of employment in the automobile industry in the coming decade. All in all, the main emphasis has been on the positive job creation effects of climate policy measures, but a number of fundamental issues have not been clarified.

The uncertainty of the expectable employment effects of the green transformation concerns not only the energy intensive industries and the automobile industry, but manufacturing industry as a whole. Most available forecasts are based on at least a neutral overall employment effect, putting the creation of new jobs in the green industries in the foreground. However, a recent Cedefop study reckons with a loss of nearly 2 million manufacturing jobs in Europe by 2020 (Cedefop 2010).

A more nuanced approach that addresses the complex effects of these policies taking into account the full scale of the expected quantitative and qualitative impacts on the labour market would, in fact, not hinder but promote the transformation process. By seeing the risks more clearly actors and policymakers would be more able to address these challenges by means of targeted policy measures.

Conclusion

We have presented the basic context of climate change mitigation policies, focusing on the European Union with a view to mapping its potential employment effects for European industry. There is a consensus in Europe that reversing climate change is the main policy priority of the next decade and that the transformation towards a resource-efficient and low carbon economy will be the decisive trend of the future. The economic tools and economic fundamentals of this process are still largely missing, however. Clarity is still lacking concerning how climate policy aims to achieve emissions cuts: by reducing activities that are energy intensive or by increasing the efficiency of energy intensive activities.

Examples of the existing economic instruments (such as the EU's ETS) clearly show this, leading to a situation in which the effective future carbon price is still not calculable. We have ambitious targets and promises but it is still uncertain by what means and at what price these objectives could be achieved.

When addressing the issue of the employment impact of this transition process, the focus is generally put on the job creation effect in the form of so-called 'green jobs'. But green jobs are not enough: the challenges arising from the transformation of existing industrial jobs must also be addressed. There are 12 million jobs in the automobile industry in Europe, only 250,000 of which can be classified as 'green jobs' for the moment. It is therefore absolutely crucial to discuss how the transformation will proceed with regard to all jobs. Similarly, the future of the energy intensive industries in Europe should also be addressed.

It is clear that the transformation towards a low-carbon economy will encompass a full-scale transformation of the whole economy, with wide-ranging employment effects. As in the case of other major restructuring processes, managing the transformation by means of appropriate policy instruments with the involvement of the social partners will decisive in its final success. It is a crucial question how the costs of the transition will be distributed among the various actors and within society.

Since the transformation to a low-carbon economy is a policy-driven process, 'anticipation' of change can be more straightforward and explicit and responses to its challenges (above all related to employment) can be planned and integrated into the policy framework from the outset. Above all, this would include the design of targeted labour market policies to ease necessary transitions and matching education and training measures. The most urgent step would be a proper assessment of the effects of concrete and planned climate mitigation policy measures for employment.

Other vital questions concern how this process can be managed in a socially sustainable way, and what role the trade unions will have and what strategies they should pursue. One thing is clear, however: progress in emissions reductions of the kind witnessed in Central and Eastern Europe and in the UK, resulting from the collapse or downsizing of industrial activity, is not the way to go for Europe.

IX Conclusions

Conclusions

Ron Blackwell and David Coats

The failure of a model

The global financial and economic crisis has invalidated many of the assumptions on which economic policy had been based for the previous thirty years. The belief that light touch regulation, limited government, low taxes, labour market deregulation and weak labour market institutions are all necessary ingredients of economic success has proved to be a recipe for volatility, excessive risk taking, growing income inequality and, in some countries, the rise of precarious employment. While the richest in many parts of the OECD saw their relative position improve – sometimes dramatically – the poorest saw their relative position deteriorate. The OECD itself documented the rise in inequality in its landmark publication *Growing Unequal* in 2008 (OECD 2008). In the United States even those on middle incomes saw little improvement in their earnings or living standards over a twenty year period. Nor was it true that the policies that we might usefully label as "market fundamentalist" led to better economic performance before the crisis broke. This troublesome fact was recognised by the OECD in their reassessment of the 1994 Jobs Study, published under the title *Boosting Jobs and Incomes* in 2006 (OECD 2006). It was accepted that two groups of countries had achieved 'good results' (defined as a high employment rate, moderate inflation and apparently robust growth): those pursuing 'market reliant' policies, such as the US and the UK, and those pursuing policies with higher taxes, stronger employment protection legislation, more generous unemployment benefits and much higher investment in active labour market programmes (including Austria, the Nordic countries and the Netherlands).

Even before the global recession it was clear that there was more than one route to growth and high employment rates. Moreover, the life chances and life expectancy of the poorest was rather better in this second group of countries than in those pursuing more orthodox policies. These must now be relevant considerations as policymakers consider how to build a new economic model in the post-crisis world.

The pre-crisis problem

Trade union objectives have remained broadly the same over a prolonged period. In large measure, this is because they are based on clear values. There is a very strong commitment to building a global economy that offers sustainable, decent jobs for all those who wish to work, allows developing countries to experience rising incomes and ensures that the growth process is consistent with the imperative of tackling climate change and protecting the environment. The model that operated before the crisis was failing to deliver these objectives. Rising inequality, stagnating wages and underdevelopment in sub-Saharan Africa could hardly be described as successes.

Moreover, much of the supposed prosperity in those countries most committed to the orthodox model was dependent on either rising house prices, against which households were willing to borrow, or a level of financial innovation (the development of exotic derivatives) that proved to be a fragile instrument for the sustained generation of demand. There was plenty of evidence that these arrangements were unsustainable and that dangerous bubbles were emerging in asset markets. But policymakers, seduced by the efficient markets hypothesis and dynamic equilibrium theory, chose to believe that 'this time is different' (Reinhart and Rogoff 2009). After all, almost thirty years of liberalisation, deregulation, tax cuts and efforts to shrink the size of the state ought, on the orthodox view, to have made the crisis impossible. Unfortunately, as with the previous "eight centuries of financial folly", to use Reinhart and Rogoff's formulation, the iron laws of economics proved impossible to resist and in the end the bubble burst. There was a misplaced belief that the supposed diversification of risk was also an effective device to eliminate uncertainty.

The goals of economic policy

For most of the recent period economic progress has been measured almost exclusively by growth in GDP per head. This is a narrow measure that is being increasingly seen as an inadequate benchmark of social progress. It is clear, for example, that beyond a certain point measured increases in GDP appear to have little or no impact on either happiness or life satisfaction (Layard 2004; Offer 2006; Wilkinson and Picket 2010). As Amartya Sen has pointed out, economic growth has to be for a purpose and the most straightforward way of characterising that goal is to say that citizens must be able to acquire the capabilities the they need to choose lives that they have reason to value (Sen 1999). Moreover, Sen's notion of 'development as freedom' means that people can enjoy genuine liberty only insofar as it is based on economic and social security.

In response to this line of argument, President Sarkozy appointed an expert panel to devise a more balanced set of benchmarks. The approach adopted by the *Commission for the Measurement of Economic Performance and Social Progress* is a welcome step in the right direction and should be endorsed by policymakers in all countries. Put slightly differently, the objective is not to accept the world as it is and adapt citizens to the demands of the economy, but to reshape the economy to ensure that it serves the interests of citizens.

Fiscal stimulus, austerity measures and the return of the conventional wisdom

Policymakers' response to the crisis was, to begin with, encouraging. The G20 played a leading role, the global economy received a coordinated stimulus, the banking sector was recapitalised and catastrophe was averted. Indeed, without this level of policy activism the trough would have been much deeper and global unemployment would have rocketed to alarming levels, with a real threat to social cohesion in some countries.

The policy response also demonstrated that the state remains an indispensable actor in the economy. Only the state had the wherewithal to recapitalise the banks and only the state had the resources to offset the reduction in demand from the corporate and household sectors. In other words, contrary to the strictures of market fundamentalists, the state had proved that it plays an essential role in the stabilisation of an inherently unstable economy.

For the sake of clarity we should emphasise that this does not mean that the trade unions automatically advocate public ownership (although there may be a case for this in some sectors) or the revival of centrally planned economies. But we do believe that the democratic state must play a role as a provider of quality public services and as a regulator, setting the stage for market actors and intervening (either through fiscal or monetary policy) to cool a speculative boom or to halt a recession. Moreover, there is a strong case for saying that the public and private sectors are interdependent; that developed economies cannot thrive with small states; and that the process of economic growth has generally been associated with a significant rise in social spending (Lindert 2004). There is very little evidence to suggest that shrinking the state, as some policymakers suggest, is a sustainable medium-term strategy. Indeed, it may act as a brake rather than a stimulus to growth.

There is also, as Tim Page makes clear in his paper, a strong case for governments to develop active industrial policies by setting clear regulatory frameworks, providing capital for investments that will not be funded on the open market and encouraging the transfer of technologies, as well as the dissemination of best practice.

Unfortunately, the timely, coordinated intervention at the beginning of the crisis now seems to have been matched by the recrudescence of the pre-crisis orthodoxy. Put more crudely, austerity policies are back with a vengeance. In part, this is because governments are concerned that the banking crisis has become a sovereign debt crisis – with borrowing, deficits and debt-to-GDP ratios rising. It is obvious that, following the Greek debt crisis, some countries are in difficulties. But countries without comparable problems appear to be embarking on a process of fiscal consolidation at breakneck speed. This is certainly true in the UK, where the government is looking to cut public spending and reduce deficits further and faster than is demanded by the economic situation. And it is, to a lesser degree, true in Germany, where an effort is being made to cut the deficit when action is urgently needed to stimulate the domestic economy. The new arrangements for economic governance in the Euro area also appear to have a built-in deflationary bias that may lock this important global region into a period of sluggish or jobless growth.

Moreover, despite the OECD's recognition of the need to balance flexibility with security in *Boosting Jobs and Incomes* (the Jobs Study reassessment), policymakers are now applying the 'going for growth' paradigm of structural reform and seem to have reverted to the belief that the only efficient labour markets are lightly regulated labour markets.

From this standpoint, the best route out of the crisis is to embrace once more the ideology of a small state, low taxes and weak unions. However, contrary to these predictions, countries with more regulated labour markets have weathered the storms of the recession rather better than the orthodox OECD approach or IMF policy prescriptions would have predicted. German unemployment is lower than unemployment in the United States – in part because of the effectiveness of the temporary short-time working scheme, coupled with negotiations between the unions and firms – and the Nordic countries are recovering moderately well from the recession.

Perhaps it is worth emphasising at this point that the OECD's original Jobs Study analysis (1994), which drove the deregulatory impulse for almost a decade, could not explain differences in labour market performance during the boom. For example, the Netherlands enjoyed better employment performance than Germany throughout the 1990s, even though it had a more regulated labour market (stronger employment protection legislation and higher unemployment benefits) (Schettkat 2005). Similarly, there is strong evidence to show that the central prediction of the OECD's thesis – that disadvantaged workers would do better in 'flexible' labour markets – was never an accurate description of reality. One authoritative study shows that disadvantaged workers in the UK (the low skilled and the young) did no better in the 1990s than their counterparts in more heavily regulated France and Germany (Schmitt and Wadsworth in Howell 2005). If all these critiques are correct then it is difficult to understand how recovery from the worst global recession for more than 70 years can be secured through the application of policies that had no impact on the position of the unemployed or disadvantaged during a period of robust growth.

Out of the crisis and beyond

Policymakers are therefore confronted with the need to abandon the conventional wisdom and develop new strategies to exit successfully from the crisis. Building a model of sustainable and stable growth demands nothing less. A necessary first step is to recognise that the state plays an indispensable role in a capitalist economy. The market depends upon the state. Indeed, one might go further and say that the market is an artefact of the state, in the sense that markets could not exist at all without, among other things, the rule of law, the impartial administration of justice, the enforcement of contracts and the protection of intellectual property rights.

This much would be accepted by all but the most extreme market fundamentalists. But recent experience shows that it is possible to go further in the way that has been described above. Most importantly, perhaps, markets, if left to themselves, will never develop effective institutions for global economic governance. Markets alone cannot solve global imbalances, deal with exchange rate questions, establish a fair trading regime, tackle climate change or reduce income inequality. On the other hand, it is equally clear that governments alone may struggle to resolve these problems. That is why civil society institutions such as trade unions remain important in shaping and legitimising such decisions certainly, for example by making the reduction of income inequality a collective bargaining priority.

Wherever one sits on the spectrum of economic policy opinion it has been clear for some time that the pre-crisis status quo offers no route out of the crisis. In this sense, there can be no return to business as usual. But, as the OECD has recognised, the situation of the global economy remains precarious. The choices are often presented as either slow growth and a prolonged period of high unemployment generated by sluggish investment or a fairly rapid return to robust growth with a particular focus on innovation, knowledge services and environmental technologies. From a trade union standpoint the latter is more attractive, but it is by no means clear that the current orientation of policy will lead to a positive outcome. And while it would be absurd to suggest that a return a stable growth path can take place with high budget deficits or rising debt-to-GDP ratios, there is a strong belief – shared by the contributors to this volume – that governments, running in fear from the bond markets (and the credit rating agencies) are cutting spending too far, too fast, putting the fragile recovery at risk. It is one thing to call for 'growth-friendly deficit reduction' and quite another for governments to cut public investment in science, research and higher education when the dominant knowledge economy narrative tells us that such things are indispensible in successful dynamic economies. Put crudely, growth-friendly deficit reduction can rapidly metamorphose into a conventional austerity programme.

If this analysis is correct then it suggests that the direction of policy today must change if a successful exit from the crisis is to take place and, more importantly, a firm foundation is to be laid for sustainable growth in the future. A synthesis of the contributions to this volume would suggest that action must be taken in the following areas:

– Policymakers must consider how demand can be generated that leads to the kind of economic progress we described above, where success is measured by more than the growth in nominal GDP per head. It is important to understand that the global imbalances that gave rise to the crisis have yet to be effectively tackled. Those countries running current account deficits need to save more and those with surpluses need to boost domestic demand. Inevitably, this requires consideration of exchange rates and the question of the relationship between the US dollar and the Chinese yuan. At the very least, G20 countries need to move beyond the conclusions of the recent Seoul summit and devise a process for the gradual and managed rebalancing of the global economy. In other words, a global economy can thrive only if it possesses effective institutions for global economic governance to which all the major players are committed. The alternative is a return to the protection of national interests, beggar-thy-neighbour policies, sluggish growth and instability. There is a very strong case for an international financial transactions tax to put some sand in the wheels of speculative investment, provide resources for fiscal consolidation and fund global public goods.
– Some emerging and developing countries have sought to ensure that the fruits of growth are more widely distributed, with a particular emphasis on reducing inequality by improving the incomes of the poorest. This is the case in Brazil, for example, and it is designed to bring it about that domestic demand grows in line with the growth of the economy. Moreover, the model is unorthodox to the extent that it adopts a pragmatic approach to deregulation and the opening of markets. This approach is to be preferred to the conventional argument for immediate liberalisation, privatisation and deregulation. It offers a development model that might usefully be pursued elsewhere, most obviously in sub-Saharan Africa where there is a pressing need for investment in infrastructure and an imperative to improve the incomes of the poorest citizens.
– One of the causes of the crisis was inadequate monetary and fiscal policy coordination at both global and national level. Policymakers must recognise that the explicit goals are to achieve full employment, rising living standards, economic stability (including price

stability) and social cohesion. Central banks should be given the objective of doing more than simply targeting inflation. But if full employment and nominal GDP growth are to supplement the inflation targeting regime then banks need more than the interest rate weapon in their arsenal. This is why consideration should be given to the introduction of asset-based reserve requirements so that central banks can pursue price stability and deflate any emerging asset price bubbles. There should also be adequate policy space for 'unorthodox' monetary policy or quantitative easing. And central banks should recognise that their judgments need to be both justified and legitimised to other social actors, not least the social partners. There is a strong case for independent central banks to have formal structures that permit such an informed dialogue.

– Turning to fiscal policy, the crisis has proved the power of counter-cyclical activism. This means that policy in the future must provide for robust automatic stabilisers that kick in when the economy begins to slow down. But there must be equally robust counter-cyclical pressures during periods of robust growth. This is when governments should be accumulating the surpluses that give them room for manoeuvre in recessions. And, contrary to the tax cutting obsessions of the conventional wisdom, sometimes it is appropriate for taxes to rise if that is the best instrument available to prevent the economy from overheating. One-sided mechanisms such as the 'debt brake', which is now part of the German Constitution and the proposed stringent fiscal consolidation rules now being proposed in Europe are potentially dangerous and should be avoided.
– At national level, policymakers should devote more attention to the question of innovation institutions and industrial policy as sources of growth and demand generation. If the global economy is to continue to grow and if OECD countries are to maintain their relative advantage then they must develop their capacities to develop new products and new services. This demands the creation of what the British commentator Will Hutton calls an 'innovation ecosystem', where the state invests in education and training (reducing spending on higher education would therefore be a major strategic error); there is easy access to capital (especially for the development of environmental technologies or knowledge based services); there are institutions for information exchange and technology transfer (like the Fraunhofer Institutes in Germany); and welfare policy is devised to facilitate economic transitions (as with the Danish approach) (Hutton 2010).

- Sustainable demand generation requires that workers have incomes that enable them to purchase the goods and services produced by a dynamic private sector. This is what is meant by 'income-led growth'. Policymakers must consider how it can be guaranteed that workers' earnings rise in line with productivity. One obvious route is through the promotion of collective bargaining, but policymakers may need to consider other instruments (labour clauses in public contracts, for example) if trade unions are either weak or absent from the scene. Moreover, an increasingly integrated global economy demands some global labour standards to legitimise the process of economic integration, to protect vulnerable workers against exploitation and ensure that workers in the developing world are able to share in the rising prosperity of their nations.
- There is much to be gained from returning to the analysis presented by the OECD in *Boosting Jobs and Incomes* (the reassessment of the jobs study) in 2006. Those countries that had achieved high employment and a more equitable distribution of incomes focused attention of the broad sweep of labour market policy, including: skills formation systems before labour market entry that give workers a sense of occupational identity and self-confidence; an emphasis on lifelong learning as a route to employability; a focus on the balance of power between capital and labour – including the strength of the trade unions and the extent of collective bargaining coverage; the pursuit of policies to narrow unjustifiable differences between groups of workers; a combination of high unemployment benefits and job search obligations with high levels of investment in active labour market programmes to get the unemployed back to work. In addition, these approaches are reinforced by a strong welfare state funded by relatively high taxation, which offers generous services (including childcare provision and maternity/paternity leave) so that women and men can combine work and their caring responsibilities. This helps to explain the better performance on gender pay equality and the high employment rate for women.

Sustainability and a reconceptualised corporation

The idea of sustainability is central to the argument presented here. This is often viewed as a question of environmental protection and resource use, but we are using the term in a wider sense to embrace the notion of a corporation that embeds sustainability in all its operations. A sustainable corporation seeks to grow by building market share or developing new products and services rather than through financial engineering or merger and acquisition activity. A sustainable corporation is a responsible corporation that recognises the duties it owes to the workers it employs and the communities in which it operates. The maximisation of shareholder value is a somewhat anaemic conceptualisation of corporate purpose and we favour a richer and more sophisticated notion that recognises the interdependence of the corporation, its employees and society.

This is not to underplay, of course, the significant challenges associated with climate change and resource use. Trade unions at global and national level have endorsed the imperative to reduce carbon emissions and more generally to decarbonise the economy. But, consistent with the generally egalitarian approach described throughout this volume, that process must be associated with a just transition to a low carbon world. In other words, the loss of jobs in some sectors must be a managed process. There must be investment in training and retraining, a proper assessment of the economic impact of environmentally driven structural change and a sharing of the burden.

Conclusion

The global financial and economic crisis necessitates a fundamental review of the prevailing economic policy paradigm. The faith in unconstrained markets should have been undermined by the collapse of the banking sector, but it now appears that policymakers are retreating to the comforting nostrums of economic orthodoxy. This would be a strategic error. Returning to policies that failed in the boom cannot be expected to return the global economy to growth following a very deep recession.

Most importantly, perhaps, there is a compelling need to achieve a higher level of clarity about the goals of economic policy. The model described in outline here goes beyond securing increases in GDP per head and adopts a more sophisticated set of measurements. It makes rather different use of monetary and fiscal policy, demands the effective regulation of financial markets and explains how both developed and developing countries can go about creating more inclusive labour markets. The priority must be a return to full employment. But this is not an argument for any jobs at any price. Sustainable work is decent work, secure work and work that offers the prospect of rising living standards, development and progression. These goals are perfectly compatible with economic stability (including price stability) and robust productivity growth. The challenge for trade unions is to make a compelling case for change. The challenge to policymakers is to demonstrate that they have heard the demand for a different approach and have acted accordingly.

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Exiting from the crisis: towards a model of more equitable and sustainable growth

Edited by David Coats

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