

# THERE IS AN ALTERNATIVE



International  
Labour  
Office  
Geneva

Edited by Nicolas Pons-Vignon

Global Labour University

**ECONOMIC POLICIES**

**AND LABOUR STRATEGIES**

**BEYOND THE MAINSTREAM**

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**There is an alternative**

**Economic policies and labour strategies  
beyond the mainstream**

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*Edited by Nicolas Pons-Vignon*

International Labour Office • Geneva

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# Preface

Market fundamentalists would have us believe that the laws of the market are as clear and straightforward as the law of gravity. Either societies do what the markets require or they will have to pay with longer term economic decline and even deeper misery. How is it that the same people who praise the value of entrepreneurial innovation and creative destruction have such static views when it comes to the market economy at large? Whatever the problem, the answer is always the same: reduce wages, deregulate labour markets, lower taxes, liberalize trade and financial markets, privatize public services and increase competition.

No other discourse seems to be so unimaginative and repetitive. But repetition does not make right what's wrong. The large variety of market economies and the very different strategies of countries in terms of responding to the global crisis show that there are choices to be made at every juncture of development.

There is an alternative. This is the key message of the 2011 Global Labour Column anthology.

There is no ironclad law saying that our societies have to become more unequal. There is no evidence that the free global movement of capital yields better results than democratically governed capital markets. There is no proof that low pay means more employment; indeed, a downward spiral on wages and working conditions is rather a recipe for deflation and long-term stagnation. Alternatives require thinking beyond the well-trod ways of the mainstream and the courage and determination to fight for them. Alternatives are not only a battle about the best ideas, but also a battle of interests.

One-dimensional thinking has been a major reason for the severity of the global economic crisis. If monopolies are bad for markets, they are even worse for our thinking. We need a plurality of ideas in order to develop and ultimately choose between different policy options.

Some key ideas emerging from this debate include the following:



- The rise in precarious employment has made labour markets dangerously pro-cyclical. Providing better protection to all workers requires not only the enforcement of existing laws, but also new national and international labour standards to restrict the abuse of power by employers.
- Wage-led recovery is essential for reducing inequality and global imbalances. Government policies in recent decades have massively tilted the balance of power in favour of capital. These one-sided policies have resulted in an unsustainable decline of the wage share.
- Around the world, workers are mobilizing and struggling to turn the tide. Workers throughout the Arab world are making history. Chinese workers are taking strike action, despite the political risk. Workers at Fiat in Italy and trade unionists in Wisconsin are mobilizing against the erosion of their fundamental rights. Public sector workers in South Africa were at the forefront of a struggle for better public services and decent wages. Growing progress is being made at the national and international levels to extend labour rights to the millions of domestic workers worldwide.

As a close partner and supporter of the Global Labour Column and the Global Labour University, the Bureau for Workers' Activities (ACTRAV) helps facilitate the search for alternatives and supports trade unions' efforts to translate these solutions into alternative policies. We are convinced that this volume will be of great interest to academic scholars as well as trade union activists and policy-makers. ACTRAV is delighted to see more and more subscribers to the Global Labour Column, as this is the clearest indicator that this work meets a real need of the global labour movement. Recognizing that language is an important vehicle for global debate, we are glad to report that this book will be available in French and Spanish.

*Dan Cunniah*

*Director, Bureau for Workers' Activities, ILO*

# Acknowledgements

The Global Labour Column, where the essays in this volume first appeared, is edited by the Corporate Strategy and Industrial Development (CSID) research programme at the University of the Witwatersrand, South Africa. The editorial team is made up of Phumzile Ncube (assistant editor), Seeraj Mohamed, Sam Ashman, Susan Newman and Nicolas Pons-Vignon. The team has been assisted by occasional reviewers from the university, Edward Webster, Michelle Williams, Jacklyn Cock, Noor Nieftagodien, Khayaat Fakier, Roger Southall, Lucien Van Der Walt and Miriam Di Paola, as well as from the ILO's Bureau of Worker Activities, Frank Hoffer and Claire Hobden.

Frank Hoffer was the initiator of the Global Labour Column as well as of the Global Labour University. His involvement in and support for the Column are key to its success and are gratefully acknowledged. Laura Brown sub-edits all articles, while Harald Kroeck is the Column's webmaster. Their (often last-minute) hard work ensures consistent quality.

Chris Edgar and Charlotte Beauchamp have overseen the production of this book with great enthusiasm, professionalism and patience. Thanks are also due to the cover designer, Werner Arnold, and to Beatrice and Clyde Reynolds of Magheross Graphics, who designed and laid out the text.

Finally, heartfelt thanks go to all the contributors to and readers of the Global Labour Column. The constant growth of our circulation is testimony to the quality of the articles we publish and we hope to offer ever-more relevant and provocative contributions on the challenges facing labour, nurturing the conviction that there is, indeed, an alternative.

# Introduction: Bringing politics back in

*Nicolas Pons-Vignon*

Many progressive economists and trade unionists have sought to engage in dialogue and negotiations with capital and governments during the global financial crisis, hoping they could achieve the adoption of reasonable and balanced policies. They may have done so because such an approach used to work in the past, especially in social-democratic contexts, or because, in the early days of the crisis, they were listened to as respectfully as during the high time of the “Keynesian compromise” in economics. They may be convinced that government should “see” what is happening and want to adopt more inclusive policies. But as the General Secretary of the International Trade Union Confederation (ITUC) Sharan Burrow puts it in this volume, “If during the crisis workers’ organizations could have anticipated that a new era of dialogue had begun, the moment has clearly passed.” Governments are indeed not seeing anything; in fact, the way in which they have responded to the crisis indicates that relying on strong arguments is insufficient. Are neoliberal policies, and the huge increases in inequality they have caused, responsible for the crisis? Well, the policies adopted in the wake of the crisis only reinforce this – from the absence of any meaningful regulation (or rather, the curtailment) of financial “innovation”, to the public bailing out of banks by states who then in turn reduce their spending, thus passing the costs of the crisis on to ordinary workers and unemployed people. Trade unions have been using their organizational and institutional power to resist relentless attacks on social and labour rights. Nevertheless, after decades of retreat, the financial crisis is rapidly weakening further their traditional pillars of power and influence. What is to be done?

Labour faces the urgent need to overcome the dilemma that it cannot let its influence slip further, while a more oppositional strategy carries the risk of further marginalization if it fails. This may be what will happen in France, even if, despite its failure to thwart the pension reform, the strength of the movement which took place in autumn 2010 breeds optimism (see the essay by L  g   in this volume). Trade unions have recognized the need to fight

precarious employment, to build new alliances (for instance, to defend the rights of domestic workers – see the essays by Hobden and by Alleva and Moretto in this volume), to make efforts to organize workers and to regain democratic control over markets. But achieving a meaningful reduction in inequality (and in the power of finance) will require both the formulation of convincing policy alternatives and a determination to fight for them. This requires more than good ideas and determined cadres, however; it demands imagination, will and the confidence of people in the possibility of change.

While it is important to recognize the positive dimensions of recent mobilizations, it is also apparent that on balance they lack political inspiration and momentum. There are four areas where the fight against neoliberalism must be waged in order to be successful and to allow a coherent project to emerge. These four areas are, in increasing order of importance, academia, ideology, policy and politics.

On the academic front, the dominance of neoclassical economics ought to be contested vigorously – at least as vigorously as it has contested the right to exist of any so-called “heterodoxy” in its heart while “colonizing” other social sciences (Fine and Milonakis 2009). It can hardly be doubted that today’s policy-makers’ inability to take decisive action to leverage state power in order to protect workers is linked to the hegemonic neoclassical discourse of the last decades. If one sees labour as a mere cost and unemployment as voluntary, it would be hard to believe that higher wages would improve a derelict situation (see Naastepad and Storm in this volume). The struggle for plurality in economics will first have to be national – and initiatives such as the newly formed French association of political economy (AFEP; see <http://www.assoekonomiepolitique.org>) are to be commended – but will also have to draw its strength from international alliances. Indeed, only a concerted international initiative will succeed in affecting the self-reproducing hierarchy of economics journals – none of which, in most classifications, include a single non-exclusively neoclassical review in the highest category!

On the ideological front, the time has come to contest the hegemony of the market. Simplistic notions such as “the private sector is more efficient” must be boldly challenged in the public debate, along with calls for the systematic inclusion of the private sector in public investment, as in public–private partnerships, or for the commercialization of the operation of state functions, whether utilities or other areas such as health care. The arguments used to support such claims are often grounded in lies (as in the case for pension reform; see Légé in this volume), or in collections of one-sided anecdotes, such as the article on industrial policy published by *The Economist* in August 2010<sup>1</sup> which

lists the failures of publically supported companies – as if all private companies were successful! Biased use of words is also at the heart of neoliberal ideology, as for example in the case of “liberalization”: it is not “liberty” which is at stake here, but increased involvement of (and profits for) private capital. At the heart of this agenda lie institutions such as the European Commission, which is persistently pushing for the “opening to competition” of sometimes very well-run public entities. In countries such as the United Kingdom, and in many of the transition countries subjected to “shock therapy”, the drawbacks of privatization and liberalization are crystal-clear. As for the workers and unions, the defence of their rights (except when it is narrowly defined) should make them proud rather than ashamed. I remember seeing a Trades Union Congress (TUC) leader almost apologizing to a BBC journalist for contesting the massive public sector cuts the Government was proposing. The journalist was scornfully saying that “Irish workers are proving much more responsible (*sic*) and willing to share the costs”. Workers’ rights are not at odds with economic growth (see the essay by Janssen on precarious work and the essay by Somavia in this volume), or with a country’s national interests (see Garibaldi in this volume). At the heart of the ideological fight back, a decisive policy to curb the influence of corporate-funded lobbies is necessary.

On the policy front, the one where most Global Labour Column discussions have focused, it is time to call for bold policies which will thoroughly break with the financial and privatizing frenzy of the last 30 years. Macroeconomic policies should be refocused to support employment creation, to play a counter-cyclical role and to support *real* stability – an objective hardly compatible, for many countries, with full-blown liberalization. Microeconomic policies, in particular industrial and competition policies, should be rehabilitated, as they are the key instrument that governments can use to stimulate and orient growth. In developing countries in particular, the possibility of using trade policy to support development objectives is absolutely essential (see Kozul-Wright and Busser in this volume). In a world where climate change is becoming an ever-more looming threat, strong policies aimed at processing minerals (creating local employment and reducing transport costs), developing alternative energy sources (see Naidoo in this volume) and ensuring minimal consumption in industry, transport networks and private and commercial dwellings would be hardly possible without state intervention. Competition policies aimed at regulating the private sector are, in a world of increasing corporate power, one of the tools most necessary for countering the influence of companies on consumers and workers alike. Likewise, the governance of corporations cannot be conceived narrowly as the accountability of managers

to shareholders; workers and their representatives must be at the heart of our understanding of corporate governance.

But none of the above fields of struggle is as important as the political one – which is itself highly dependent on the previous three. The most impressive achievement of neoliberalism has undoubtedly been its dramatic weakening of the political power of workers, unions and the parties aligned with them. In many cases, the politics of the latter have been dramatically altered, with many “labour” parties now having programmes that could hardly be distinguished from their right-wing counterparts. Unions have lost many workers, especially outside the public sector, and the growing “precariat” described by Guy Standing (2011) is often either disillusioned with unions or afraid to join them because of explicit or implicit threats by employers. Restoring the power of workers and unions, starting with the workplace, is more than ever a priority: a strong and mobilized base is the necessary blood of any successful political movement. It is very encouraging to see strikes in the public (for instance in South Africa; see Ceruti in this volume) as well as in the private sector that are increasingly articulating broader political demands. In the United States, the recent movement against the curtailment of public sector workers’ collective bargaining rights in Wisconsin (and the threat of similar campaigns in other US states) may signal both the political awakening of unions and the end of “Reagan’s spell”, under which many working- and middle-class Americans supported policies that harmed them.<sup>2</sup> Linking workplace and other progressive movements in order to promote a new political project, however, will require overcoming the “third way” impasse which so many parties have embraced in order to secure electoral success.

The Global Labour Column has established itself as a forum of debate on the nature of the crisis and on the policies which should be adopted to defend the interests of workers worldwide. In so doing, it serves as an intellectual and policy toolbox which does not shy away from asking tough questions, such as: Why did a policy change not happen despite the failure of the current economic regime? How should unions change, and what must they change in order to weigh in more strongly on the policy choices that confront the working class?

After issuing a (largely unheeded) call not to “waste the crisis” in the first Global Labour Column anthology, this second anthology confronts, in its first part, the policies that have been implemented in the wake of this great depression – as well as the resistance they have met. From Italy to South Africa, popular struggle against neoliberalism and “austerity” policies are analysed and contextualized. That the current crisis is rooted in inequality is not only an

increasingly shared and undisputable view, but deepening inequality is also a tendency which does not stop. Neoliberalism must therefore be challenged, from its theoretical underpinnings (in neoclassical economics) to its continuing dominance over economic policy.

As one of the continents hit hardest by the crisis, Europe is extensively discussed in Part II, which opens with a visionary article by Andrew Jackson warning Europeans against following the Canadian austerity model. Many of the solutions currently put forward to “deal” with the diverse economic problems of EU Member States are vigorously contested – not least proposals suggesting that wage deflation would be the key to saving the euro (see Janssen on European economic governance). To prevent the collapse of Europe (and the daunting consequences this could have), it must be defended – and reinvented. The neoliberal Europe, focused on defending the interests of large corporations, whose real “Constitution” is the Single European Act of 1986 (a cut-and-paste version of an employers’ white paper),<sup>3</sup> must give way to a progressive entity that seeks to reduce inequality between and within its Member States.

In Part III, the impact of neoliberal globalization on development policy is discussed together with possible alternatives. The increased openness and fiscal “discipline” imposed on developing countries following the debt crisis of the 1980s contrasts with the readiness to extend new borrowing facilities to the banks and financial operators that brought the global economy to the brink of collapse.<sup>4</sup> The massive drop in demand by rich countries has shown the crucial importance of building domestic demand (isn’t development about this?) rather than focusing solely on cutting labour and other costs in the hope of being competitive in export markets (see Ghosh in this volume). As far as “good policies” are concerned, the consensus on free trade seems weaker than ever and many developing countries are – justifiably – encouraged in their struggle to regain policy space so they can use industrial and social policies to support development (see the article on Brazil’s achievements by Baltar in this volume).

Part IV focuses on the central issue of inequality, which was at the root of the current crisis and serves to reveal the class interests which have been the engine of neoliberalism (see Mohamed and Onaran in this volume). Growing inequality is intimately linked to the undermining of wages and workers’ rights, not least through the pressures of private equity funds (see Caporale Madi and Gonçalves and in this volume).

As discussed in the last section of the book, the defence of workers’ rights and wages is absolutely necessary to ensure sustainable growth in the world. Indeed, decent work and wages will provide a much more stable (and dignified) source of effective demand than will structured finance. The role of international

labour standards in bringing about a more coordinated approach to wages and working conditions is discussed in this volume by Hoffer, while ILO Director-General Juan Somavia calls for “decent work for all everywhere” – since the risk (real or imagined) of low-wage competition can act as a powerful disincentive in individual countries. The programme is ambitious, as it will imply reversing deep trends such as the exclusion of many workers from wage negotiations or even protection (see Hobden on domestic workers) or growing casualization and wage inequality (see Janssen and Belser). Such ambition is necessary if we want to believe that there is an alternative; it will require a broad and vigorous mobilization to succeed. It is high time to bring politics back in.

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- Standing, G. 2011. *The precariat: The new dangerous class* (London and New York, Bloomsbury Academic).

## Notes

- <sup>1</sup> “The global revival of industrial policy: Picking winners, saving losers”, *The Economist*, 5 August 2010, <http://www.economist.com/node/16741043>. Interestingly, the online debate on *The Economist's* website yielded an overwhelmingly “pro” industrial policy result, with 72 per cent of voters disagreeing with the motion that “industrial policy always fails”.
- <sup>2</sup> On Wisconsin, see C. Feingold, “The march to protect workers’ rights and the middle class”, *Global Labour Column*, 28 March 2011, as well as R. Fantasia, “Could Wisconsin break Reagan’s spell?”, *Le Monde diplomatique*, April 2011.
- <sup>3</sup> On this issue, see F. Ruffin, “A Bruxelles, les lobbyistes sont ‘les garants de la démocratie’”, *Le Monde diplomatique*, June 2010.
- <sup>4</sup> On financialization, see Herr and Stachuletz in this volume as well as Frédéric Lordon’s brilliant essay on the financial crisis (2008).

Nicolas Pons-Vignon is Senior Research Fellow with the Corporate Strategy and Industrial Development (CSID) research programme, University of the Witwatersrand, South Africa. His research focuses on industrial development and policy in South Africa, as well as on labour, poverty and development aid. He is the editor of the *Global Labour Column* and the founder and course director of the annual African Programme for Rethinking Development Economics (APORDE; <http://www.aporde.org.za>). He has contributed to the design and teaching of two new economics postgraduate degrees (in *Development Theory and Policy*, and *Economic and Development Policy*) at his university. Prior to joining CSID, Nicolas was a consultant at the OECD Development Centre and worked for an international non-governmental organization (NGO) in London, Morocco and Paris.



## PART I

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### *A luta continua:* Global trade union struggles

# Maturing contradictions: The 2010 public sector strike in South Africa

*Claire Ceruti*

The huge strike in August 2010 by South African public sector workers brought the number of strike days in that year to the highest ever. Teachers and hospital staff went on strike for three weeks despite police harassment of picket lines and a series of court interdicts to prevent police, soldiers and nurses from striking.<sup>1</sup> The strike started after members forced their leaders to reject government's "final offer" of 7 per cent and ZAR 700 (€70) housing allowance. After seeing the government's lavish expenditure on the 2010 soccer World Cup, strikers found it difficult to believe that government could not meet their demands. The public servants were asking for an 8.5 per cent wage increase and ZAR 1,000 (€100) a month housing subsidy. However, the strike was much more than a wage strike: three years before, public sector workers struck during the dying days of the regime of previous president, Thabo Mbeki, while the 2010 strike was a major test of his successor, Jacob Zuma, and thus of the unions' strategy for social change.

The strike also threatened the alliance between the ruling African National Congress (ANC), the South African Communist Party (SACP), and the biggest trade union federation, the Congress of South African Trade Unions (Cosatu), whose affiliates comprise a majority in the public sector. Cosatu's strategy for change since the end of apartheid has been to influence government policy through this alliance. The strategy foundered under Mbeki, who was the architect of a home-grown neoliberal programme for South Africa before he was president. Under Mbeki, corporate tax was cut, more than a million jobs were lost and homelessness grew quicker than provision of low-cost government housing, leaving 15 per cent of the country's population living in self-built iron shacks today.

The revolt against Mbeki was a long time maturing. It finally exploded on several fronts. From 2005, some of the poorest townships in South Africa took to the streets before municipal elections. The service delivery protests demanded not only the "better life" promised in ANC election campaigns, but

also more accountable government. There was also a revival of wage strikes. These developed in tandem with a revolt inside the ANC and crisis in Cosatu's strategy. Union leaders were increasingly embarrassed that Mbeki used the alliance to assert his authority over the unions, while dismissing their policy suggestions. Rather than concluding that Cosatu should become more independent, its leaders looked for friendlier faces within the alliance. A variety of forces, including Cosatu's general secretary, Zwelinzima Vavi, sided with Zuma after Mbeki expelled him from the cabinet. Zuma did not take the strikers' side in 2007, but argued for both parties to return to negotiations. However, the December 2007 conference of the ANC (now simply known as "Polokwane" after its location), which voted for Zuma as ANC president, also promised better conditions for public sector workers.

***The 2010 strike ... exposed some of the contradictions between members' interests and broad strategy of union leaders***

The 2010 strike unfolded against the post-Polokwane reconstitution of the alliance, and exposed some of the contradictions between members' interests and the broad strategy of the union leaders. The 2007 strike was initiated by union leaders kicking against their marginalization in the alliance, and was enthusiastically supported by the members. The 2010 strike, by contrast, was forced on reluctant leaders by the righteous expectations of the members.

On the one hand, union negotiators were confident that their new comrades in government, beholden to the unions for helping them to power, would make a satisfactory offer. On the other, government negotiators hoped their comrades in the unions would sell a deal to the members. They were under pressure to rein in wage demands both because of the fiscal hangover from the World Cup and also to reassert authority amidst the new confidence of various alliance members to critique "their" government publically. However, members were expecting nothing less from Zuma than to meet their demands. Any early misconceptions that government negotiators were acting against Zuma's real intentions and against ANC policy were quickly dashed when Zuma appeared on national television, just days into the strike, asserting the government's right to dismiss "essential workers" who continued to strike.

Government came down hard on the strikers. Police used rubber bullets and water cannons on pickets at several hospitals on the second day of the strike and fired on teachers who walked onto a highway near Soweto. The mainstream media conducted a vitriolic campaign, blaming strikers for deaths of babies and disrupting education. Months before, six babies had died in a hospital under "normal" conditions because of a shortage of basic disinfectants. Two months

earlier, schooling was suspended for the World Cup, while in Nelspruit students remained without a school after their high school was converted into stadium offices. Without a strike support committee bringing affected communities into direct contact with the strikers, this moralistic pressure proved key in isolating strikers as the strike dragged on.

However, political considerations were also important to understand why the strike was concluded as it was on 6 September with an agreement that most strikers felt was imposed from above. Cosatu was about to announce its proposals for economic policy ahead of the ANC's national general council, and therefore could not afford an all-out defeat of the strike, but neither could they afford to reach a breaking point with Zuma's camp if they wanted their policies to be heard. On 27 August, a government spokesperson, Themba Maseko, was quoted in the *Business Day* newspaper as saying: "We are beginning to see and hear too many statements that are taking the strike beyond labour relations. It worries us."

*... [Cosatu] could not afford an all-out defeat of the strike, but neither could they afford to reach a breaking point with Zuma's camp*

Vavi therefore played a very contradictory role throughout the strike. His role followed the logic of collective bargaining with a political edge: a negotiator influenced by strategic considerations related to the alliance. At a march in Johannesburg on 26 August, 12 days into the strike, Vavi echoed the strikers' anger, declaring that "the alliance is once again dysfunctional". He also lambasted "predatory elites" in the ANC and – crucial to the strikers' confidence – announced that the federation had filed notice for a one-day general strike in solidarity with the public workers. However, behind the scenes he was working hard first to avert a strike and then to settle the strike. Vavi describes this role in a remarkably unselfconscious letter after the strike, responding to the teachers' union's accusations that they had been sold out. The letter encapsulated the contortions of a union leader caught between his comrades in government and the fledgling force pushing up below. Vavi wrote that the negotiators were "acutely aware [of] how difficult it was for government to move" and described a number of attempts to reach a compromise on figures suggested by the public sector union officials, but apparently not caucused with their members.

Shortly after the 26 August march, Zuma ordered the parties back to negotiations. Many strikers took this as a signal that they were winning. The announcement of the new offer – 7.5 per cent – was a major blow to their morale. Most were also furious that Vavi announced this deal on national radio before it was put to the members, urging strikers to accept it because it was

“impossible” to win anything more. Vavi’s reading was that government negotiators felt betrayed by their union comrades who had twice promised that they could sell a deal to members, only to be told the members had rejected it.

Despite Vavi’s recommendation, most hospitals and most regions of the Cosatu teachers’ union rejected the offer, often unanimously. However, after three weeks of no-work no-pay, combined with worries about patients and students, and demoralized, shrinking picket lines, the strikers lacked inspiration to continue. After some days of uncertainty, the strike was “suspended”.

The political residues of the strike have not washed away easily, however. At the end of 2010, the Zuma regime remained nervous about the ability of its alliance partner to control its members and took it as a full-frontal attack when Cosatu called a “civil society conference” to which the ANC was not invited. The government’s New Growth Path made many promises to Cosatu and few concessions to its economic suggestions, while making a social pact – a new means of binding the unions – central. Less visible, but no less important, is the political residue in the minds of strikers. It is evident that strikers have begun to generalize beyond their own sectoral issues. Strikers in 2010 sympathized with service delivery protests much more readily than in 2007. Secondly, strikers learned a hard lesson in the logic of the alliance and of collective bargaining. At least one striker felt that the strike became a lever for Vavi’s own political ambitions. Finally, strikers in 2010 moved quickly to directly criticizing Zuma. The strike demonstrated that the contradictions are likely to unfold much more quickly for Zuma than for Mbeki.

## Note

<sup>1</sup> Government and the unions have failed to reach agreement on who is an essential worker.

*Claire Ceruti is a researcher attached to the South African Research Chair in Social Change at the University of Johannesburg. She has been doing research about class and strikes.*

# The struggle against pension reform in France

Philippe L  g  

In 2010, France experienced an intense social struggle. The triggering factor was the pension reform which the government of Prime Minister Fran  ois Fillon argued was necessary to “save the pension system”. The French system relies on compulsory basic and supplementary state pension schemes financed mainly by contributions (proportional to wages) and taxes decided at the national level. According to the government, because of the growing number of retired people and an ageing population, it is necessary to raise the legal retirement age from 60 to 62 (and from 65 to 67 for a full pension) in order to encourage people to work longer. But the trade unions are very sceptical about this reasoning, for the average age at which workers cease activity is 58.8 years. And 60 per cent of workers are not in employment when they claim their pension rights: they are either unemployed or on disability. For example, “25 per cent of nurses and 40 per cent of auxiliary nurses are on disability when they retire” (Lambert 2010). This essay first analyses the terms of the debate, and then discusses the struggle around the pension reform.

## *Unconvincing official arguments for pension reform*

“It is demographic, not political. If you live longer, then you must work longer.” The previous French Governments used similar arguments in support of the pension reforms that took place in 1995, 2003 and 2007. The ratio between the number of retired people and the number of pension contributors is undoubtedly increasing – but by how much? It is now clear that previous official reports exaggerated the demographic trends. The birth rate did not fall and the economically active population will not decline. The latter will actually increase until 2015, and then remain constant unless policies are adopted to increase women’s employment. The evolution of the active population is a political issue: it is limited to a demographic issue only when the government has no employment policy!

***The evolution of the active population is a political issue***

There are only two possible adjustment policies when a population is getting older: either reduce the pension per capita or increase the share of national wealth dedicated to pensions (which at the end of 2010 was 13 per cent of GDP in France). Workers understood that, despite official propaganda, the proposed reform did not favour the latter solution. Because of uneven and incomplete careers and also as the result of unemployment and increasingly casual jobs, the only outcome of the reform would be a decrease in pensions. Indeed, the effects of similar reforms proved to be regressive. According to the French Conseil d'Orientation des Retraites (Pensions Advisory Council), the pension represented on average 79 per cent of a person's pre-pension wage in 1995, but the ratio fell to 72 per cent in 2007 and is expected to be 65 per cent in 2020. The effects of the 2003 Fillon reform provide strong arguments against the 2010 Fillon reform.

The evolution of the pension system is the result of a complex set of factors, factors which the government deliberately mixes up. In 2007, the French pension system was running a slight surplus. In 2008, it had a deficit of €6.9 billion which has increased to €32 billion in 2010 (€11 billion for basic pensions and €21 billion for supplementary pensions). Yet only 10 per cent of this deficit was linked to the increasing number of retired people. The main cause of the deficit was the economic crisis, with the GDP share of spending for pensions holding stable but income decreasing because of unemployment and sluggish growth. Well, who is responsible for the crisis, one could ask? Having bailed out the banks, the government is now asking workers to make the effort. Yet it would be possible to finance the deficit by raising the contributions paid by employers. Of course,

*Having bailed out the banks, the government is now asking workers to make the effort*

capital owners will argue against "increasing the costs of labour", a move which is assumed to endanger the competitiveness of companies that will then have no choice but to lay off workers or relocate. But in actual fact, any subsequent problem of competitiveness could be solved by decreasing dividends. In 1980, dividends were equivalent to 4.2 per cent of total payroll, a ratio which rose to 12.9 per cent in 2008. Hence, the only problem with pensions is a distribution problem – and the "competitiveness" argument is simply misleading (Husson 2003).

### *Pensions at the root of a broader social movement*

Two associations (Attac and Fondation Copernic 2010) made a strong case against the reform, developed alternative analyses and gathered social and political forces on the left. During the spring, they organized debates all over the country. The demonstrations called by all trade unions were a real and surprising success: 1 million people were on the streets on 27 May and

2 million on 24 June. After the summer break, the movement grew even stronger. Truck drivers, teachers, port and rail workers, students and a very large number of private sector workers went on strike and united in a large movement against the government. They participated in huge demonstrations (3.5 million people gathered on 12 October), blocked highways and organized general meetings. Because of the strike, 10 of the 12 national oil refineries shut down and many petrol stations were without fuel for two weeks. The movement nevertheless remained popular, receiving the approval of nearly 80 per cent of the population. Its strength forced the unions to remain united against the government. It prevented the CFDT<sup>1</sup> (the less pugnacious of the two largest French unions) from withdrawing from the movement.

How can one account for such a large and popular movement? The evolution of the pension system is a matter of civilization, and pension reform was not the only source of revolt. Unemployment and deteriorating working conditions also featured prominently in the general meetings. In the debate concerning the conditions under which workers employed in difficult or hazardous jobs can retire earlier, the government wrote that “wage-earners must be physically worn-down when retiring”.<sup>2</sup> But what could be more justified than workers benefiting from retirement before they are ill or exhausted?

Moreover, for the vast majority of French people, the government had lost much of its legitimacy. In September, when Eric Woerth, the minister in charge of the pension reform, said that the text “could not be changed”, everyone knew that he had been much

*What could be more justified than workers benefiting from retirement before they are ill or exhausted?*

more understanding with wealthy people when he had been the budget minister. During the summer, the Woerth–Bettencourt scandal had exposed the close relationships between those in political and economic power. With a fortune estimated at \$20 billion, Liliane Bettencourt, the main shareholder of L’Oréal, is one of the wealthiest people in the world. In June, tape recordings revealed that she had dodged taxes by using undeclared Swiss bank accounts and that Woerth’s wife had been given a job managing Bettencourt’s wealth. Ms Bettencourt received a €30 million tax rebate while Mr Woerth was budget minister. Moreover, Bettencourt’s former accountant has claimed that conservative French politicians were frequently given envelopes stuffed with cash to finance their campaigns.<sup>3</sup>

Further evidence of the relationship between political and economic powers appeared in articles concerning the French President’s brother, Guillaume Sarkozy. He is not only a textile entrepreneur and the vice-president of the French employers’ association, but also the general manager of Malakoff Médéric. In 2010 this mutual insurance company created a private subsidiary company



(Sevriena) to take advantage of the pension reform. While Nicolas reduces state pensions, Guillaume sells supplementary private pension schemes. Nicolas Sarkozy is widely perceived as “the President of the very wealthy” because he created the famous “tax shield”, providing protection against taxes on high incomes.

### Conclusion

The French social movement of autumn 2010, particularly the strike by oil workers, showed the great power and determination of the working class. But the government defeated it by conscripting energy workers and ordering the riot police to disperse picket lines before promulgating the reform. The struggle’s outcome was influenced by three elements. First, the movement’s economic impact has been weakened by a reactionary law of 2007 forcing rail workers to give *individual* 48-hour notice of strike actions. But the government went much further by conscripting certain workers from the private sector. The unions initiated a procedure against this illegal restriction of strikes, which is now in process. Secondly, the fragility of the movement itself was partly due to the crisis and unemployment, which had placed the workers in a difficult position. Finally, Sarkozy was putting his political future in the balance with this reform. Hence the challenge was a very difficult one: any victory was impossible without bringing Sarkozy and the government down. However, the movement afforded many people interesting experiences in democratic mobilization, and they all reached the same conclusion: a battle has been lost but the war is not over.

### Notes

<sup>1</sup> Confédération française démocratique du travail.

<sup>2</sup> See <http://www.retraites2010.fr/le-projet-de-loi/mettre-en-place-un-dispositif-de-prevention-et-de-compensation-de-la-penibilite>.

<sup>3</sup> See <http://www.guardian.co.uk/world/2010/jul/12/nicolas-sarkozy-bettencourt-scandal>.

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*Philippe Légé is Assistant Professor of Economics at the University of Picardie (UPJV, France). His work is in the history of economic thought and the analysis of the current crisis. He is a member of the French Association of Political Economy (AFEP).*

# Fiat is at war, says Sergio Marchionne

*Francesco Garibaldi*

Pomigliano, situated in the economically depressed region of Campania, is the second largest Fiat plant in Italy. An experiment aimed at redefining the Italian system of industrial relations is taking place at this plant. It started with an agreement designed out of the Italian labour relations law. According to Sergio Marchionne, Fiat's CEO, this is a necessary step to fight the war posed by global competition.

The Pomigliano agreement, signed by three of the four metalworkers' unions (FIM, UILM and FISMIC), with the exclusion of the most representative (FIOM), gave a strong impetus to the process, started in 2009, of the deconstruction of the social pact set up in July 1993.<sup>1</sup> The pact, similar to the European tripartite incomes negotiation system, was based on a dual system of bargaining: on one hand, a national contract for each sector with an upper limit to wage increases, defined by the government and dependent on national macroeconomic conditions; and on the other, the possibility of the bargaining company's agreements to redistribute the firm's specific productivity gain. The core of the system was the national collective agreement regulating the main features of the employment relation. The company-level bargaining was only designed to fine-tune secondary aspects, not to allow local actors to depart from the national contract's clauses. The system was ineffective in defending wages from inflation; as a result, in the past 10 years, there has been a shift of five points in the ratio of wages to profits in GDP.

Another negotiating system, replacing the 1993 system, was implemented in April 2009. Signed by three of the four union federations and Confindustria (the Italian employers' federation), it paved the way to a separate collective agreement in the metalworking sector, which signed in October 2009. The new sectoral agreement increased the role of company-level bargaining, at the expense of the national sector contract. Moreover, it introduced a three-year term for all aspects of sectoral collective agreement, whereas previously pay terms applied for two years and non-pay terms for four years.

In between, the government launched a white paper introducing a new concept for social policies. The new metal sector agreement and the white paper framed a general shift in the Italian system of industrial relations and of the welfare state from a two-level system centred on the national contract to a new system centred at the company level, allowing concessions bargaining through derogation on specific features. Alongside this, a new welfare system emerged, based on the devolution of many public prerogatives to the private sector.

CGIL, the main Italian trade union, did not sign the April 2009 agreement and continued to support the centrality of the national contract, particularly relevant in Italy where almost 90 per cent of employees work in companies with fewer than 20 employees (and where bargaining at the company level would therefore produce uneven and unpredictable consequences). FIOM-CGIL, the metalworkers' union, did not sign the sectoral agreement of October 2009. Instead, FIOM asked for a referendum to ratify the new agreement, but FIM and UILM refused to do so. As a result, employees could not express their opinions on the new contract, signed by two of the three main unions – but not the biggest one.

### *From class conflict to workplace cohesion?*

In the midst of a very difficult situation for most European car producers, mainly due to overcapacity of the automotive industry, Mr Marchionne depicted the new fierce global competition in the sector as a “war” between people working in the same company and those working in other areas of

*From [Marchionne's] perspective ... capitalists, managers and employees of a specific company have to fight, side by side, against all the other companies to survive*

the world. From this perspective, the difference of interests between workers and managers/capitalists, not to mention the class conflict, is irrelevant. Capitalists, managers and employees of a specific company have to fight, side by side, against all the other companies to survive. Of course, during “war”, some rights cannot be guaranteed and multi-nationals must try to standardize employment relations. When a system such as the Italian one is less prepared for the war because it is too rigid and protective, it must be changed.

The problem is, therefore, not only to reach agreements with trade unions on flexibility and cost control, but also to change the nature of industrial relations; managers must be allowed to reshape the employment relation. Marchionne asked the workers to undergo a dramatic worsening of working conditions: the increase of the working week to 48 hours; the reduction of the breaks from two 20-minute to three 10-minute breaks; and the lunch break

moved to the end of the shift. On top of these new conditions, aimed at increasing productivity, Marchionne has also requested a collective and individual liability clause over all contract terms; virtually every employee and union must accept all conditions of the contract under penalty of exclusion from the company. This particular clause firstly seeks an ultimate disciplining of the workforce and secondly the ousting of the most representative and combative metalworkers' union from the plant and ostensibly from the whole sector: if FIOM were to refuse the new contract terms, it would be automatically deprived of trade union rights. Moreover, from an individual point of view, the agreement forbids any strike against the new regulations. This new approach to industrial relations represented a shock for the Italian system for many reasons.

*The agreement forbids any strike against the new regulations ... [yet] according to the Italian Constitution, the right to strike is not a trade union right but an individual right*

### *Labour rights under attack*

The main formal issue raised against Marchionne's new approach is that, according to the Italian Constitution, the right to strike is not a trade union right but an individual right. For instance, a group of employees, even if they are a minority, can strike against an agreement signed by the trade union. A union, on the other hand, must be legitimated by the employees it claims to represent, meaning they cannot impose a dramatic worsening of workers' rights without consulting them. The right to strike can be limited by the law for the sake of the public interest, as happens in certain areas of the public sector (e.g. hospitals and transport), but this discipline does not change the constitutional nature of the right: trade unions cannot sign an agreement limiting the right to strike without the explicit consent of members.

A second issue is the nature of the national contract and its relation with company-level bargaining. In its original form, the contract used to allow minor derogation at the company level. The possibilities for derogation increase in the revised form of the contract; nevertheless, what is reached in a specific company cannot be applied to the sector as a whole. To achieve such a sector-wide derogation is clearly what Fiat seeks to do.

The third issue is that the separate contract for the metalworkers did not legally replace the previous contract, which included FIOM, and will be formally valid until the end of 2011. It follows from the fact that the FIOM has not agreed to replace the old contract. This is important for all social actors, as in Italy contracts have a continuation clause, so if a new contract is not signed by all the signatories, the old one remains in force.

However, Fiat decided to press ahead with the new contract for the Pomigliano plant. Commenting on the possible result of the referendum among the workers, Fiat's CEO stated openly that, in case of a negative vote, the investment of Fiat to relaunch the plant would be cancelled.

The Pomigliano agreement was signed against the background of this threat, and the workers were asked to ratify it in a referendum. FIOM did not refuse to bargain on flexibility but it refused to sign the agreement and to endorse the use of a referendum in this case because the agreement altered the conditions under which an individual right – the right to strike – could be exercised. Such an alteration cannot be decided by trade unions, let alone employers, because this right is not theirs. The positive vote in the referendum was, however, fully endorsed by the other unions because they feared that employees would be made redundant by Fiat. While all the unions and the press were convinced that the referendum would be a landslide victory for Marchionne, nearly 40 per cent of employees – and the majority on the assembly lines – refused the agreement. Marchionne reacted very angrily because, although Fiat technically won the referendum, it found itself in the uneasy situation of having to operate a factory facing serious opposition and collective action from a large part of its workforce.

It was because of this result that Marchionne decided to “up the stakes” and to condition further investment in Pomigliano to an alignment of the national branch contract for metalworkers to the one adopted in Pomigliano. This would require changing the national branch contract with the agreement of Confindustria (the employers' association) as well as FIM and UILM. Only if this condition were fulfilled would Fiat implement its commitment to invest. This would extend some of the most shocking concessions made in Pomigliano to all Italian metalworkers, starting with the curtailment of the right to strike, with the threat of monetary and disciplinary retaliations for each employee and for trade unions should a strike nonetheless take place.

This goal was achieved in September 2010 with an alteration of the separate collective agreement in the metalworking sector signed in October 2009, extending the clauses valid for Pomigliano to the sector as a whole. To add insult to injury, Fiat decided to shift the production of higher value added products from Pomigliano to Tychy in Poland, while transferring a product with lower added value from Tychy to Pomigliano (namely the new Panda). However, should the management not feel certain that it can exercise strict control over the plant, Fiat decided to create a new company from scratch, firing all the employees and rehiring only those who fully accept the new collective agreement.

The result is that investment in Pomigliano is still uncertain, but metal-workers have surely seen their rights shrinking dramatically and their solidarity becoming fragmented.

## Note

<sup>1</sup> See <http://www.eurofound.europa.eu/eiro/1998/03/feature/it9803223f.htm>.

*Francesco Garibaldi is an industrial sociologist and the former director of the Institute for Labour (IPL) and of the Institute for Economic and Social Research (IRES-CGIL) at CGIL, Italy's largest trade union confederation. For more information, visit <http://web.me.com/garibaldof/Sito>.*

# Trade unions and worker struggles in Guangdong

*Chen Weiguang interviewed by Boy Lühje<sup>1</sup>*

BL: How do you assess the labour conflicts in the auto supply industry in South China in the spring and summer of 2010?

CW: The strike at Honda Nanhai and other auto components factories in the Pearl River delta in June and July 2010 triggered a strike wave that involved several tens of thousands of workers. In the city of Guangzhou alone, more than 60 factories had strikes, including Honda Dongfeng and other major auto suppliers.

The basic cause of the strikes was low wages and poor working conditions, but the low wages were the main factor. The Guangdong provincial government basically did not view these strikes negatively. We as a trade union found the workers' demands just and reasonable. Honda and Toyota in Guangzhou are both foreign–Chinese joint ventures, and workers' wages in these companies were between 2,500 and 3,000 RMB<sup>2</sup> per month. But in Honda Nanhai and many other comparable companies, the wages were much lower, around 1,200 RMB. These companies are profitable ... but their basic wages were about the legal minimum, around 900 RMB.

*The basic cause of the strikes is low wages*

We therefore believe that the demands of the workers were justified. But we hope that such economic disputes do not develop into political incidents and will not disrupt social order; this is our bottom line. We have to say that our strikes were very orderly – there were no walkouts from the factories to the streets, no destruction of machinery, no playing politics. Everything remained in the framework of disputes within factories. In all of the more than 60 conflicts in Guangzhou this summer, negotiated settlements were achieved. We can therefore proudly say that in Guangzhou no striking worker was dismissed and not one worker was arrested by the police, although the strikes included tens of thousands of workers. Of course, most of the strikes were rather short, between two or three hours and three days. We also taught our Japanese employers that they cannot treat their workers in such harsh ways.

BL: In the strike at Honda Nanhai, which gained the most attention from the national and international media, the trade union behaved in very different ways from what you just described.

CW: In this case, the trade union was not well prepared in its thinking. At the time of the strike, it could not respond with clarity to the demands of the workers. The workers did not accept the trade union as their representative, and the factory trade union lost the workers' trust from the beginning. As the strike went on, the union wavered between management and the workers, and it saw itself as a mediator. Standing between the two sides is the worst position.

In addition, the workers were confronted with physical force from outside the factory. These incidents cannot be blamed on the trade union, since these individuals were not trade unionists, but outsiders. They hoped to end the strike quickly by disguising themselves as trade unionists. They pushed and dragged workers and hurt some of them slightly. Some workers said they were beaten. The workers felt threatened and left the workshops again. Originally, some had been ready to go back to work.

After the incident, the trade union issued a letter of apology in an effort to calm the situation. Writing such a letter was equivalent to admitting people were beaten. After the letter was posted on the Web, the whole world criticized the trade union. The union failed to explain its position clearly. Because it did not take a clear stand from the beginning, the chain of events following the incident put the union in a bad light. The impact of such an event is very difficult to dispel within a short period of time, and writing this letter only complicated things for the union.

BL: What was the situation in the other cases, which garnered less public attention?

CW: In the labour conflicts at Honda's suppliers in the city of Guangzhou, especially in the Nansha district, our approach was very different and the trade union behaved proactively. Basically, since 2007 we have educated the trade

***Trade union cadres ... must represent the workers and not play the middleman***

union cadres that they must represent the workers and not play the middleman. In the event of a strike, even very short ones, the trade unions have to be on the side of the workers and may not act as mediators. When the strike in Nansha occurred, we asked the district-level trade union to intervene immediately and give voice to the demands of the workers. To our knowledge, the wages of workers in this company were similar



to those in Honda Nanhai. According to the factory trade union, the workers were demanding an increase in wages and fringe benefits, such as free meals during night shifts and air conditioning in the dormitory. But the company only accepted free meals during night shifts. So we were supporting the workers, but at the same time we were telling them not to disrupt the public order, and not to damage equipment and obstruct vital operations.

From the beginning to the end, the company did not want to bargain. They told the workers: You can have a raise of 450 RMB, but if you do not accept within 10 minutes, you will have to leave the company. The workers did not give in. They simply continued their strike. This alarmed management, because after three days the Toyota Nansha main factory would have had to stop work. The workers knew their strength. In the end, the company had no other choice than to change its behaviour and bargaining stance. After four hours of negotiations, a wage increase of 825 RMB was agreed upon. The workers perceived this as a victory, and the employers could live with it. The workers' wage now is around 2,000 RMB, still somewhat different from the main factories of Honda and Toyota.

A very important factor concerning the outcome of this conflict was the attitude of the top political leaders in our province. They had a clear understanding that the nature of the dispute was economic and the strikes should not be treated as destabilizing incidents. Mass activities such as collective resistance, road blockages, protest marches and mass petitioning are considered as being in this category. But in this case, the workers did not leave the factory, everything remained peaceful, there was no yelling and shouting, and it was more like silent resistance. Our provincial party committee noted that these were not destabilizing incidents and that police force should not be used. The government should act as a mediator, and the trade union should bargain with the employer.

BL: Looking into the future, how do you view the prospects for democratic management of enterprises and collective bargaining?

CW: This year's strike movements taught us many lessons. First, they educated our trade union cadres to take a very clear position when handling such conflicts. Second, they taught the employers to treat workers with dignity and not as machines. Third, they taught many of our leaders that labour relations is a very important issue. We have talked for years about the importance of wage negotiations, but this has not had a real impact on the various levels of our leadership and society. After these strikes, many people think it is a good

*After those strikes, many people think it is a good idea to promote wage bargaining*

idea to promote wage bargaining. Apart from the discussions about collective bargaining, the question of democratic elections is of the greatest concern to trade union cadres. We now have plans to introduce truly democratic elections of factory trade union representatives. Elections for trade union representatives exist, but how are candidates being selected? Often, the elections do not work very well, and most of the time a small group of leaders decides to support candidates who fit their interests, giving workers only a very limited choice. These superficial elections, in fact, are really appointments. We want to change these methods. Candidates should be recommended by the collective mass of employees: this way, we will be able to create a choice among capable candidates approved by the workers and bottom-up democracy can take shape. At the same time, top-down processes will also become more focused.

We believe that democracy must be rational and that responsible people should become leaders. Only this sort of democracy constitutes active progress, and is not a destructive force.

BL: What is your view of the prospects for coordinating wage levels between companies and establishing industry-wide wage standards?

CW: I am strongly in favour of industry-wide collective bargaining because wage standards can be much more efficiently negotiated at the level of entire industries than they can in companies of various types. We therefore have to bring into play industry trade unions and employer organizations. In the wake of the recent labour conflicts at Denso Nansha in Guangzhou, we looked into the possibility of creating an industrial trade union for the automobile sector. This seems inevitable, yet conditions are not yet ripe at the city level. But we are trying this at least at the district level. In Nansha, the conditions do exist, and the trade union at the Toyota factory in Nansha has taken the lead in developing regular contacts with the trade union at lower-tier suppliers.

I have learned about the way bargaining is conducted in Singapore. There, the workers' wage is split into three parts: the base wage, monthly premiums and yearly bonuses. The first component makes up 70 per cent of regular pay; this is negotiated by trade unions and employers' associations at the industry level. The latter two elements are negotiated between unions and management at the factory level. The main part of the wage is subject to industry-wide negotiations, and the smaller part remains open to negotiation within the company. This leaves room for differences, but the differentiations cannot

become too big. Besides, a proportion of the base wage of around 70 per cent of regular monthly income is quite healthy. In China, the base wage is very low and the freedom of employers to determine wages is too great. In comparison, I find the Singapore method very good.

BL: What can be learned from the experiences of Western trade unions in this context?

CW: As China becomes more open to the market and to the global economy, there is no reason why the trade unions should not study the wealth of international experience, particularly systems of wage negotiations. But this learning must be integrated with our country's own conditions and experience. Our attitude should be realistic and we should learn from the facts. In this context, we should vigorously support exchange with foreign trade unions and experts.

## Notes

<sup>1</sup> The interviewer selected and translated the text.

<sup>2</sup> One hundred renminbi is equivalent to 15 US dollars.

*Chen Weiguang is Chairman of the Guangzhou Federation of Trade Unions and Deputy Chairman of the People's Congress of the City of Guangzhou.*

*Boy Lüthje is a Senior Fellow at the Frankfurt Institute of Social Research, specializing in economic transformation and labour in China.*

# Domestic workers in Switzerland protected by the country's first sectoral employment contract

*Vania Alleva and Mauro Moretto*

In Switzerland as elsewhere, the State has been retreating on social policy in recent years. This is causing a decline in provision of social services and, consequently, to an increase in demand for domestically based services. Nobody knows exactly how many waged employees are currently working in Swiss private households (as many are unreported), but statistics suggest that their numbers are continually increasing. At the end of 2007, the Unia trade union, on the basis of various studies,<sup>1</sup> estimated the number of full-time jobs in the sector at about 125,000 (or approximately 4 per cent of the total workforce). More than 90 per cent of these employees are women. Many are migrants, often without any legal residency status. They come from a broad range of countries, where they often had gained academic qualifications and worked in other occupations. Recently, increasing numbers of women from the new EU Member States have been finding jobs in Swiss private households.

## *Fighting low wages and poor working conditions*

Despite the legal risks and other incentives to stay hidden, more and more private household workers are contacting Unia. They are reporting appalling working conditions: extremely low wages, hefty deductions for board and lodging, no social security or pension coverage, massive daily workloads, pay stoppages if they fall ill or if the employer goes on vacation, uncompensated work on public holidays and no overtime arrangements. Small wonder that all the available studies underline this sector as the one with the highest proportion of precarious employment relationships and working poor.

For more than 10 years now, Unia, together with other unions in the Swiss Federation of Trade Unions (SGB/USS), has been fighting against the social scandal of working poverty and for substantial pay rises in low-wage sectors. At the turn of the twenty-first century, these joint efforts had yielded some important successes in sectors such as hospitality and retailing.

However, as Switzerland still does not have a general legal minimum wage, this struggle has come up against certain limitations – especially where there is no organized negotiating partner on the employer side with whom to agree on binding minimum wages.

At the end of 2007, Unia and the SGB/USS called upon the Swiss Government to make use of the legal possibilities created as part of the measures allowing free movement of persons between Switzerland and the EU, and to decree for this category of workers the first-ever Switzerland-wide “standard work contract” (*Normalarbeitsvertrag*, or NAV) with binding minimum wages and working conditions. An NAV is not a collective agreement, but rather a sector-specific legal minimum wage for sectors in which there are no collectively agreed provisions.

At the same time, Unia drew public attention to the highly precarious working conditions experienced by domestic employees. The Swiss Government finally took up the union’s concerns and asked an expert group to work out the parameters for an NAV with binding minimum wages. Participants included representatives of the cantonal and national authorities, employer organizations and organizations in related sectors (cleaning and hospitality), as well as the authors of the present article, who represented the unions. The expert group reported back in mid-2009 with a proposed NAV that took account of multiple elements and requirements. The main focus was on the setting of minimum wages that would reflect the wide-ranging and physically demanding tasks involved in private domestic work. Concretely, the expert group defined three wage categories on the basis of experience and training: 1) untrained employees; 2) experienced employees; and 3) employees with vocational training or long experience. For the domestic employees’ protection and security, other elements going beyond the legal requirements are vital. Among these are working time arrangements (including overtime), holidays and leave, and the continued payment of wages in case of illness. Although the Unia representatives pressed for these elements to be included in the proposed NAV, they were left out – both because they are covered by existing cantonal NAVs and because the legislation underpinning national NAVs does not provide for them.

### *A first step in the right direction*

Politically and administratively, the draft NAV had to overcome some resistance and many hurdles. Some cuts had to be accepted, notably to the effective minimum wage levels, before the national government decreed the first NAV for domestic employees, with binding minimum wages and the force

of law, in October 2010. To date, this is the only national-level NAV, so its significance goes beyond the sector for which it was adopted.

The NAV came into force on 1 January 2011, and it is an important step in the right direction. The compulsory minimum wages are:

*This is the only national-level NAV, so its significance goes beyond the sector for which it was adopted*

- CHF 18.20 per hour for untrained workers
- CHF 20 per hour for untrained workers with four years of professional experience or for workers with two years' training
- CHF 22 per hour for workers with three years' training.

This is less than the expert group proposed, but it is nonetheless a significant improvement on the current situation and it sends out an important signal to domestic workers employed in Switzerland. The minimum wage for untrained domestic employees corresponds to about 55 per cent of the average gross wage. The mandate given the expert group had specified that the minimum wages set for domestic employees were under no circumstances to exceed the minimum wages negotiated by the social partners for the related cleaning and hospitality sectors. However, by pointing out the many different tasks performed by domestic workers, who for example often help to care for children and elderly people, the experts were able to justify a partial waiver of this requirement. For these minimum hourly wages to apply, a domestic employee must work on average at least five hours a week for the same employer. The main reason for this is that workers who clean several households on a purely hourly basis in fact earn considerably more (as a rule, CHF 25 or more) and are therefore scarcely affected by wage dumping.

The Swiss delegation will now be in a good position, at the International Labour Conference in June 2011, to push hard for the adoption of the new Convention that will enshrine fair employment conditions for domestic workers worldwide.

### *Implementation: An uphill task*

Now for the difficult, challenging part: implementation. The canton of Geneva has had its own domestic workers' NAV with minimum wages since 1 July 2004 – a precursor to the national NAV. So far, experiences with it have been very positive. Admittedly, it is difficult to monitor whether the NAV is being correctly applied, as we often do not know in which households domestic employees are working. But word has increasingly got around among these

workers that the NAV gives them certain rights. And when necessary, they do go to the labour courts to get those rights upheld. The highest-profile case, won by Unia Geneva, secured back payments of CHF 70,000 for a married couple who were both working as domestic employees. The NAV does provide

***The NAV ... enables employees to defend their rights more effectively***

protection and does enable employees to defend their rights more effectively. Employers are also better informed about their duties. Experience in Geneva shows that employers want to avoid the courts and will often, in case of dispute, pay the minimum wage without further ado.

Monitoring of compliance with the NAV is first and foremost the task of the tripartite commissions in the cantons. Thanks to the binding minimum wage rates embodied in the NAV, these commissions have the instrument they need in order to ensure and enforce, at the very least, effective protection against wage dumping. Verification of the NAV, however, is seriously hampered by the opaque and fragmented nature of this segment of the labour market. To get the new NAV applied, the tripartite monitoring bodies will need support through other means, including broad information campaigns targeting both employers and employees.

Still to be tackled is the question of the residency status of domestic employees from non-EU countries. Although the degree of exploitation certainly does not depend on residency status alone, the demand for the regularization of undocumented immigrants remains crucial. Only through such legal security can lasting improvements be achieved in the living and working conditions of these employees and their families. Beyond regularization, it is absolutely crucial to de-couple access to courts from the residency status of migrants; this will go a long way in reducing these workers' precariousness.

***Information and targeted union organizing***

Further challenges face Unia and other organizations engaged in this field. As domestic employees cannot be informed and organized at their workplaces, alternative locations have to be sought or created. Essential to this is the closer networking of trade unions, migrants' associations with strong representation of women, and organizations working in the migration field. Here, Unia in particular can build on its long years of cooperation with the many associations through which migrants maintain links with their countries of origin. The union's experience as an intercultural mediator must be adapted to the domestic workers' situation. Conscious efforts must be made to recruit and train contact persons and reps who know the specific living and working circumstances of

domestic employees and speak their languages. Equally, social and political alliances are needed in order to offset the limited scope for self-organization. This entails organizing targeted information meetings, language courses or integration courses which promote empowerment, exchanges of experience and collective processes.

## Note

<sup>1</sup> Among them, Alleva, V. and P-A. Niklaus (2004), *Leben und Arbeiten im Schatten. Studie der Anlaufstelle für Sans-Papiers und GBI* (Basel, ECOPLAN).

*Vania Alleva is a member of the executive committee and leader of the service sector branch of Unia, the Swiss inter-professional trade union.*

*Mauro Moretto is a member of the leadership of Unia's service sector branch.*



## PART II

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# Rethinking European economic governance

# Beware the Canadian austerity model

Andrew Jackson

This article was written following media reports that former Canadian Finance Minister and Prime Minister Paul Martin had been advising the UK and other European Governments to adopt drastic fiscal retrenchment measures based on alleged Canadian “success”. The Canadian policy experiment was savage for its time, but has been eclipsed by the scale of the spending cuts imposed by the new Coalition Government in the United Kingdom. As in Canada, it is notable that the UK cuts have not been precipitated by an immediate fiscal crisis or foreign debt crisis.

Martin was Canada’s Minister of Finance from 1993 to 2003, then served a short term as Prime Minister. He spoke on Canada’s 1990s debt reduction strategy to a February 2010 Public Services Summit organized in the United Kingdom by the *Guardian*, and Canadian newspapers reported that he was being tapped by the Europeans for advice on fiscal matters. Martin himself said that he engaged in “informal” discussions with several European ministers and senior officials seeking advice on how to confront that continent’s debt crisis. “There’s a huge, huge interest,” said Hamish McRae, a prominent columnist with the *Independent*, who advised readers that the route out of Europe’s debt crisis was by following Canada’s example. “Boy oh boy. Canada, along with four or five other countries, is attracting tremendous attention here.”<sup>1</sup>

This is unfortunate, since the Canadian example should prompt concern rather than blind imitation. Canada stands out among the OECD countries for reducing deficits and debts through deep and permanent cuts to social programmes and public services, at great cost to working families.

***Canada stands out among the OECD countries for reducing deficits ... at great cost to working families***

In most OECD countries (with the major exception of Japan), government debt levels stabilized or fell as a share of GDP from highs in the mid to late 1990s until the start of the Great Recession in 2008. The basic drivers of debt reduction are well known. Debt will shrink if the economy grows faster than

interest on the accumulated debt, and/or if deficits (revenues less expenditures) shrink due to spending cuts or tax increases. From a labour and progressive perspective, the desirable approach to debt reduction is to maintain strong economic growth at low real interest rates and, if necessary, to raise taxes in a fair way to pay for the needed maintenance and expansion of programmes. For most OECD countries, debts stabilized from the mid to late 1990s without major overall spending cuts as economies recovered from the downturn of the early 1990s, and as interest rates fell from very high levels (though not by nearly as much as they should have done in the Euro area). For the OECD area as a whole, gross government debt as a share of GDP increased very slightly from a peak of 72 per cent in 1998 to 73.1 per cent in 2007, driven mainly by much higher debt in Japan. For the Euro area, debt shrank very significantly from 80 per cent to 70.9 per cent of GDP over the same period, and the US debt also fell by 10 percentage points of GDP from its peak in 1993 through to 2007.

*The desirable approach to debt reduction is to maintain strong economic growth at low real interest rates*

At one level, Paul Martin's reputation as a deficit and debt-slayer is well deserved. As Canada's Minister of Finance, he (together with like-minded provincial governments) presided over a huge reduction in Canada's gross debt, from a well-above average of 101.7 per cent of GDP at its peak in 1996 to a well-below average of just 65 per cent in 2007. This was one of the most sweeping fiscal consolidations in the OECD, and certainly the largest one amongst the G7 countries. A mixed bag of small countries also saw major debt reductions over roughly the same period: Australia, Belgium, Denmark, Finland, the Netherlands, New Zealand and Sweden.

What makes the Canadian experience really stand out is very heavy reliance on spending cuts to eliminate the deficit and then run budget surpluses. In 1996, when Canadian debt peaked, spending was 46.6 per cent of GDP, down a bit from a peak of over 50 per cent of GDP in the recession of the early 1990s. By 2007, spending was just 39.1 per cent of GDP, or more than 7 percentage points down from the peak debt year. By contrast, spending in the OECD area as a whole fell by only 0.7 percentage points of GDP between 1998 and 2007, and in the Euro area by 2.6 percentage points. Canada relied more on spending cuts than most of the smaller countries mentioned above. Canada also stands out in that it did not rely at all on tax increases to lower the deficit and debt. Indeed, once surpluses emerged after 2002, corporate and personal income taxes were cut. Revenues as a share of GDP fell from 43.8 per cent of GDP in the peak debt year to 40.7 per cent in 2007. By contrast,

revenues remained unchanged for the OECD as a whole, fell well under 1 percentage point of GDP in the Euro area, and rose a bit in the United States as the Clinton Administration raised taxes quite significantly as part of its debt reduction strategy.

Putting the burden of debt reduction on social spending cuts rather than on taxation meant that the burden of Canadian deficit reduction fell on the lower end of the income distribution, and this was a significant factor behind the pronounced increase in Canadian income inequality over the 1990s. Between 1993 and 2001, the after tax and transfer income share of the bottom 80 per cent of families fell as the share of the top 20 per cent rose from 36.9 per cent to 39.2 per cent. Part of the decline in total Canadian government spending over the mid to late 1990s was cyclical, driven by a gradual fall in the national unemployment rate from a very high level. But by far the greater part came from a major retrenchment of the welfare state. As Minister of Finance, Martin cut federal transfers to persons by 1.9 percentage points of GDP. With elderly benefits virtually untouched, most of the burden fell upon federally administered Unemployment Insurance.

Access to benefits was restricted, and the maximum benefit was frozen in nominal terms for a decade. Today, Canada has one of the least generous unemployment schemes in the OECD. During the current downturn, only one half of unemployed workers have qualified for benefits, and the maximum benefit is just 60 per cent of average earnings. The average unemployed worker qualifies for a maximum benefit period of less than nine months.

*Today, Canada has one of the least generous unemployment schemes in the OECD*

Between 1992 and 2000, Martin also cut deeply into federal transfers to the provinces, which fell by 1.9 percentage points of GDP. Most of the burden fell on social programmes under provincial jurisdiction, notably public health insurance (which covers physician and hospital care) and welfare or social assistance which provides basic income support. The old formula under which the federal government paid one half of welfare costs was scrapped, and welfare rates were slashed in real terms in almost every province. Because of cuts to unemployment insurance and welfare, poverty rates remained at near recession levels through most of the 1990s and the incomes of the bottom half of households rose very modestly, despite falling unemployment.

Martin's cuts stopped the Liberal Government from implementing their promise to introduce a national childcare and early learning programme, leaving working families pretty much on their own in seeking care arrangements. Worse, his fiscal revolution and abdication of federal leadership in

social policy made Canada a much more market-dependent society, moving it much closer to the US model. Between 1993 and 2002, the difference between the level of non-defence programme spending in Canada and the United States fell from a huge 15.2 percentage points of GDP to just 5.7 percentage points.

Martin and others argue that Canada was in such a fiscal mess in the mid-1990s that there was no alternative to deep cuts. However, as argued at the time by the labour movement and leading Canadian macroeconomists such as Lars Osberg and Pierre Fortin (both past Presidents of the Canadian Economics Association), rising debt was not the result of over-spending but of a very deep recession between 1989 and 1991, exacerbated by the exceptionally high real interest rates inflicted by Bank of Canada governor John Crow in his search for the holy grail of zero inflation.

The cyclically adjusted budget balance in the mid-1990s was the same as the OECD average (4.6 per cent of GDP in 1995), and below that in the Euro area. Canada could, like other countries, have made much more modest fiscal adjustments to gradually return to balanced budgets as the economy improved. Taxes in the mid-1990s were a bit lower than the European average and could have been raised at least in line with US taxes under Clinton. Canada had no real trouble financing government borrowing, which was and is overwhelmingly denominated in Canadian dollars.

A key feature of Canada's deficit wars was the deliberate cultivation of fear. As documented by Canadian journalist Linda McQuaig in her book *Shooting the Hippo*, the media and officials fanned totally groundless fears of a debt default and even resorted to talking down Canada's debt standing in influential international circles such as the *Wall Street Journal* editorial board to create a sense of crisis.

The macroeconomic consequences of Canada's huge fiscal retrenchment were limited by a shift to easier monetary policy, and a significant depreciation of the Canadian against the US dollar. Canada grew somewhat faster than the United States and most of Europe from the early 1990s to 2000 despite fiscal restraint. But unemployment was very slow to decline, falling from 11.2 per cent in 1992 to a still very high 8.7 per cent in 2000. Average real hourly and weekly wages stood still over this entire period, underscoring how far the economy fell short of its potential. For working Canadians, the 1990s were experienced as a lost decade.

As Paul Martin argues, Canada's experience holds lessons for others. The key lessons are that deep fiscal restraint is hugely damaging to the well-being of working families, and that better alternatives exist.

## Note

<sup>1</sup> <http://www.ottawacitizen.com/business/Europeans+Paul+Martin+advice/2616493/story.html>.

*Andrew Jackson is Chief Economist and National Director of Social and Economic Policy with the Canadian Labour Congress (CLC), where he has worked since 1989. He is also a Research Professor in the Institute of Political Economy at Carleton University, a Research Associate with the Canadian Centre for Policy Alternatives, and a Fellow with the School of Policy Studies at Queen's University. He has written numerous articles for popular and academic publications, and is the author of Work and Labour in Canada: Critical Issues (Canadian Scholars Press, 2005).*

# Why the Stability and Growth Pact does not work

Till van Treeck

The current crisis of the Eurozone clearly shows that the European Stability and Growth Pact (SGP) does not work. A European “rescue plan” was finally agreed upon by the Member States on 9 May 2010 after a long period of hesitation, especially in Germany. It has, for the time being, prevented the breakdown of the monetary union, as it could potentially grant up to €750 billion of credit to Euro countries with financing problems. But this rescue plan has merely bought time. The structural flaws of the SGP still need to be addressed.

The main problem with the SGP is that it focuses on the financial position of only one sector of the economy, namely the state. According to the SGP, no state should ever run a government deficit of more than 3 per cent of GDP, with the further stipulation being a balanced budget over the medium term.

*The main problem with the SGP is that it focuses on the financial position of only ... the state*

Moreover, public debt shall not exceed 60 per cent of GDP. The only legally binding constraint for any government is the excessive deficit procedure, which will set in as the government deficit exceeds 3 per cent of GDP. The two other important sectors of the economy, namely the private and the foreign sectors, are ignored by the SGP.

Yet, it simply does not make sense to argue that a higher than 3 per cent government deficit is unsustainable without looking at the financial balances of the private and foreign sectors of the economy. Remember that the financial balances of the three sectors necessarily sum to zero. This means that when one sector is running a deficit, then the remaining two sectors of the economy are running a joint surplus of exactly the same magnitude. If, for instance, the state runs a deficit of 2 per cent of GDP and the private sector (households and companies combined) has a deficit of 10 per cent, then the current account deficit of this country will be 12 per cent (the financial balance of the rest of the world vis-à-vis this country will be 12 per cent). Yet such a scenario, which could hardly be considered sustainable, would not give rise to any sanctions

within the current framework of the SGP. If, on the other hand, the private sector has a surplus of, say, 10 per cent of GDP but the government runs a deficit of 3.5 per cent (implying that the country has a current account surplus of 6.5 per cent), then the government deficit will be considered too large and the country will face sanctions as defined by the excessive deficit procedure.

These scenarios are not merely hypothetical but of concrete empirical importance, as the following examples illustrate:

- Spain has never violated the 3 per cent criterion of the SGP between 1999 and 2007. The public debt-to-GDP ratio decreased from 62 per cent to 36 per cent. The Government even achieved surpluses in the biennium 2005–07 of up to 2 per cent of GDP. At the same time, the private sector was running huge and persistent deficits of up to 12 per cent of GDP. As an implication of this, Spain was systematically running current account deficits of up to 10 per cent of GDP.
- In Ireland, the situation was quite similar. The public debt-to-GDP ratio decreased from 49 per cent of GDP to 25 per cent from 1999 to 2007, and the Government almost always achieved surpluses (of up to 5 per cent of GDP). At the same time, the financial balance of the private sector was systematically negative (up to –7 per cent of GDP).
- By contrast, in Germany the Government was in deficit from 2001 to 2006, and the 3 per cent limit was violated during the period 2002–05. From 1999 to 2007, the public debt-to-GDP ratio increased from 61 to 65 per cent. At the same time, however, the private sector was persistently running surpluses, which always exceeded the government deficit, and at times were as large as 9 per cent of GDP. This implies that Germany was persistently running a current account surplus, which increased up to almost 8 per cent of GDP in 2007.

What do we learn from these examples? From 1999 (the year the euro was introduced) to 2007 (the year before the global crisis started), it seemed that public finances were more “solid” in Spain and Ireland than in Germany. Yet in the course of the global economic crisis and the crisis of the Eurozone more specifically, Spain and Ireland were soon counted amongst the infamous “PI(IGS)” countries that have become the focus of speculative attacks in the financial markets. (Portugal, Ireland, sometimes Italy, Greece and Spain have been called the “PI(IGS”).) In fact, public debt rapidly increased in those countries as soon as the private spending and credit booms – which had driven those economies before the crisis – came to an end. (In Greece and Portugal,



both the government and (to a larger extent) the private sector had been in deficit even before the crisis.)

The important lesson to be learned from the current crisis is that when the private sector financial balance is unsustainable, then the financial balance of the government will also be unsustainable, irrespective of whether it is in deficit or surplus. More specifically, the combined balance of the government and the private sector is a much better indicator of whether a country is prone to speculative attacks than is the government deficit or the public debt. This partly explains, for instance, why Germany is considered as highly “creditworthy” by the financial markets, although public debt is much higher than in, say, Spain or Ireland, and the 3 per cent criterion of the SGP has been repeatedly violated since the introduction of the euro. As a consequence, the focus of a new and better stability pact should be on current account imbalances.

How can we explain the large current account imbalances in the Eurozone? One important factor is the increasing divergence in unit labour costs. In a monetary union, changes in international price competitiveness can no longer be corrected through changes in nominal exchange rates. Rather, when changes in unit labour costs (which are closely related to national inflation rates) differ among member countries, then some countries persistently gain competitiveness relative to others. Now, between 1999 and 2007, unit labour costs have increased by less than 2 per cent in Germany, but by 28 per cent to 31 per cent in Greece, Ireland, Portugal and Spain. This means not only that all other countries have lost in terms of price competitiveness vis-à-vis Germany, but also that as a result of lower price inflation, real interest rates have been higher in Germany. This contributed to the weakness of domestic demand, which was corroborated by an exceptional increase in income inequality and poverty (which depressed private consumption) and the retrenchment of the welfare state and public spending more generally (which increased precautionary personal saving and depressed the growth contribution of government expenditure). A lot of policy mistakes have certainly been made in the deficit countries as well. But a monetary union cannot survive in the longer term when its largest member country (Germany accounts for more than a quarter of the GDP of the Eurozone) hardly contributes to aggregate demand, instead following an essentially neo-mercantilist growth strategy.

*Changes in international price competitiveness can no longer be corrected through changes in nominal exchange rates*

A new stability pact would therefore have to oblige countries with large current account deficits to take measures that reduce nominal unit labour costs

growth and, in the final instance, to pursue more restrictive fiscal policies. At the same time, when a country has an excessive current account surplus, fiscal policy needs to be more expansionary and wage moderation needs to be stopped. This is also true for the current situation, where the old SGP imposes fiscal consolidation plans on all countries simultaneously. While this implies a serious threat to growth for the Eurozone as a whole, a more sensible approach would be for the surplus countries to allow for an expansionary fiscal stance, as long as private demand remains fragile and current account imbalances remain large.

*Till van Treeck is an economist with the Macroeconomic Policy Institute (IMK) at the Hans Boeckler Foundation in Düsseldorf.*

# European economic governance: The next big hold-up on wages

Ronald Janssen

One of the main purposes of the current drive for European economic governance is to transform wages into the main or even single instrument of adjustment under the monetary union. Strangely, this idea appears to enjoy a high degree of consensus among both conservative and progressive economists. For the former, extreme wage flexibility including wage cuts and subregional deflation is necessary if the rest of the Eurozone is to catch up rapidly in competitiveness with Germany. For the latter, the rebalancing of competitive positions is to proceed by setting up some kind of “wage planification” process at the European level in which German wages are to go up while wages outside Germany are going down and stay down for many years to come.

Both views are based on the idea that there exists a direct and straightforward link between wages and competitiveness, as if one unit change in wage costs equals one unit change in competitiveness, or even jobs. However, a closer look at the German experience reveals that this assumption is totally flawed: competitive prices are *not* at the basis of Germany’s massive export boom. What really drives German exports is the growth of its export markets: If those economies into which Germany is exporting enjoy an economic boom, then German exports closely follow. Here, a recent analysis from the European Commission (2010) finds that the dynamism of Germany’s export markets explains almost the whole of the 7.3 per cent annual average increase in its export volumes over the 1999–2008 period, whereas the contribution of more competitive pricing on German export performance is barely noticeable (0.3 per cent).

**Competitive prices are not at the basis of Germany’s massive export boom**

How do we explain the fact that a decade of real wage stagnation has barely had any impact on Germany’s spectacular export boom? The answer has to do with the specialization pattern of German industry, focusing on products which the more dynamic (emerging) economies are most eager to buy (for example, machinery, telecommunications equipment and transport infrastructure). This

type of specialization pattern has the effect of making demand for German exports price inelastic: it is technical know-how (how to produce efficient machinery) and quality. In this equation, prices are a subordinate. Indeed, econometric studies (Artus 2010) find that a 10 per cent reduction in German export prices increases export volumes by only 4 per cent. In the case of France, a similar price reduction would boost export volumes by as much as 12 per cent.

The fact that the demand for exports is relatively irresponsive to prices also explains why German business opted not to pass on falling unit labour costs in manufacturing into lower export prices. Doing so would only have made a small difference in export demand and overall production, implying a limited increase in total profits. The alternative – boosting profit margins by

*[German] business mostly used the sacrifices that were forced upon workers during an entire decade to increase its own profit margins and dividend payouts*

maintaining output prices while squeezing wages – was substantially more attractive. In other words, business mostly used the sacrifices that were forced upon German workers during an entire decade to increase its own profit margins and dividend payouts, instead of creating jobs by becoming more competitive. In the end, it is not surprising to

observe that the share of profits in Germany's non-financial sector has skyrocketed from 36.3 per cent of gross added value in 2000 to 41.4 per cent in 2008 (Eurostat 2009).

All of this implies that the ongoing discussion on European economic governance should be turned completely upside down. Pushing for competitive wage deflation in the southern part of the Eurozone is a dead end. Given the deeply ingrained structural features of German industry, wage cuts in Spain or Portugal will barely alter these countries' relative competitive positions with Germany. As argued above, the world is buying German exports not because they are cheap but because of their quality and of their type. By cutting wages, Southern Europe will mainly be competing for export demand with economies such as those of France and the countries of Central and Eastern Europe – or with themselves. However, the French economy, with high unemployment, is not exactly in the best position to digest the export shock that a wave of Southern wage deflation would bring about. Competing with Central and Eastern Europe on the basis of wages is also a lost cause: wages there are still much lower while most of these countries are outside the Eurozone and may/will respond to competitive wage devaluation with competitive currency devaluation. This would leave workers in the South of Europe to compete ... with each other. The "winner" will be the country that cuts wages the most

compared with the rest of the South. The taste of this “export victory” will be bitter, since the gain will come at the expense of a deep depression of domestic demand in the entire South of the Euro area.

Unfortunately, the bad news does not end here. The mechanics of monetary union should not be forgotten, either. With the economic weight of the South of Europe in the entire Euro area being limited to 15 per cent, whereas the weight of Germany is as high as 25 per cent, the response of monetary policy will necessarily be ambiguous. The European Central Bank is forced to set interest rates according to the average situation in the Eurozone, not according to the situation in those parts of it that are in most trouble. This actually means that wage cuts in the South will be met with higher, not lower, interest rates as set by common Euro area monetary policy. With deflation taking hold while nominal interest rates are rising, the policy trap which these distressed economies find themselves in will be complete.

*With deflation taking hold while nominal interest rates are rising, the policy trap which these distressed economies find themselves in will be complete*

In a cynical way, history is extracting its own revenge. When the single currency project was being set up back in the 1990s, rumours inside the Delors Commission claimed that monetary union would in the end cause so many problems that politicians would have no other choice than to take Europe forward. At that time, this referred to policies such as a substantially higher European budget, European investment policy and European taxes. Europe indeed now finds itself in such a situation, and calling for emergency action. However, blinded by the old obsession with cost competitiveness, it is cracking down on workers. This will prove to be a fatal mistake: extreme wage flexibility, even if it is presented as a type of “central wage planification” in co-management with trade unions, in the end boils down to a big hold-up on wages.

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*Ronald Janssen works as an economic adviser in Brussels.*

# Change or lose Europe

*Frank Hoffer and Friederike Spiecker*

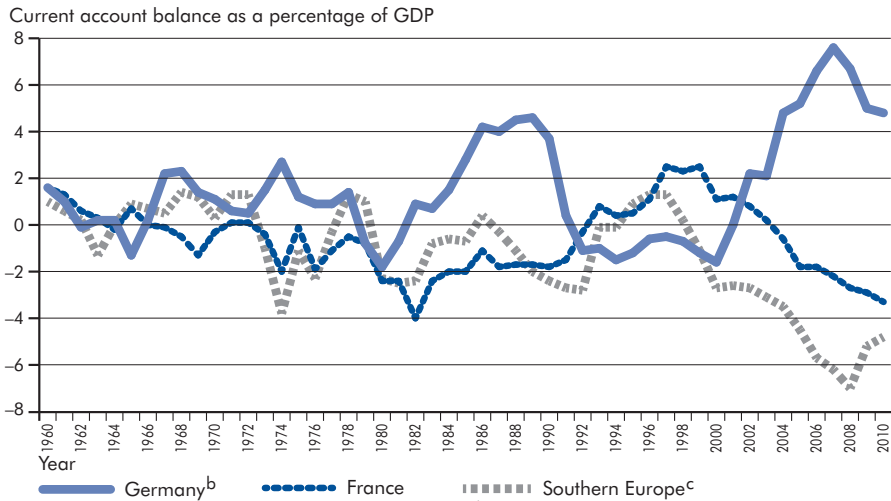
When asked what he thought of Western civilization, Mahatma Gandhi replied: “I think it would be a good idea.”

After an agonizing depression and another devastating war, Europe finally followed Gandhi’s advice and moved from centuries of antagonism, war and “beggar-thy-neighbour” policies to a world of cooperation and integration. Reintegrating post-Nazi Germany, bringing the former Portuguese, Spanish and Greek dictatorships into a democratic Europe and opening up to Eastern Europe were milestones in this complex integration process based on political will, cooperation and regulated markets. But it was only after the ideological shift in the 1980s and 1990s that mainstream thinking changed, concluding that the best form of cooperation was fierce competition and radical market liberalization. However, deregulation, the common market and the single currency did not create the promised land of prosperity, but resulted instead in declining wage shares and greater inequality.

*After the ideological shift in the 1980s and 1990s ... mainstream thinking changed, concluding that the best form of cooperation was fierce competition*

The benefit of a single currency in a large market across several countries lies in a common employment and growth-oriented monetary policy for all member countries, rather than a monetary policy narrowly focusing on the needs and priorities of the anchor currency as in the former European exchange rate mechanism. However, in a world dominated by deeply rooted neoclassical and monetarist beliefs, this benefit had no chance of materializing.

Relinquishing internal exchange rate flexibility deprives governments of an adjustment mechanism to respond to unequal economic performance. This increases the need for (a) coordinated wage, fiscal and especially tax policies to avoid a race to the bottom which would inevitably have a negative impact on overall growth, and (b) joint infrastructure and industrial policies to improve productivity and reduce regional development differences.

Figure 1 Fifty years of international trade<sup>a</sup>

<sup>a</sup> Current account balance in percentage of GDP – negative value: deficit. <sup>b</sup> Until 1990, West Germany <sup>c</sup> Greece, Italy, Portugal and Spain.

Source: AMECO Data (November 2010), authors' calculations.

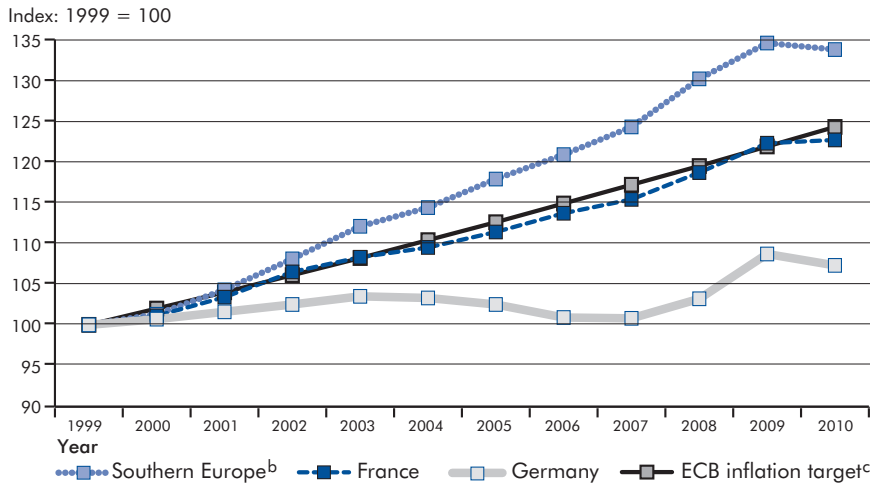
With the euro, balanced trade requires that wages in all Member States grow in line with national productivity plus the targeted inflation rate of the European Central Bank (ECB). Otherwise, countries with relative higher growth in unit labour costs will systematically lose market share and build up trade deficits. The case for a coordinated wage policy to avoid imbalances, beggar-thy-neighbour policies and a waste of potential growth is overwhelming: it is alarming that it has been ignored for so long. Those who let unit labour costs rise too fast are equally responsible for the explosion of imbalances after

***This lack of policy coordination resulted in rapidly growing trade imbalances after 1998***

the abolition of the exchange rate mechanism as those who gained market shares through wage restraint. This lack of policy coordination resulted in rapidly growing trade imbalances after 1998 (Figure 1).

Prior to the euro, Germany's above-average productivity growth and export surpluses were frequently adjusted through currency appreciation. Trade imbalances stayed within 2 per cent of GDP and – contrary to today – German workers benefited from German competitiveness as the Deutschmark (DM) appreciation made imported goods and sunny holiday destinations abroad cheaper.

Under the new currency regime, however, it was almost exclusively businesses that benefited. This mercantilist strategy was costly to Germans. Wage dumping translated to export growth, depressed domestic demand and

Figure 2 Unit labour costs<sup>a</sup> in France, Germany and Southern Europe<sup>b</sup>

<sup>a</sup> Index of economy wide unit labour costs: 1999 = 100. <sup>b</sup> Greece, Italy, Portugal and Spain. <sup>c</sup> Index with the target rate of 2%.

Source: AMECO Data (November 2010), authors' calculations.

the lowest growth rate in the Eurozone. Given these German wage developments, even France, which achieved wage growth in line with productivity (Figure 2), suffers from a growing trade deficit with Germany (Figure 1).

Regardless of government actions, rebalancing is bound to occur; the question is how and with what consequences for growth, distribution and, ultimately, political stability. Realignment can be achieved through either wage cuts in deficit countries, a rise in wages in surplus countries or constant transfers from the former to the latter. However, it makes a world of difference whether the realignment occurs by “deflationary” means, forcing everybody to follow the German example, or within an overall growth regime that avoids the pitfalls of wage deflation.

Three scenarios are possible:

1. *Deflationary cost-cutting.* This is what European institutions and surplus countries currently impose on deficit countries. The result will be a deflationary depression in deficit countries with high unemployment, negative growth and public debt accelerating as share of GDP. Internal devaluation will require a massacre of public services and nominal wage cuts of 20–30 per cent for countries such as Greece, Ireland, Italy or Spain. Their economies will shrink and so will the intra-European export market for surplus countries. Ultimately, after having sold and privatized what is left of



public assets in a depressed market, countries will default. Ironically, this “no bailout policy” will cause involuntary transfers, as creditors will have to write off part of the credit. These banks – mainly from surplus Germany – will again claim their systemic relevance and German taxpayers will be asked to save them. This “solution” might be as costly for taxpayers as direct transfers to Greece or Ireland. The outcome of such an austerity policy is unfortunately a negative sum game within Europe, and its only rationale is the unlikely prospect that the shrinking internal market will be overcompensated by export surpluses outside the Eurozone. If popular resistance does not force European Governments and the EU to change policies, it is difficult to see how the euro and ultimately European integration can hold.

2. *Constant public transfers.* This is the reality within the German currency union since 1990. The constant “trade deficit” between West and East Germany is being closed through a stream of public transfers. Such a transfer system on a European scale currently looks politically impossible, even if some form of European unemployment insurance would be desirable further in the integration process.

3. *Wage-led growth.* A wage-led growth-oriented policy coordinated by Eurozone Member States is the only realistic way to avoid repercussions

**A wage-led growth-oriented policy coordinated by Eurozone Member States is the only realistic way to avoid repercussions deriving from deflation**

deriving from deflation. Such a policy must be based on: (a) a rapid extension of domestic demand in surplus countries through wage, income and fiscal policies; (b) giving all Eurozone Governments access to low-interest euro bonds; and (c) productivity-enhancing investment in pan-European infrastructure. Only if the surplus

countries drive economic growth and increase aggregate demand can deficit countries regain market share and avoid a long and painful depression. However, even under the favourable conditions of economic growth, rebalancing will only be possible if the deficit countries accept below-average unit labour cost growth over a longer period of time and if the surplus countries change their aggressive export strategy and strengthen internal wage growth so that unit labour costs rise above average. During this period, nominal wage growth in deficit countries must stay positive. Wage policy must act as a barrier against downward pressures on wages that risk pushing countries into deflation, as seen in Japan. Realignment within an overall regime of nominal wage growth would allow the reduction and eventual reversal of permanent German trade surpluses.

The necessary policy changes cannot be understood within a narrow enterprise logic, namely the view that wages only represent costs and not income and demand (an irreplaceable condition for sustainable, productivity-enhancing and equitable growth). Democratic governments need to focus on the common good of full employment and must provide a framework to achieve collective bargaining wage settlements that ensure wages growing in line with productivity. This should include:

- a legal minimum wage at 50 per cent of the average wage;
- government support for coordinated or centralized collective bargaining and universal application through legal extension mechanisms;
- labour market regulations minimizing all forms of precarious atypical employment and limiting the excessive power of employers in the labour market;
- that governments – as the largest employers, investors and procurers – ensure public sector wages grow in line with the defined wage norms, and provide contracts only to companies that adhere to collective bargaining agreements;
- productivity-enhancing public investment;
- a progressive European tax on trade surpluses overshooting 2 per cent of GDP in two consecutive years to give surplus countries the choice either to stimulate their own economies or to provide transfers to neighbouring countries that have pursued balanced functional wage policies but lost market share because of the mercantilist strategies of surplus countries;
- a tax on enterprises that try to gain a competitive advantage through wage depression instead of innovation. Unlike the Polish Government which introduced the Popiwek tax against wage inflation in the 1990s, enterprises would have to pay a 50 per cent tax on the gap between the actual increase of the hourly wage and a wage increase fully reflecting productivity growth and targeted inflation rates to avoid wage deflation. This would encourage employers to share productivity gains with their employees and would ensure wage growth in line with macroeconomic requirements for sustainable growth.

To support such an inclusive rebalancing strategy, the European Central Bank should (a) raise its inflation target to 3–4 per cent, to provide more space to adjust without making deflationary nominal wage cuts; and (b) aim to

achieve coordinated exchange rate policies between the major trading blocs, to ensure that internal balancing does not result in external imbalances.

For Europe, adopting a coordinated wage policy oriented towards less inequality, more balanced trade and robust economic growth is not only necessary and possible: it would in fact be a good idea.

*Frank Hoffer is Senior Researcher at the Bureau for Workers' Activities of the ILO.*

*Friederike Spiecker is a macroeconomist and independent consultant. She has published widely together with Heiner Flassbeck, Chief Economist at UNCTAD, on German, European and international economic policy.*

## PART III

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**Development policies:  
Time to do away with the  
neoliberal dogma**

# Trade, employment and development: Back on track?

*Richard Kozul-Wright*

In today's world of increased economic and political interdependence, achieving a broad-based, rapid and sustained growth in incomes and employment involves even more complex policy challenges than in the past. This was the case before the recent crisis, but it is even more so as policy-makers in both developed and developing countries look for ways to mitigate the damage from that crisis and build a more sustainable recovery.

The ILO is concerned that the kind of integrated policy framework and the accompanying degree of policy coherence required to respond effectively to the crisis within and across countries is still not in place. In particular, the kind of mutually supporting links between macroeconomic policies, social protection systems and active labour market measures are still not established to ensure both an inclusive (job-rich) recovery and to realize the Millennium Development Goals (MDGs) within an acceptable time frame. This worry is very much shared by the United Nations Conference on Trade and Development (UNCTAD). Indeed, when the development agenda is expanded beyond the MDGs to include the traditional issues of catch-up productivity growth, economic diversification and technological upgrading, then our worries tend to be amplified.

At the G20 Summits and other meetings, for instance the September 2010 conference in Oslo co-hosted by the ILO and the IMF, there have been signs that the stranglehold on policy design of the financial institutions has begun to loosen. There have been some important steps away from policy orthodoxy, particularly by the IMF, on issues such as inflation-targeting, capital controls and counter-cyclical policy measures.

***There have been signs that the stranglehold on policy design of the financial institutions has begun to loosen***

These are welcome developments, but at the end of the day actions speak louder than words. The kind of programmes put together by the Washington institutions since the crisis have continued to carry much of the damaging

policy baggage of the recent past, particularly with respect to pro-cyclical adjustments and targets and squeezing public investment programmes, including in least developed countries (LDCs). Despite the recognition that the growth in global interdependence poses greater problems today, the mechanisms and institutions put in place over the past three decades have not only fallen short on surveillance and the policy coordination challenge but have in many respects contributed to the dissonance and tensions that eventually culminated in the financial crisis that hit in 2008. The failure to make reforms now runs the very serious risk of returning to “business as usual” and the danger of repeating the boom–bust cycles of the recent past.

The kind of institutional changes needed for financial stability – and the “global public good” which the IMF promises to deliver – have made little headway in recent discussions. These include: (a) larger, more predictable and less conditioned flows of development finance; (b) adequate international liquidity to support counter-cyclical macroeconomic policy-making at the domestic level; (c) the management, through some kind of orderly workout mechanism, of sovereign debt crises; (d) a stable exchange rate system; and (e) a more representative form of international governance (though small steps have recently been agreed on this). The problem with achieving progress on these fronts has in one sense not been too little coherence, but instead too much: namely an almost blind faith, particularly at the international level, in freely functioning markets to generate prosperity and stability at the national, regional and global levels.

This is a debate which is not over, though there is a good deal more realism than a few years ago. But what seems not open to question is the fact that by focusing exclusively on a narrow definition of fundamentals (efficient markets, rational expectations, balanced budgets, price stability and so forth), the Washington institutions have consistently missed every single one of the major economic crises that have occurred over the past 25 years, from the savings and loans collapse in the United States in the late 1980s, to the Asian financial crisis of 1997, to the sub-prime meltdown and the collapse of the Icelandic economy in 2008. The Washington institutions have also missed (or worse, neglected) one of the most persistent trends in the global economy over the past three decades, namely the massive increase in income inequality which has occurred, albeit to varying degrees, in almost all countries. This trend is closely linked to the rise of unregulated financial markets and institutions, a trend strongly promoted by these same institutions, and which is the characteristic feature of globalization in our era. This is certainly one of the reasons why rising inequality has been accompanied by such a volatile mixture

of shocks, imbalances, asset cycles and generally sub-standard economic performance.

The key imbalances in this regard are, on the one hand, the falling wage share and the rising level of household indebtedness and, on the other, the rising profit share and the declining (or stagnant) levels of productive investment. Failure to address these imbalances has made for a weak and uneven recovery and a persistent state of labour market distress even when growth has picked up. In its latest Trade and Development Report, UNCTAD identified these trends as underlying the jobs crisis in many developing countries even prior to the recent crisis. Unsatisfactory labour market outcomes, in developing countries as much as developed countries, are also due to unfavourable macroeconomic conditions that inhibit investment and productivity growth, along with inadequate wage growth which continues to repress domestic demand. External demand can compensate up to a point, but there are dangers with this strategy which can reinforce wage repression and limit capital formation.

*There are dangers with this strategy which can reinforce wage repression*

The ILO argues that the rebalancing of labour market conditions will require the improvement of wage determination mechanisms, measures to promote productivity growth and the narrowing of income inequalities. This view is very much supported by UNCTAD's analysis. We would also put a very strong emphasis on strategies to enhance domestic demand as an engine of employment creation. The mixture of employment-friendly monetary, financial and fiscal policies will have to be tailored to particular local conditions and constraints. Industrial policies will also need to be added to the policy mix; this is already happening in a number of middle-income developing countries.

A critical role in moving to a jobs-rich development path must be ceded to a developmental state which aims to create and manage rents in line with the objectives of inclusive growth. A key question is whether we have global arrangements capable of providing the financial and monetary stability to help these countries pursue development strategies that sustain the expansion of employment and output and encourage the structural diversification necessary for their own long-term success and their effective insertion into the international trading system.

It should be clear to all by now that the question of stability and appropriate alignment of exchange rates (particularly among the G-3 currencies) remains unresolved, and large swings have posed a persistent threat to global financial stability, to the international trading system and to exchange-rate policy and other aspects of external financial management in developing countries. The

daily volatility in these rates can often offset annual gains in domestic productivity and drastically alter international competitiveness. This problem has been recognized in recent discussions (though the language of “currency wars” is unhelpful and misleading), but has been ignored in current global arrangements which are based on a false dichotomy between trade and finance. The international division of labour is still greatly influenced by commercial policies which favour products and markets in which more advanced countries have a dominant position and a competitive edge. High tariffs, tariff escalation and subsidies in agriculture and fisheries are applied extensively to products that offer the greatest potential for export diversification in developing countries. The panorama of protectionism is no better for industrial products, including footwear, clothing and textiles where many developing countries have competitive advantages. The abuse of anti-dumping procedures and product standards against successful developing-country exporters creates further obstacles. Given the adjustment that developed countries will be required to take in the coming years, it is not difficult to imagine a worsening of this situation, unless these countries can make the appropriate expansionary responses which allow their citizens to adjust as living standards rise.

It is also widely believed that the existing arrangements do not allow sufficient policy space to developing countries to overcome their longer term payments constraint by pursuing targeted trade, industrial and technology policies and thus increasing their export capacity in more dynamic sectors. There are increasing concerns that persistent policy orthodoxy and global arrangements have the result of kicking away the ladder by which today’s advanced countries attained their present levels of economic development, denying developing countries many of the policy instruments that were widely and successfully used in the past.

The need for a more effective multilateral trade and financial system cannot be ignored; indeed, developing countries continue to have a stake in building such a system. Controlling finance remains the place to begin this task, just as it was back in 1945. As Keynes noted at that time: “It is very difficult while you have monetary chaos to have order of any kind in other directions ...”

*Richard Kozul-Wright, a senior UN economist, heads the unit on Economic Integration and Cooperation Among Developing Countries at UNCTAD. He was previously in charge of the World Economic and Social Survey at UNDESA, New York. He holds a PhD in economics from the University of Cambridge, and has published papers on economic history and development issues.*



# Trade, labour and the crisis: Time to rethink trade!

*Esther Busser*

Trade has been one of the main transmission channels of the financial and economic crisis to developing countries, where many jobs were lost in export sectors. This was largely due to a reduced demand for goods in industrialized economies as well as to a lack of access to credit for the financing of exports.

At the international level, calls against protectionism have been manifold. These calls have been made in the ILO Global Jobs Pact, G20 declarations and government statements in organizations such as the WTO and the OECD. Despite these calls and the common understanding that closing off markets would have negative effects and risk a further deepening of the crisis, several countries have resorted to protectionist measures. Discussions about trade and the crisis have mainly focused on whether countries have resorted to protectionist measures and on the nature of these measures as well as their impacts. However, these discussions only reflect a part of the overall picture on the role of trade in the crisis. They do not touch upon trade's role in promoting a sustainable recovery and on the task of addressing the underlying imbalances in world trade. Two important questions, therefore, need to be raised. The first is whether the pre-crisis model of export-led growth in some countries and debt-fuelled consumption in others is sustainable. The second is whether the outcomes of export-led growth have indeed been beneficial for the long-term employment and development perspectives of developing countries.

The crisis has shown that the push for trade liberalization and open markets over the past couple of decades, as promoted by the WTO, the major economies and transnational corporations, has resulted in an export- or "market access"-focused trade model, which in turn has created a situation in which many countries became dependent on export markets for their growth. As witnessed in the current crisis, such a situation makes dependent countries vulnerable in cases of shocks, particularly when demand drops simultaneously in all markets, resulting in job losses. This constitutes a crucial difference from

the Asian financial crisis, which limited itself to Asian countries and allowed them to export themselves out of their crisis, an option not available currently.

***Certain voices have been calling for a rebalancing of trade ... to rebalance global demand***

Certain voices have been calling for a rebalancing of trade, not only to reduce vulnerability to trade shocks but, more importantly, to rebalance global demand. Such voices have been heard in several forums, including in the G20, the IMF, the ILO and other UN organizations. Such a rebalancing would require less dependence on export markets and more emphasis on creating diversified domestic markets in all countries, that are based on consumption and wage-led growth as well as a re-establishment of wage–productivity linkages. These calls for rebalancing, however, are being made amidst the dominance of a free trade paradigm. The “no protectionism” slogan is regularly accompanied by a call for “further trade liberalization”. Mixing the two is problematic, especially when it comes to rebalancing efforts that do require a substantial rethinking of the role of trade and trade liberalization in sustainable recovery and development. The G20 statement at the June 2010 Toronto Summit called upon “the OECD, the ILO, World Bank and the WTO to report on the benefits of trade liberalization for employment and growth at the Seoul Summit”, clearly showing how the current impetus towards trade liberalization continues to reign. This rebalancing exercise, moreover, questions the long-term growth perspectives to be achieved in developing countries by free trade and the current specialization pattern. The vulnerabilities of developing countries are unfortunately not only limited to their dependence on export markets, but also to specialization in low value-added activities in highly competitive markets.

Despite some diversification and industrialization successes, particularly in Asia and in a few Latin American countries, many developing countries have witnessed a specialization in limited numbers of low value-added economic activities. This strategy has not only increased the dependency of these countries on export markets, but has also failed to bring about diversification and to substantially raise income levels and decent work opportunities. Trade liberalization has played a major role in this process. An exclusive focus on trade liberalization has forced countries to specialize in products in which they have a so-called natural comparative advantage, namely either in agriculture and natural resources or in low value-added and labour-intensive manufacturing. This is problematic because commodities and low value-added manufacturing (such as textiles and clothing) are characterized by highly competitive markets, low prices, low productivity gains, low wages, poor working conditions and powerful supply chains that have reinforced competition and a race to the

bottom. In other words, specializing in production in which developing countries have a natural comparative advantage only allows for limited productivity and wage improvements. In such a context, creating decent employment and higher levels of income remains difficult and rather challenging. Strategies that only focus on entering and stagnating in the lower ends of global supply chains are therefore problematic and limit prospects for a diversified economy.

A rebalancing approach should thus aim at creating decent and productive employment through diversification of economies. This would entail increasing productivity in sectors such as agriculture while at the same time building comparative advantage and productive capacity in higher value-added activities characterized by increasing returns to investment and a higher potential for productivity gains. Such a strategy for development is not only the key to more productive employment, higher wages and decent working conditions, but is also instrumental in increasing aggregate demand and stimulating the growth of domestic markets.

What is important to understand, though, is that such a development and rebalancing strategy is only possible if governments reinvigorate their developmental role, build the relevant institutions, diversify their economies and adopt proactive and strategic trade and industrial policies. The challenge is to recognize the importance of these policy instruments aimed at putting diversification, productivity increases in agriculture, industrial development and structural transformation at the top of the agenda if decent and productive employment is to be delivered. This can only be done if trade agreements and trade liberalization are looked at in a different way and assessed on the basis of their impacts on development and decent work. Unfortunately, over the last two to three decades, countries have been set on a path of trade liberalization, which has largely eliminated such instruments and policy space through commitments to trade and investment agreements.

Such policy space is crucial if countries currently confined to low value-added activities want to move up the value chain, diversify their economies and rely more on domestic and wage-led growth. Experiences in industrialized countries and successful emerging economies have shown that trade liberalization has to be gradual, so as to allow economies to build up their productive capacity and specialize in the right activities. There is an important role for the state in channelling investment, protecting domestic markets, providing access to finance and attracting new technology. A variety of policy instruments will be necessary

*Trade liberalization has to be gradual, so as to allow economies to build up their productive capacity*

to ensure industrial development, including the strategic and flexible use of tariffs (low for inputs and higher on products in which competitiveness is being developed), subsidies, reverse engineering, local content and other investment requirements and export taxes. Many of these instruments have either been prohibited or strongly limited by current trade agreements.

Although the Doha round seems stalled, the demands to revive it are frequent and the aggressive bilateral trade liberalization led by the United States and the EU continues more than ever, reducing much of the remaining policy space for developing countries. In a similar way, policy space is being reduced in developing countries that are in the process of accession to the WTO, slashing their tariffs, opening up their services and reducing their policy space far beyond that of WTO members with comparable levels of development, thus having a strong impact on their long-term development perspectives. A much more viable strategy would be to promote regional integration, diversification and development. Unfortunately, the current impetus towards liberalization hinders such regional strategies.

Governments will have to shift from a laissez-faire approach in trade to a more active role whose core objective is the creation of decent and productive employment through industrialization and structural transformation. To put industrial policies high on the agenda again requires a serious reconsideration of the current free trade paradigm. Instead of eliminating vital policy space, a new trade regime should actively promote the use of it, as some protection will be needed to enable industrialization and to create decent work. A new trade regime such as this is imperative if a sustainable recovery is to become a reality.

*Esther Busser has been the Assistant Director in the Geneva Office of the International Trade Union Confederation (ITUC) since February 2009. She previously worked as trade policy adviser for the ITUC from 2003 to 2009.*

# Reform options for financial systems

*Hansjörg Herr and Rainer Stachuletz*

The project of neoliberal globalization gained momentum in the late 1970s through free market policies in the United Kingdom and the United States. Domestic and international financial systems became increasingly liberalized and deregulated, with the following important results.

## *Integration of financial systems*

The deeper integration of international financial markets resulting from the deregulation of capital flows, together with the switch to flexible exchange rates after the breakdown of the Bretton Woods system, created a new source of shocks and uncertainty, as well as a new field of speculation.

## *The increasing role of non-bank financial institutions*

Non-bank financial institutions such as investment banks, hedge funds and private equity funds became important players. These institutions usually have a speculative orientation, looking for high short-term returns and working with extreme leverages. Non-bank financial institutions do not only use their own huge funds for their speculative activities; they tap the commercial banking system to mobilize additional funds for diverse investments in and outside the financial markets. Thus commercial banks became more exposed to extreme kinds of risk. In addition, segments of the financial market that had once been sheltered, such as the real estate sector, became fully integrated.

***Segments of the financial market that had once been sheltered ... became fully integrated***

## *Development of a shadow financial system*

A shadow financial system with a low level of regulation (or none whatsoever) flourished, gaining importance. Scarcely regulated offshore centres became international financial centres, facilitating tax evasion, money laundering and other internationally organized criminal activities.

### *Securitization, financial innovation and derivatives*

Securitization exploded after the 1970s: firms and financial institutions preferred to hold short-term marketable paper instead of bank deposits; economic units of all types issued a growing variety of debt securities to acquire funds; banks sold their rearranged credit portfolios to non-bank financial institutions; and rating agencies without any legally binding mandate gave this paper high ratings. Government regulators were put in a ridiculous dual position: first they were consulted on how to design these credit derivatives, then they had to evaluate their quality.

These derivatives were initially designed to reduce the price-related risk of financial instruments, for example changing asset prices, the price of foreign currencies or changing interest rates. Their pricing is relatively transparent and the derivatives are marketable. Default and other qualitative risks (for example, climate change and natural disasters) are evidently hard to price, and thus less tradable. Nevertheless, these products – hard to standardize or even to value – were developed and actively traded in less regulated over-the-counter markets.

The fundamental problem with risk markets is that risks are not eliminated through trade, they are simply reallocated. In many cases, both contract partners are speculators, and the market is transformed into a big casino where governments and taxpayers become unwitting guarantors.

### *Powerless central banks and supervision*

The central banks became onlookers in the new financial system. In fact, the interest rate remained their only tool to control price level changes, asset price bubbles, exchange rate movements and GDP growth. The central banks do not have instruments to guide funds resulting from expansionary monetary policies towards productive investment. Due to unstable international capital flows, monetary policy in many instances has had to follow the primacy of external stabilization.

### ***Price bubbles in all asset markets have become more frequent***

As a result, price bubbles in all asset markets have become more frequent, with negative economic consequences. At the same time, exchange rate volatility and increasing current account imbalances added to the instability of financial markets. Often, price bubbles accompany credit expansion, which in many cases does not finance real activities. The big picture is that indebtedness increased. For example, private household debt as percentage of GDP in the United States increased from below 50 per cent in the 1970s to over 100 per cent towards the end of the first decade of the

current century, and enterprise debt increased in the same period from around 75 per cent to over 125 per cent.<sup>1</sup> The ratio of government debt to GDP in many countries has also increased sharply in recent decades.

The deregulation of financial systems that began in the 1970s produced an unsustainable credit expansion for almost all sectors in many countries and a general layering of debts. Bubbles, unsustainable credit, international exchange rate turbulence and growing current account imbalances indicate a more and more fragile financial system. Even if the current crisis can be overcome, without fundamental changes a new bubble, one with probably even more disastrous consequences, will surely develop.

As a fundamental reform option, we favour a financial system in the tradition of the Glass–Steagall Act and the original Volker Plan. These plans were much more radical than the watered-down legislation passed in the United States in July 2010.

What could the blueprint of a stable financial system that serves economic development look like?

Such a financial system should be divided into banks and non-bank financial institutions. Such regulation implies a distinct wall between banks – as the major source of finance for enterprises – and more risk-oriented and speculative non-bank financial institutions. Commercial banks would be forbidden to engage in proprietary trading, e.g. speculating with their own or borrowed funds: they would not be allowed to own investment banks, hedge funds or private equity funds, nor to give credit to those institutions and other non-banks. If the latter wanted to get funds for their businesses, they would have to attract money held by households. These funds would create sufficient capital for start-ups and other ventures not financed by commercial banks. Financial or any other business relations to institutions outside the regulated financial systems (e.g. offshore) would be strictly banned.

*The financial system should be divided into banks and non-bank financial institutions*

The allocation of loans originated by banks should be regulated by the central banks. Loans to the real estate sector could be quantitatively restricted as consumption credit. Equity holdings for such credit could be discretionarily changed by monetary authorities. This would allow counter-cyclical equity holding in contrast to Basel II, which leads to unwanted pro-cyclical effects.

Real estate financing and large parts of the private equity industry, with their specific social and financial dimensions, could be considered a special case, and these activities would be permitted only to specialized and state-licensed

institutions. The real estate market could be made a special segment, with regulated credit relationships with the rest of the financial system.

Banks in a liberalized environment are apt to follow aggressive and risky business strategies to defend or increase their market share. To reduce destructive competition between banks, in a regulated financial system competition among commercial banks could be limited by fixing, for example, real deposit rates of commercial banks. Also, ceilings for interest rates could be given by the central banks. In a very highly regulated system, the central banks could even fix interest rates and the quantity of credit the banks were allowed to give. The advantage of such a regulated credit rationing system is that restrictive monetary policy can be implemented without increasing interest rates.

Derivatives should be sold and bought only in regulated and controlled markets. Strictly controlled position limits could curtail speculative attacks. Only certain standardized products which have been checked by a supervisory agency would be allowed, and only certain licensed agents would take part in the market. Securitization of credit would be possible to a certain extent, since if the originator of a loan was forced to keep a substantial part of the loan on its books and derivatives were standardized, securitization would be harmless.

Last but not least, such a system needs international capital controls to give central banks the proper instruments to control unstable international capital flows. Current account imbalances should be kept small. The debates during the Bretton Woods negotiations in the 1940s could be a starting point for the development of such a system.

The financial system outlined above is not imaginary. It existed in the United States and most other industrialized countries after the Second World War. Comprehensively regulated systems existed – and still exist in various forms – in the East Asian miracle countries. The Chinese financial system after 1978 also fits such a mould. Financial systems in these countries offered sufficient and cheap credit to the enterprise sector, stimulating growth and employment without financial market instability.

For many, the above blueprint does not seem politically enforceable. However, the fragility of our current financial system will continue. History may create a window of opportunity for a change. If such an opportunity comes, we should know what to do.



## Note

<sup>1</sup> Fed, Flow of Funds Accounts Database 2010.

## Further reading

Dullien, S.; Herr, H. EU Financial Market Reform. International Policy Analysis 2010 (Bonn, Friedrich Ebert Foundation) available at: <http://library.fes.de/pdf-files/id/ipa/07242.pdf>.

*Hansjörg Herr is Professor at the Supranational Integration at the Berlin School of Economics and Law and is the economic director of the master's programme in Labour Policies and Globalization of Global Labour University.*

*Rainer Stachuletz is Professor of Finance at the Berlin School of Economics and Law. He is currently working as a consultant for the State Bank of Viet Nam at the Banking Academy in Hanoi.*

# What does wage-led growth mean in developing countries with large informal employment?

*Jayati Ghosh*

The past decade has been one in which export-led economic strategies have come to be seen as the most successful, driven by the apparent success of two countries in particular: China and Germany. In fact, the export-driven model of growth has much wider prevalence, as it has been adopted by almost all developing countries.

This adoption was associated with suppressing wage costs and domestic consumption in order to remain internationally competitive and to achieve growing shares of world markets as far as possible. Managing exchange rates to remain competitive, despite either current account surpluses or capital inflows, became one of the major elements of this strategy. This was associated with the peculiar situation of rising savings rates and falling investment rates in many developing countries, and with the holding of international reserves, which these countries then sought to place in safe assets abroad.

These developments are related to a classic dilemma of mercantilist strategy, which is evident in exaggerated form for the aggressively export-oriented economies of today: they are forced to finance the deficits of those countries which would buy their products, through capital flows that sustain the demand for their own exports, even when these countries have significantly higher per capita income than their own. The flows of capital from China and other countries of developing Asia is an egregious example of this. The strategy also generated fewer jobs than a more labour-intensive pattern based on expanding domestic demand would have done, which meant that employment increased relatively little, despite often dramatic rises in aggregate output. This is why, globally, the previous boom was associated with the South subsidizing the North: through cheaper exports of goods and services, through net capital flows from developing countries to the United States in particular, through flows of cheap labour in the form of short-term migration.

The recent collapse in export markets halted that process for a while. Although there has been a recovery, it is very evident that such a strategy is unsustainable beyond a point. This is particularly true when a number of relatively large economies seek to use it at the same time. So, not only was this a strategy that bred and increased global inequality, it also sowed the seeds of its own destruction by generating downward pressures on prices because of increasing competition as well as protectionist responses in the North.

So there are both external and internal reasons why it is hard to sustain such a strategy beyond a point. Externally, deficit countries will either choose or be forced to reduce their deficits through various means, and protectionist responses. Internally, the potential for suppression of wage incomes and domestic consumption will meet with political resistance. In either case, the pressures to find more sustainable sources of economic growth, particularly through domestic demand and wage-led alternatives, are likely to increase.

*The pressures to find more sustainable sources of economic growth ... are likely to increase*

The process of global economic rebalancing was initiated by the financial crisis and is now likely to get accentuated through the current fragile recovery and potential instability of the near future. One important result is developing countries (and the surplus countries like China in particular) can no longer depend on exports to the United States as their primary engine of growth. The US trade deficit is set to shrink, and at a fundamental level it really does not matter whether this occurs through exchange rate changes, changes in domestic savings and investment behaviour, or increased trade protectionism. So countries must diversify their sources of growth and must look for other export markets as well as for internal engines of growth. This is what makes arguments for a shift in strategy towards domestic wage-led growth so compelling.

In developed countries with relatively strong institutions that can affect the labour market, including collective wage bargaining, effective minimum wage legislation and the like, it is probably easier to think of wage-led growth (and strategies to allow wages to keep pace or at least grow to some extent) along with labour productivity growth. But what about most developing countries, where such institutions are relatively poorly developed and where many if not most workers are in informal activities, and often self-employed? How are wage increases and better working conditions to be ensured in such cases? And what does a macroeconomic policy of wage-led growth entail in such a context?

In fact, it is still both possible and desirable to get wage-led growth in such contexts. There are five important elements involved in such a strategy for developing countries with large informal economies:

- Make the economic growth process more inclusive and employment-intensive, providing direct resources to the sectors in which the poor work (such as agriculture and informal activities), areas in which they live (relatively backward regions), factors of production which they possess (unskilled labour) and outputs which they consume (such as food).
- Ensure the greater viability of informal production, through better access to institutional credit to farmers and other small producers, greater integration into supply chains and marketing that improves their returns, and technology improvements that increase labour productivity in such activities.
- Provide increases in public employment that set the floor for wages (for example, in schemes such as the one enabled by the National Rural Employment Guarantee Act in India), and improve the bargaining power of workers.
- Provide much better social protection, with more funding, wider coverage and consolidation, more spending on health care and more robust and extensive social insurance programmes, including pensions and unemployment insurance.
- Increase and focus on the public delivery of wage goods (e.g. housing, other infrastructure, health, education, even nutrition) financed by taxing surpluses.

The last point is often not recognized as a crucial element of a possible wage-led strategy, but it can be extremely significant. Furthermore, such a strategy can be used effectively even in what are otherwise capitalist export-oriented economies, as long as surpluses from industrialization and exports can be mobilized to provide wage goods publicly. Indeed, this has been an important and unrecognized feature of successful Asian industrialization from Japan to the East Asian Newly Industrialized Countries to (most recently) China. The public provision of affordable and reasonably good-quality housing, transport facilities, basic food, school education and basic health care all operated to improve the conditions of life of workers and (indirectly) therefore to reduce the money wages that individual employers need to pay workers. This not only reduced overall labour costs for private employers, but also provided greater flexibility for producers competing in external markets, since a significant part of fixed costs was effectively reduced.

*The public provision [of social services] provided greater flexibility for producers competing in external markets*

What are the macroeconomic advantages of such a strategy? Quite apart from the obvious benefits in terms of reducing poverty, improving income distribution and the conditions of informal workers, there are positive implications for the growth process. Such a strategy allows for more stable economic expansion based on increasing the home market, and need not conflict with more exports either. It encourages more emphasis on productivity growth, thereby generating a “high road” to industrialization.

Clearly, if countries in which the majority of the world’s population are concentrated are actually to achieve their development project in a sustainable way, new and more creative economic strategies have to be pursued. Wage-led growth, including through measures such as those outlined here, is likely to be an essential element of such strategies.

*Jayati Ghosh is Professor of Economics at Jawaharlal Nehru University, New Delhi, and Executive Secretary of International Development Economics Associates (<http://www.networkideas.org/>). She has consulted with many international organizations and governments, and works actively with progressive organizations in India and elsewhere.*

# More pay and more jobs: How Brazil got both

*Paulo Eduardo de Andrade Baltar*

So far, the twenty-first century has been good to many Brazilians. Formal employment and the minimum wage have risen, the purchasing power of those earning average pay has recovered, open unemployment has fallen, and undocumented subcontracting has been curbed. Average household incomes have risen and poverty has declined. Positive macroeconomic developments, a range of progressive government policies and improved collective bargaining outcomes have all played a part in this.<sup>1</sup>

## *Purchasing power regained*

Under the two successive presidencies of Luiz Inácio Lula da Silva (“Lula”), income inequality in Brazil has shown just a small decrease, from a Gini index of 0.58 in 2002 to 0.55 in 2008. Much more significant is the marked change in the labour market configuration, which has had a very positive impact on poverty levels. From 61.4 million people in 2003, the number living in poverty dropped to 41.5 million in 2008 (a decline from 34.3 per cent to 21.9 per cent of the total population). Those in absolute poverty fell from 26.1 million in 2003 to 13.9 million in 2008 (from 14.6 per cent to 7.3 per cent of the population).

The recovery in the purchasing power of the minimum wage has been crucial here. It really gained momentum from 2005 on, when the federal government made an explicit commitment to promoting it. Between 2003 and 2008, the minimum wage rose faster than inflation, providing workers at the base of the income pyramid with significant real gains (38.3 per cent). The government established a policy of annual adjustment that takes account of past inflation and adds up the average GDP growth of the two previous years. There has also been an important, though smaller, increase in the real median wage. Its purchasing power rose by 23.5 per cent.

***Between 2003 and 2008, the minimum wage rose faster than inflation***

### *Formalizing jobs*

The increase in the average growth rate of GDP over the period 2004–08 had significant positive impacts. The labour market absorption of working-age people increased and unemployment went down. At the same time, the relative weight of informal employment, self-employment and unpaid work declined. The proportion of formal employment in the whole economically active population (including the unemployed) aged 15 and above increased from

***There was an especially significant increase in the formalization of youth jobs***

36.1 per cent in 2004 to 40.9 per cent in 2008. There was an especially significant increase in the formalization of jobs for youth. This is important, as formalization brings workers within the effective scope of labour law and social security provisions.

More than 95 per cent of the formal jobs created are on open-ended contracts. However, this does not imply job security. Brazilian employers have great flexibility in hiring and firing. For example, in 2009, in the midst of the crisis, just under a million formal jobs were created within a total of 33 million employees registered in Brazil. But that was the net job creation figure. There were 15.2 million dismissals as well as 16.2 million new hires.

Recent Brazilian experience contradicts the frequent assumption that a minimum wage will lead to net job losses and inflationary pressures. Rather, it points to the importance of public regulation of the national labour market. In Brazil, employees who are formally hired cannot be paid less than the established legal minimum. But the minimum wage is also a reference point for most informal workers and many of the self-employed. And its revaluation has had a positive influence on wage negotiations, especially on setting wage floors for some occupational categories.

### *Income transfers*

Social security provisions have been a further important means of income distribution. A non-contributory scheme brought in for rural workers has helped put them on an equal footing with urban workers, and a Continuous Money Benefit has ensured an income for some particularly disadvantaged groups. In both cases, the benefit cannot be below the value of the minimum wage (in line with the general social security guidelines for retirement or survival benefits). But the explicit policy of revaluing the minimum wage has not worsened social security deficits, as the good performance of the economy and the expansion of formal jobs has boosted the system's revenues. On the other hand, the increased purchasing power of the rural pensioners and other poor beneficiaries has resulted in increased disposable income in the country's

smaller communities, especially those in the long-impooverished north-east. More effective social security coverage has also indirectly helped to improve the labour market, as a guaranteed income for senior citizens enables them to stop seeking work. And it also allows some dependent minors to avoid premature entry into the labour market, thus reducing the incidence of child labour.

The various conditional income transfer schemes have been grouped into one single Family Grant programme which now covers more than 11 million families. It transfers a monetary supplement to families with an insufficient income per capita to avoid situations of extreme deprivation. In return, they agree to maintain their children's and teenagers' school attendance, seek medical care for expectant mothers and newborn babies and withdraw their children from child labour. This programme is intended as temporary support, allowing family members some time to seek better labour market insertion. However, even during the period of economic growth and employment expansion in 2004–08, the vast majority of the families were unable to meet the conditions for leaving the programme.

Unemployment insurance is another important safety net. Despite the employment expansion in 2004–08, the number of people drawing unemployment benefits actually rose. This was because the greater formalization of jobs, which increased the number of those covered by unemployment insurance, was not accompanied by a reduction in employee turnover. The increased expenditure on unemployment pay-outs also stemmed from the real increase in the minimum wage, as the minimum benefit is equal to the statutory minimum wage. Unemployment benefits helped to maintain households' spending power during the worst period of the economic crisis, between the end of 2008 and the beginning of 2009. The benefits have also been contributing to the promotion of decent work in Brazil, as they are payable to workers who are rescued from slave-like employment relationships, during the time it takes to reinsert them into the labour market.

### *The role of trade unions*

Although it has seven recognized trade union centres and more than 1,600 unions, the Brazilian labour movement has been demonstrating greater unity in action in recent years. Even during the crisis of 2008–09, a large proportion of the occupational categories managed to bargain up the purchasing power of their wages. The negotiating climate has changed significantly since 2003. Rights are no longer being bargained away in exchange for the maintenance of employment. The relaunch of Brazil's development agenda has increasingly shifted the union focus to winning back lost rights and making broader



demands – notably for a 40-hour week. The unions' relationship with government has also moved forward, facilitated by President Lula's social origins and the 1988 constitutional provisions for greater policy participation by the social actors.

### *A real development agenda*

The Brazilian labour market still faces considerable structural problems, but opportunities do exist for sustained development in the coming years. It should be characterized by a policy of economic growth, an active industrial policy, coordination of efforts to solve the infrastructural problems, respect for the environment, expansion of the public services, the linking-up of production chains, investment in science and technology, and restructuring of the State. Provided employment can be generated, there is also the possibility of extending public labour regulation and social protection. Public institutions should be strengthened as a way of fighting labour market fraud. The ILO Termination of Employment Convention<sup>2</sup> should be applied in order to counter unjustified exemption mechanisms. Although Brazil ratified this Convention in 1995, it pulled out of it again in 1996. A trade union reform should be brought in, so as to increase the representativeness of the unions and secure their organizing rights in the workplace. Also crucial is continuity in the policy of revaluing wages, particularly the legal minimum wage.

Brazil can and should create a development model that distributes income and dignifies citizens.

### Notes

<sup>1</sup> Paulo Eduardo de Andrade Baltar et al., *Moving towards Decent Work. Labour in the Lula government: Reflections on recent Brazilian experience*, GLU Working Paper No. 9 (Berlin, 2010).

<sup>2</sup> The Termination of Employment Convention, No. 158 (1982).

*Paulo Eduardo de Andrade Baltar is a researcher at the Centre for Labour Economics and Trade Unionism (CESIT) in the Institute of Economics of the State University of Campinas (UNICAMP), Campinas, São Paulo, Brazil.*

## PART IV

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### Inequality at the root of the crisis

# Time for a new paradigm

Sharan Burrow

These are truly times for anger.

The world is barely re-emerging from the deepest economic crisis in a century, yet the very policies and mindset that caused the problem in the first place are back with a vengeance. Indeed, the world economy risks sliding back into crisis as dangerously short-sighted policies are put into place. The brave words of reform from world leaders in the G20 meetings of 2009 are now largely forgotten and have been replaced with the old scriptures of fiscal consolidation and calls to address the “fundamentals”.

*The very policies and mindset that caused the problem in the first place are back with a vengeance*

And thus the world is fast slipping into a self-defeating round of “competitive austerity” where everyone seeks salvation from austerity at home through export-led growth. This is a strategy that might have worked for some for a time, but those days are gone: credit-driven consumption in a few key countries can no longer make up for the lack of wage-driven consumption worldwide.

Weakness in wage growth has been shown to be a prime cause of the crisis. This should come as no surprise: with globalization, there has been a growing disconnection between wage growth and productivity. Whereas worker compensation rose in parallel with the improvement of productivity until the early 1980s, overly restrictive monetary policies, trade liberalization, labour market deregulation and employers’ strategies have combined since then to weaken this link. The consequences are now well documented: the share of labour income has dropped in most countries, inequalities have increased almost everywhere and consumption has been maintained in large part through credit.

What is worse is that since the 1990s the decline in labour’s share of income has been highly pronounced in countries with trade surpluses (see Figure 1). In other words, the winners of the new global trading system have not shared those gains with their workforce. This is profitable for some individual companies, but it is bad for overall growth and prosperity. Ultimately, it is unsustainable.

Figure 1 Change in wage share, 1995–2005



Source: *World of Work Report 2010*, ILO.

With unemployment and household debt still high in some of the key jurisdictions in the world (including both the United States and Europe), and with governments engaging in counter-productive austerity, it is more urgent than ever to ensure that workers get their fair share. More than a moral issue, it is also the only way to extricate ourselves from the current macroeconomic mess.

We need a fundamental change in paradigm. First, jobs and decent work can no longer be some collateral by-product of economic policies geared to rolling out the red carpet to “investors”. Full employment has to become anew the central objective of economic policy, and it should be expected that governments use all their levers – fiscal, monetary, regulatory and industrial – to achieve it. In parallel, we need active policies to improve workers’ capacity to engage in collective bargaining to link wages to productivity growth once again.

All of this will require new “rules of the game” internationally. As it stands, the current international economic and financial system has given the upper hand to speculators and tax evaders, fostered instability and put the burden of economic adjustment on the parties that were already experiencing difficult times. As a result, the fate of entire societies has not improved much over the past 30 years. This needs to change.

First, we need to reform the currency system to ensure that adjustment is not achieved mostly by deflating deficit countries, but through “reflating” surplus nations. In this way, the system would ensure that the adjustment led to more growth for all, not further wage and price depression. This idea

is not new; it was first proposed by J.M. Keynes back in 1944 and has elicited renewed interest recently. Such a system would perhaps entail capital controls of some kind, but that would remain a lesser evil than the costs of disorder.

Second, we need new regulations on tax havens as well as on taxes on income and wealth. Controlling tax evasion and tax competition has to become a policy priority. At a time when the average working person is being asked to shoulder the bailout costs of the financial system, the least that can be asked is that all pay their fair share. Eliminating these loopholes is not nearly as complicated as some make it sound and would bring much-needed resources into the fiscal purse. In the same spirit, the establishment of an international financial transactions tax to raise new resources would go a long way to making it possible for financially strapped governments to fund the necessary increase in Official Development Assistance to achieve the Millennium Development Goals (MDGs) as well as the mitigation costs of climate change. It has been estimated that, for the United States alone, such a tax would conservatively raise in the neighbourhood of \$US170 billion, the equivalent of the entire funding of the MDG programme ...

Last but not least, we need a renewed focus around the enhancement and respect of labour standards by all. When it comes to labour rights, the world faces a classic “free rider” problem. Now more than ever, it is essential to ensure a basic international social floor, that all countries endeavour to respect basic standards and that competitive advantage does not come at the expense of the “overexploitation” of workers. If it is true that “labour is not a commodity”, the manner in which we achieve economic prosperity is as important as the goal itself.

None of these ideas is particularly radical. What sets them apart from the current orthodoxy is that they give prominence to workers’ needs and aspirations, and pragmatically define a “high” road to economic development.

The experience of the last three years shows that departures from economic orthodoxy are feasible at times when the “establishment” is going through near-death experiences, but that this does not have a lasting effect. In hindsight, the brief flirt with Keynesianism when the financial system was on the brink of collapse only lasted as long as it was needed to save the banks.

*In hindsight, the brief flirt with Keynesianism when the financial system was on the brink of collapse only lasted as long as it was needed to save the banks*

If during the crisis workers’ organizations could have anticipated that a new era of dialogue had begun, the moment has clearly passed. Our social “partners” have left the restaurant and presented us with the

bill: austerity, tax increases, wage concessions, increased precariousness, public sector retrenchment, cuts in public pensions and so on.

If much of the solution to our problem is international, trade unionists will have to find ways to exert their power and influence internationally as we confront the consequences of the crisis. Both opinion polls and the wave of strikes and protests in many countries show the growing discontent with one-sided and short-sighted policy solutions.

In times of anger, the moment is certainly not for business as usual ...

# A crisis of distribution, not a fiscal crisis

Özlem Onaran

We are in a new episode of the global crisis: the struggle to distribute the costs. This crisis has been one of the outcomes, since the 1980s, of increased inequality at the expense of labour. Lower wage share created demand deficiency; this coupled with financial deregulation reduced investments despite increasing profitability. Financial innovations and debt-led consumption seemed to offer a short-term solution, which has collapsed since 2007. The crisis was tamed via major banking rescue packages and fiscal stimuli. Now the speculators and business lobbies are re-labelling it as a “sovereign debt crisis” and putting pressure on governments in a variety of countries ranging from Greece to the United Kingdom to cut spending to avoid taxes on their profits and wealth.

*The speculators ... are  
relabeling it as a sovereign  
debt crisis*

In Europe, the crisis laid bare the historical divergences. At the root of the problem is the neoliberal model which turned the periphery of Europe into markets for the core. The restrained policy framework – which is based on strict inflation-targeting, and which lacks fiscal transfers targeting productive investments in the periphery – is the root of the divergences. The Stability and Growth Pact, as well as EU competition regulations, limited the implementation of national industrial policy. In the absence of investments to boost productivity and unable to devalue, the only option open to countries at the periphery of Europe such as Greece, Ireland, Portugal and Spain was lower wages. But this did not save them either, since Germany was engaged in a much more aggressive labour market policy. Between 2000 and 2007, unit labour costs declined by 0.2 per cent a year in Germany while they increased by 2 per cent in France; 2.3 per cent in the United Kingdom; and between 3.2 per cent and 3.7 per cent in Greece, Ireland, Italy and Spain. At the periphery, labour costs have increased faster than in Germany due to higher inflation. However, there was still wage moderation in these countries: in the 1990s and 2000s, productivity increases exceeded changes in real wages in all western

EU countries, with the gap being largest in Germany. Overall, labour's share in income declined sharply in Europe. In Germany, Italy, Portugal and Spain, real wages even declined in the 2000s. The phenomenal advantage of Germany was due to wage suppression rather than increasing productivity.

With weak domestic demand due to low wages, exports were the main source of German growth at the expense of current account deficits at the periphery of Europe. Germany is like the China of Europe, with large current account surplus, high savings and low domestic demand. At the periphery, consumption led by private debt has filled the gap that low exports and high imports have created. In Greece, and to a lesser extent in Portugal, the fiscal deficit also increased along with the debt of the households and corporations.

This is the background of the sovereign debt crisis unleashed in Greece. Indeed, in 2008–09, before the Baltic States, Greece, Hungary and Romania were under attack. Now, together with Greece, the attention of the speculators has turned to the public debt and deficits in Ireland, Portugal and Spain, and now again towards the core: to Belgium, Italy, the United Kingdom and even the United States. The EU's joint rescue packages with the IMF came after months of destructive dithering and speculations about Greece's default and exit from the euro. The European Central Bank, which acted as a lender of last resort to private banks, did not fulfil the same function in the case of the Eurozone governments until May 2010 when, ironically, the banks it saved speculated fiercely about default. The Eurozone Governments are indeed protecting their own banks that are holding Greek bonds, the bulk of which are held by German and French banks. Greece is now being pushed to follow Ireland and Latvia as role models in dramatic cuts in public sector wages, pensions and spending, and increases in taxes. Portugal and Spain have also subscribed to an austerity recipe. The new UK Coalition Government declared its commitment to severe cuts.

The speculators now worry that these measures are not a solution to the problems: first they think the default of Greece is inevitable given the popular resistance and the size of the debt. Second, in a schizoid way, they are worried that austerity measures will deepen the recession not only in Greece but many other rich countries, and create a double-dip recession. Despite severe cuts, the budget deficit might not improve: as further recession decreases tax revenues, this makes it harder to pay the debt back. A long recession is likely without fiscal stimuli. The uncertainty about the recovery is deterring new investment and hiring. Income and job losses, insecurity and the pressure to pay back debt are restraining consumption.

The current EU policies are assuming that the problem is fiscal discipline. They do not address the structural reasons behind the deficits and the



“beggar-thy-neighbour” policies of Germany. The austerity packages are pushing the countries into a model of chronically low internal demand based on low wages. The deflationary consequences of wage cuts may turn the problem of debt to insolvency for both private and public sectors. In the past in Germany, low domestic demand was substituted by high exports. But it is not possible to turn the whole Eurozone into a German model. Without the deficits of the periphery, the German export market will also stagnate.

*Redistribution: The solution to inequality and crisis*

The existing wage suppression policies hurt all working people alike. The popular view in Germany misses the fact that the German workers’ loss of wages, unemployment benefits and pension rights created part of the problem in Greece. This is a crisis of distribution, and a reversal of inequality at the expense of labour is the only solution. The governments agreeing to the cuts are avoiding taxing the beneficiaries of neoliberal policies and the main creators of the crisis. The public debt would not be there if it were not for the bank rescue packages, counter-cyclical fiscal stimuli and the loss of tax revenues. This crisis calls for a major policy restructuring, combining the solutions to inequality with long-term aims of ecological sustainability. These include the following:

*The governments agreeing to the cuts are avoiding taxing the beneficiaries of neoliberal policies*

- A highly progressive system of taxes – coordinated at the EU level and taxing both income and wealth, with higher corporate tax rates, inheritance tax and financial transactions tax – is the way to make those responsible pay for the crisis. A progressive income tax mechanism with the highest marginal tax rate increasing to 90 per cent above a certain income threshold could also introduce a maximum income. Debt restructuring can be formulated via a progressive wealth tax on government bonds with the highest marginal tax rate reaching 100 per cent for holdings above a certain amount of bonds. This would make the speculators pay the costs of the crisis.
- There is a need for a correction of the wages to reflect the productivity gains of the past. To facilitate convergence, a minimum wage should be coordinated at the EU level.
- Higher productivity growth in poorer European countries will help to create some convergence in wages, but regional convergence should be supported by fiscal transfers and public investments in poorer regions. Furthermore, a European unemployment benefit system should be developed to enable

redistribution from low to high unemployment regions. This would require a significant EU budget financed by EU-level progressive taxes.

- The Stability and Growth Pact must be abolished. The European Central Bank should become a real central bank with the ability to lend to Member States.
- Public spending should aim at full employment and sustainability via public employment in labour-intensive services such as education; childcare; nursing homes; health, community and social services; and public investments in ecological maintenance and repair, renewable energy, public transport, the insulation of the housing stock and the construction of zero-energy houses.
- To maintain full employment, a substantial shortening of working time in parallel with the historical productivity growth is also required. This is also an answer to the ecological crisis: for ecological sustainability, economic growth has to be zero or low (equal to the growth of “environmental productivity”). For such a regime to be socially desirable, it needs to guarantee full employment and an equitable distribution, i.e. shorter working time and substantial redistribution via an increase in hourly wages and a decline in the profit share.
- In sectors that are under the threat of mass layoffs, for instance the auto industry, nationalization and restructuring via a gradual transfer of labour towards new green sectors should be considered.
- To finance long-term investment, the redesign of the financial sector, based on a public banking sector, is urgent. Financial regulations, including capital controls, are important but not enough.
- Public ownership is also required in critical sectors such as housing, energy, infrastructure, the pension system, education and health, where decisions cannot be left to the private profit motive. This public ownership should involve the participation of the stakeholders (for example, workers, consumers and regional representatives) in decision-making and economy-wide coordination of important decisions for a sustainable development based on solidarity.

*Özlem Onaran is Senior Lecturer at Middlesex University, London. Her research areas include globalization, distribution, employment, investment and crisis.*

# Social forces drive financial insecurity

Seeraj Mohamed

The frequency of financial crises has increased and we are concerned about how soon to expect the next one. The liberalization of cross-border capital flows has increased the possibility not only of contagion from crises elsewhere but that financial profligacy in one country is easily exported to another. Economic policy-makers have a duty to protect their countries from contagion, global financial volatility and the domestic adoption of profligate financial practices, and they can do this by asserting policy sovereignty. The global trade union movement can play an important role by fighting for policies that limit the power of finance.

Civil society, including trade unions, should campaign for economic policies that protect countries from financial crises and contagion. Global trade unions are well placed to coordinate these campaigns across countries. Widespread financial liberalization leads to increased socio-economic insecurity and loss of jobs, factors which weaken the social fabric and create increased hardship for the poor. The rich are able to diversify their investment portfolios and move their wealth abroad if necessary. They can weather the storms of financial instability and crises while the poor are stuck in the eye of the storm.

**Widespread financial liberalization leads to increased socio-economic insecurity and loss of jobs**

Many countries are pondering changes to the regulation of financial institutions and markets. However, one should not expect huge changes. James Carville, American political commentator and strategist for former President Clinton's 1992 election campaign, was quoted in the *Wall Street Journal* (25 February 1993) as saying, "I used to think if there was reincarnation, I wanted to come back as the president or the pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody." The political and economic power of financial institutions, including many that are "too large to fail", is enormous. Large private corporations and governments are expected to make their policies and practices palatable to the

few hundred people operating global financial markets and the major credit ratings agencies. Furthermore, economic policy-makers and central bank leaders of many countries are drawn from the large financial institutions or expect to work for one of those institutions in the future. The large and very powerful financial institutions have the ability to capture and intimidate policy-makers and regulators. They are able to direct how they are regulated by government and, as the recent crisis shows, they are able to acquire bailouts when they have driven their financial systems into crises.

One would expect that the global financial crisis would have undermined the economic and political power of financial institutions. It is necessary to understand the social forces driving the power of financial institutions to understand why they have proved so resilient to financial crises and popular political outcry. The reversal of welfare programmes and state provision and support for pensions, health insurance, unemployment benefits, housing and other necessities drives the power and influence of finance. Demographic factors in many developed countries have a huge impact on global financial markets. Their populations are ageing and want to ensure that they have sufficient investment for their retirement years. These populations also invest more in health and other insurance products because they are less able to depend on the state. Most of these investments are through institutional investors, which have put pressure on large corporations to focus on high short-term returns.

As a result, the approach in many of the largest global corporations to investment and employment has changed. There is increasing evidence that economies that are more financialized have reduced levels of investment in manufacturing. Institutional investors can capture rents and profits in developing countries and they do not have to support long-term investments and decent jobs in their home countries. Furthermore, the ageing populations in developed countries are politically important and influential, particularly during election years. Policy-makers in these countries are usually older and share the interests of those who support institutional investors.

We live in a world where many governments will not increase their spending on social security and welfare services. As sovereign debt problems mount, the rhetoric is to cut fiscal spending, further reduce social services and to increase the retirement age. Financial institutions have profited from the inadequacy of social services and from the insecurity of the aged in the recent past. Widespread programmes to reduce fiscal spending will drive even more people to find private providers for social services and to invest more in private pension funds. Finance, particularly institutional investors, will profit from this

increased insecurity. The power of institutional investors stems from the allocation of the capital people pay for social services, retirement investments and risk insurance. They have the global financial markets as their playground. Therefore, we cannot expect major changes or ample regulation in these markets unless the social forces that drive the power of finance are addressed. The agenda of the international trade union movement should be more than ever to reverse the reduction of social services and retirement provision by governments. They must fight programmes that cut social spending and increase the insecurity of the poor.

Ultimately, the fight should be to decommodify education, health and other social services, as well as pensions, and to make the state the primary provider of these services. The global trade unions should act to counter the ability of financial institutions to capture and intimidate economic policy-makers and regulators. They have to convince their members to use their power as consumers of private social services, health insurance and retirement policies to campaign against the destructive behaviour of the institutional investors that sell these services.

*The fight should be to decommodify ... social services ... and to make the state the primary provider of these services*

States with a developmental economic programme should put in place measures to curb the power of financial institutions in their domestic economies and to protect their economies from speculation, turbulence, crises and contagion from the rest of the world. Trade unions have to partner with other social movements to fight for changes in economic policies and for more developmental programmes. As a political constituency, they have to push much harder for more effective regulation of finance. Unless we can wage a global campaign against the uncontrolled power of finance, we face the threat of more financial crises in the future. If the past few decades point to what we can expect, there could be more regular and increasingly severe crises. The workers and the poor will bear a disproportionate amount of the pain associated with them.

*Seeraj Mohamed is Director of the Corporate Strategy and Industrial Development Research Programme (CSID) in the School of Economics and Business Sciences at the University of the Witwatersrand, where he teaches in the Economics Department and the Global Labour University master's programme. His work is in economic policy research, analysis and development. He has worked on economic and industrial policy for two decades.*

# Paying for inequality: The costs of NAIRU-based macroeconomics

C.W.M. Naastepad and Servaas Storm

Mainstream macroeconomics is in a deep crisis in the wake of the financial collapse of mid-2007 and the ensuing Great Recession. What the crisis has revealed is that the remarkable macroeconomic performance of the United States and the United Kingdom from 1995 to 2006 was just a façade. Hiding behind it, a mountain of unsecured credit and housing debt was accumulating, as a constantly expanding network of secondary markets seemed to be sharing the risk created by such debt, apparently diminishing the risk exposure of individual holders. How that debt mountain collapsed is now well known. Yet mainstream economists did not in any way foresee the crisis, bringing out the failure of the orthodoxy of an entire era in economic thought, teaching, practice and policy advice. As Citigroup's chief economist Willem Buiter (2009) wrote (in the *Financial Times*): "The typical graduate macroeconomics and monetary economics training received at Anglo-American universities, during the past 30 years or so, may have set back by decades serious investigations of aggregate economic behaviour and economic policy-relevant understanding. It was a privately and socially costly waste of resources." We believe that the theory of the non-accelerating inflation rate of unemployment (NAIRU), which belongs to the core of graduate macroeconomics and monetary economics, is seriously implicated in creating the crisis. NAIRU theory helped shape the broader macroeconomic conditions within which the spectacular macroeconomic imbalances could build up and eventually lead to collapse. The NAIRU approach must be discarded to provide the space for "serious investigations of aggregate economic behaviour".

The NAIRU is the equilibrium unemployment rate; it bears a strong resemblance to Marx's reserve army of (unemployed) labour. Equilibrium unemployment is the outcome of the conflict over income distribution between workers (unions) and firms. Workers negotiate money wages designed to give them a certain standard of living, while firms set prices as a profit mark-up on labour costs. Wage-setting is assumed to depend on the expected price level

and exogenous wage-push factors (including employment protection legislation, social security and minimum wages) and negatively on the unemployment rate. Competing claims by workers and firms are made consistent by means of variations in unemployment. If workers demand “excessive” wage increases (i.e. exceeding productivity growth), equilibrium unemployment will increase, forcing workers to reduce their wage claims. NAIRU theory holds lessons for both macroeconomic policy and labour market policy. Its key macro policy implication is that governments and central banks *should not* try to promote full employment, because efforts to push the unemployment rate permanently below the critical threshold (the NAIRU) will fail, as doing so will generate only accelerating inflation (not growth). Fiscal and monetary policies are ineffective, as unemployment is regarded as structural or “voluntary”; workers supposedly either lack the required skills or prefer social transfers to employment. The key employment policy lessons of the NAIRU doctrine are that labour markets should be deregulated, welfare states trimmed down, and the institutional wage bargaining position of unions weakened, so as to reduce real wages (relative to productivity) and improve firms’ profitability. This would, according to the doctrine, lead to increased investment, reduced unemployment (especially of the lower-skilled) and improved overall macroeconomic performance. It follows that there exists a conflict, or trade-off, between growth and equity. In other words, the price to pay for higher employment is a low-pay sector.

Why and how is the NAIRU model implicated in the current crisis? As Gabriel Palma (2009) compellingly argues, the process of financial deepening in the United States (and globally) has been closely related to the *huge sustained increase in income inequality* after 1980, in a process of simultaneous causation.

**NAIRU-based economics  
created deregulated labour  
markets and scaled-down  
welfare states**

NAIRU-based economics created the deregulated labour markets and scaled-down welfare states within which the very sharp rise in inequality, especially in the United States, occurred and at the same time legitimized high inequality as the unavoidable by-product of a low-unemployment economy enmeshed in global competition. These huge inequalities have in turn destabilized the system by making it more prone to financial instability. This last fact is easily explained.

One side of the increasing inequality in the United States has been stagnant average real incomes for the bottom 90 per cent of US households. This has led not only to a decline in personal savings but it has also created a “captive market” for bank loans and sharp increases in household indebtedness (to sustain the “American Dream” on credit). The flip side of the coin has been a

dramatic rise in real income and wealth of the top 10 per cent (and especially 1 per cent) of households, which created superabundant liquidity in US financial markets, transforming them into unstable institutions incapable of self-correcting. High net worth individuals (HNWIs) were the leading providers of finance to hedge funds, which in turn were the leading buyers of securitized mortgages. The HNWIs demanded above-average returns on their investments from the hedge funds, as they were also paying hedge fund managers above-average fees and bonuses.

Rising inequality is at the root of the (financial) crisis. On the one hand, increased inequality depressed aggregate demand and prompted monetary policy to react by maintaining low interest rates, which itself allowed private debt to increase beyond sustainable levels. On the other, the search for high-return investments by the HNWIs led to a process of “virtual wealth creation” on an unprecedented scale, based on financial innovations which could go on and on in effectively unregulated financial markets. Net wealth became overvalued and high asset (house) prices gave the false impression that high levels of debt were sustainable. The crisis revealed itself when the “financial weapons of mass destruction” exploded. Crucially, superabundant credit “was not used to finance new [technical] inventions” as in earlier boom periods; as Robert Skidelsky (2009) explains, “it *was* the invention. It was called securitized mortgages. It left no monuments to human invention, only piles of financial ruin.” Financial markets collapsed once inequality-driven imbalances and instability became too large. So although the crisis may have emerged in the financial sector, its roots are much deeper and lie in a structural change in income distribution that has been going on for almost 30 years.

*Although the crisis ... emerged in the financial sector, its roots ... lie in a structural change in income distribution*

NAIRUvian macro and labour market policies must take a large part of the blame for unleashing and at the same time legitimizing an unequal, unstable and unsustainable profit-led growth process. To prevent financial fragility and crisis, the key issue for macro policy is to impose “compulsions” and “restrictions” on the capitalist system, to discipline firms, investors and financial markets. Labour market regulation could be one such systemic compulsion, in addition to stricter financial regulation and firm-level co-determination, aimed at discouraging non-productive, speculative activity. More egalitarian wage-led growth and low unemployment are crucial to avoid the build-up of excess liquidity that triggered the global financial crisis. This is why a serious rethinking of the NAIRU approach to macroeconomics is needed. The present crisis offers a historical opportunity for progressive change: given the loss of



credibility of financial laissez-faire (Anglo-Saxon style), the legitimacy crisis of stock-market capitalism and the cynicism of Wall Street and the City, the global crisis could force a return of the democratic state, of regulation and of more egalitarian full-employment policies – provided there is a viable alternative to NAIRU macroeconomics. The urgent need is therefore a reconstruction of macroeconomics in which the various positive contributions which labour and labour market regulation make to macroeconomic performance are given their rightful place.

Wages, for instance, are not merely a cost to firms (as the NAIRU model assumes). Higher wages also provide macro benefits in terms of higher demand and faster productivity growth. Higher wages mean higher (consumption) demand, higher capacity utilization for firms, and hence higher profits. Capital accumulation, in turn, will increase in response to the growth in demand and profit. This will result in higher productivity, because investment in new equipment embodies the most advanced technologies, also due to more rapid learning-by-doing in firms. Higher wages and labour market regulation (offering strong legal protection to workers and giving them an effective say and stake in how they do their jobs and how firms are run) will motivate workers to commit to firms through higher productivity. Higher wages and pro-worker regulation will also motivate firms (and make it easier for them) to step up investment in labour-saving technological progress, thus raising productivity growth. Finally, central wage-setting is good for overall productivity, as it rewards highly productive enterprises and forces the relatively unproductive ones out of business.

If these positive contributions by labour and labour market regulation are taken into account, it can be shown (Storm and Naastepad 2011) that there

***More regulated and coordinated industrial relations systems are associated with higher labour productivity growth***

is no conflict between growth and equality. The main reason is that more regulated and coordinated industrial relations systems are associated with higher labour productivity growth. Higher productivity growth and stronger technological dynamism in turn allow for higher real wage growth (while maintaining firms' profits and investment), thus creating the conditions for high and egalitarian growth with relatively low unemployment. The mainstream NAIRU approach rules out any possibility for egalitarian growth. Hence, the first step in creating progressive change is to expand the academic space and the public visibility of *alternative* macroeconomic approaches (beyond the NAIRU approach) that do address the deep economic problems of our time.

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C.W.M. Naastepad and Servaas Storm are both Senior Lecturers in Economics in the Faculty of Technology, Policy and Management at Delft University of Technology. Naastepad works on macroeconomics, (un)employment and technological change. Storm works on macroeconomics, globalization, agricultural development and the economics of climate change. He is one of the editors of the journal *Development and Change*.

# Private equity investments and labour: Current trends and challenges for trade unions

*Maria Alejandra Caporale Madi and  
José Ricardo Barbosa Gonçalves*

The recent global economic crisis revealed how deeply the social life of the working class has been affected by deregulated finance. In the aftermath of the crisis, the impact of private equity funds on working conditions has been attracting lots of attention, since private equity funds – such as Blackstone, Carlyle Group or Texas Pacific Group – have been responsible for the employment standards of tens of millions of workers. Truly, as workers are confronted with over US\$1 trillion in worldwide concentrated private equity buyout power, the relevance of private equity funds is outstanding in an analysis of the perspectives of mergers and acquisitions, employment and organized labour.

## *The new employers and the rationalization strategies*

This scenario has consolidated the work of new social actors: the fund managers of the private equity funds. Fund managers' services include fund-raising, financial statement analysis, company selection, restructuring implementation and ongoing monitoring of investments. Fund managers centralize endowments from investors such as financial institutions, institutional investors – including pension funds – and high net-worth individuals, among others, in order to assume key roles in the acquisitions of high profit potential.

In this financial and productive setup, capital has turned out to be faceless. In relation to the questions “Where does capital reproduction happen to be?”, “How does capital reproduce itself?” and “Who is benefiting from the capital reproduction process?”, the answers rely on the fund managers' actions that attract the owners of capital to specific business. These investors have been attracted by fund managers who not only promise high short-term profits but also offer the incentive of seductive “irresponsibility” toward the portfolio companies. The fund managers assume full responsibility over the business, and thus have the autonomy to implement any kind of operational and financial restructuring strategy. The real target of the fund managers is to sell the companies within 10 years of their acquisition.

In fact, in the United States and many European countries, the behaviour of fund managers, entirely premised on profit targets aimed to increase short-term cash flow, has increased workers' exploitation. Beyond the "rationalization" strategies, social conflicts and tensions are strengthened, as restructuring actions reshape the control of workers and increase staff turnover, outsourcing and casual work. Under the fund managers' pressure, the portfolio companies turn out to be subordinated to narrow economic efficiency targets that shape employment relations for the worse. Workforce displacement and loss of rights are also part of the spectrum of management policies aimed at cost reduction. The challenges to the employment conditions that have been negotiated by trade unions through collective bargaining reveal the emergence of private equity funds as major "invisible" transnational employers. In fact, this "faceless capital" configures new employment relations and increases pressure on organized labour.

*Private equity firms ... have  
been threatening ...  
workers' rights through their  
financial strategies*

Private equity short-term returns and exit strategies have increased the challenges on collective bargaining power because of accelerated cost-cutting through layoffs, closures, outsourcing and further reductions in productive investment. In this context, the Global Unions have reported that private equity firms, mainly buyouts, have been threatening employment, working conditions and workers' rights through their financial strategies (IUF 2007).

### *The Global Unions' agenda*

The Global Unions have been mobilizing against this business model of the private equity funds, which poses risks not only to the sustainability of productive investment and employment in domestic markets but also to the stability of the international financial system. This mobilization has included joint efforts and activities with the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Association (IUF) and Union Network International (UNI), as well as cooperation with the Trade Union Advisory Committee (TUAC), the International Trade Union Confederation (ITUC) and International Metalworkers' Federation (IMF), among others.

The Global Unions have been defending the view that the re-regulation agenda could promote long-term productive investment growth, employment creation based on the Decent Work Agenda, employment security and the protection of trade unions' rights. To achieve these goals, the following rights and condition should be secured for workers: (a) collective bargaining,

information, consultation and representation within the workplace; (b) trade union representatives should be informed about the capitalization and debt structure of the buyout deals, as well as who the ultimate investors are; and (c) additional government protection should be provided to workers affected by private equity takeovers – this could follow from the recent steps taken to uphold the employer responsibilities of private equity firms (ITUC 2007).

In addition, in the Global Unions' view, regulatory reforms should address transparency to guarantee full access to audited financial accounts. In particular this would involve the disclosure of:

- the characteristics of debt contracts (e.g. total amount, types and maturities, rates and schedules);
- restrictions on assuming more debt and the identity of the lenders/holders of the debt securities, if they are not publicly traded;
- analysis of earnings (e.g. debt-to-earnings ratios, dividends-to-earnings ratios, fees and special dividends financed through additional debt);
- business plan guidelines (e.g. exit strategies, plans for sell-offs and closures, management of cash flows, financial assets);
- investments in plants, equipment and research;
- labour condition strategies (e.g. employment methods, training and pension funds/retirement benefits and negotiations with unions).

Regulatory reforms should also enforce changes in tax regulation to cover private equity regimes so that tax systems are not biased toward short-term investor behaviour. The regulatory Global Union agenda also includes the revision of corporate governance frameworks to include unlisted companies. Such regulation could include: measures to discourage short-termism; greater transparency and public reporting requirements; more supervision by public authorities; limits to debt; changes in taxation of capital gains; and ensuring that private equity funds comply with all relevant employer obligations (ITUC 2007).

***Regulatory reforms should also enforce changes in tax regulation to cover private equity regimes***

According to the Global Unions, it is also important to address regulatory changes to enhance the stability of the international financial system. This reveals a strong concern about the risks that private equity funds, mainly buyouts, pose to the sustainable growth of national economies in the global economy.

## Conclusion

According to the ITUC (2007), “only government action can curb the external impact and the outright exploitation of these investment activities”. Current trends in investment and private equity indeed provide an important opportunity for discussion and reflection about the global articulation of workers and unions. This relates to trade union representation as well as to the challenges presented by the impact of the political and economic forces beyond the private equity business model that organizations face.

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*Maria Alejandra Caporale Madi and José Ricardo Barbosa Gonçalves are both Professors at the Instituto de Economia, State University of Campinas (UNICAMP), and researchers with the Centre for Labour Economics and Trade Unionism (CESIT). Caporale Madi's work focuses on financialization, corporate governance and social exclusion, while Gonçalves researches neoliberalism, trade unions and social exclusion.*

## PART V

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### Workers' rights and wage-led recovery: The basis for sustainable growth

# Working for decent work for all everywhere

Juan Somavia

The global crisis has, once again, illustrated how central decent work is to the lives of women and men everywhere, to the stability of families and peace of communities. Encouragingly, the crisis has also set off bold and decisive decisions to counter the downturn. Useful lessons can be drawn from the last 18 months during which the prevailing economic consensus was turned on its head. Rising to the challenge of the global jobs crisis requires a thorough rethink of the relationships between economic growth and employment. A high level of productive employment should be an objective of the same order as low and stable inflation and sound public finances.

## *A global employment challenge*

Today, half of the world's labour force of 3.2 billion is in various forms of vulnerable employment. Some 1.2 billion persons work and live in poverty. Out of every 10 persons, 2 have access to basic social protection. This crisis existed before the last global crisis.

During the Great Recession, employment dropped by approximately 1 per cent. Globally, 212 million persons are unemployed and looking for work. Two unemployed persons in five are young women and men between the ages of 15 and 24. In many countries the number of unemployed workers discouraged from active job search, and those working involuntarily in part-time occupations, has risen dramatically. In emerging and developing countries lost wage employment is being replaced by lower quality informal employment. In all countries the rate of growth of real wages has slowed considerably, or wages have stagnated or fallen.

The outlook for tomorrow: the world will require some 440 million new jobs over the next 10 years just to keep up with the growth in the labour force.

In pulling these strands together, the world is facing a momentous employment challenge.

*In emerging and developing countries lost wage employment is replaced by lower quality informal employment*



### *Encouraging initial responses to the crisis*

Fiscal and monetary policies have been used decisively to counter the fall in economic activity as of late 2008. The recommendation of the IMF to invest 2 per cent of GDP in counter-cyclical fiscal spending has been by and large heeded by governments. This additional funding was tapering off in 2010.

In June 2009, the International Labour Conference adopted a Global Jobs Pact with strong backing from governments, employers and trade unions from ILO member States. The Pact is essentially a template for employment, labour and social policies, based on the Decent Work Agenda, to counter the crisis. It has inspired and continues to inspire many countries. The central purpose of the Pact is to shorten as much as possible the lag, observed in many previous crises, between economic recovery and recovery of employment.

The G20 has given strong impetus to international coordination. During 2009, in London and in Pittsburgh, G20 leaders recognized the significant impact of the crisis on employment. They committed to “restoring the global economy to full health” so that “hard-working families the world over can find decent jobs”. To that end, they called for “an employment-oriented framework for future economic growth”, pledging to put “quality jobs at the heart of the recovery”.

Crisis responses have included the extension of unemployment benefits, broader coverage of social protection programmes, additional spending on infrastructure, support for small enterprises, and a range of measures, from working time adjustments to employment subsidies, to cushion the impact of the downturn on employment. The ILO has estimated that the extraordinary fiscal stimulus and automatic stabilizers saved or generated 21 million jobs across G20 countries in 2009 and 2010, equivalent to 1 per cent of total employment in these countries.

### *Accelerating recovery in employment*

More than two years on from the collapse of Lehman Brothers, the world is gradually recovering from the recession, but at very different speeds across regions, and in the midst of heightened risks of an overall weak recovery in employment. Accelerating recovery in employment remains the overriding priority.

Emerging and developing countries are recovering more quickly, and employment growth was close to pre-crisis levels in the third quarter of 2010. These economies, and a few industrialized countries, are benefiting from strong growth in China. By and large, they have avoided a financial crisis with bank lending being a key counter-cyclical instrument. Brazil, China and India are facing shortages of skilled labour, calling for better policies to link

vocational education and training to the needs of enterprises. The key challenge for these countries, to sustain their growth, is the gradual raising of the quality of labour, the most direct route to expand domestic consumption. This requires a range of measures from labour market policies to broader social protection and better pass-through of productivity gains to wages.

In the United States, Japan and Europe in 2010 and the next few years, growth is likely to be too weak for employment to recover rapidly. Although unemployment may have peaked, it is likely to remain high for some years. There is a real risk of long-term unemployment leaving permanent scars on persons. Measures specifically targeted at employment can help, such as targeted subsidies, skills development and job search assistance. Even in countries with fiscal constraints, such measures are cost-effective.

One of the reasons why the crisis was more short-lived in emerging countries than in higher-income countries is the functioning of credit markets, which expanded in the former and dried up in the latter. Bank credit to the real economy is still well below pre-crisis levels in advanced countries, constraining job growth in small enterprises.

### *Thinking differently about economic growth and employment and decent work*

The global employment challenge is with us. The ILO is playing its role, in close cooperation with employers' organizations and the trade union movement, and with other global institutions such as the IMF, UNDP, WHO, and WTO, to alert and mobilize governments on the central role of balanced responses combining employment, investment, sustainable enterprises, labour market institutions, social dialogue and social protection.

For a number of objective reasons, linked to the severe social impact of this crisis, the unsustainable pattern of globalization and the changing geography of world output, support for the Decent Work Agenda is being reinforced at the highest political levels, in global, regional and national institutions and in public opinion. This broad and encouraging acceptance is increasingly being translated into tangible policy shifts. Yet much more is needed.

For the world to tackle the global employment challenge, it must think differently about how macroeconomic policy addresses employment. A high level of productive employment and decent work must become a national priority and benefit from the same consensus, across all government policies (central banks included), as low inflation and sound public finances. Employment policies are cost-effective, as they tend to raise the potential output level, reduce compensatory social expenditure and maintain social stability.

Thinking differently is a responsibility of all. Several critical and protracted issues need to be addressed in a different way if the world is not to return to the same unsustainable pattern of globalization as before the crisis.

Let me mention a few of these issues. In a world awash in liquidity, productive investment is far too low. Aggregate demand is deficient. The financialization of the economy is distorting the real economy. Investment and employment are suffering from these distortions.

*In a world awash in  
liquidity, productive  
investment is far too low*

Rising inequality and weakened middle classes have been identified as proximate causes of the crisis. The share of wages in total income is declining globally, with wages trailing productivity increases. Tax policies have become less progressive. Together, these trends are weakening aggregate demand and hence future growth. Small enterprises are the engine of employment generation, but struggle to provide decent conditions of work. Institutions for social dialogue vary greatly in their contribution to decent work outcomes. A universal floor of basic social protection is an achievable objective. Holders of public purses must be convinced of the multiple benefits deriving from such a floor, from lower poverty to less consumption volatility and empowerment of persons. Incentives and investments in green jobs and in a just transition to greater energy efficiency are the seeds of future sustainable growth.

At the ILO, a fair globalization providing opportunities for all is a better path to sustained global growth and stability. Recent discussions at the International Labour Conference are profiling the ILO as a major source of “thinking differently” whilst remaining true to our values balancing economic and social advancement. Let us deepen and broaden our analysis and discussions.

*Juan Somavia is Director-General of the International Labour Organization.*

# International labour standards: An old instrument revisited

Frank Hoffer

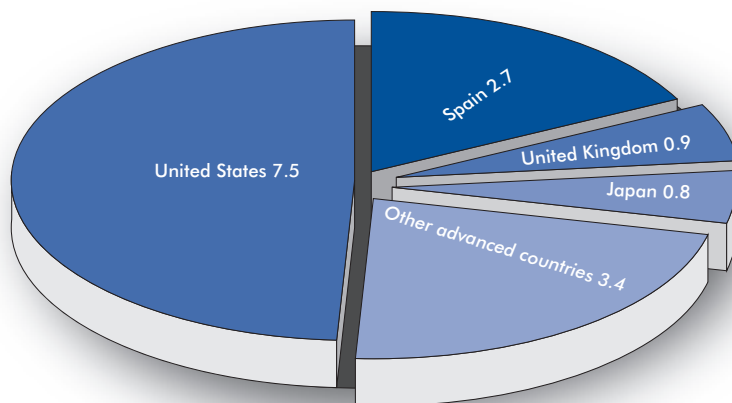
In the past several decades, the labour markets in many countries have been deregulated and trade union strength has declined. Trade liberalization and deregulated financial, product and labour markets have created a mutually reinforcing trend towards weaker regulatory provisions. Decreased labour market 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 developments has translated into massive export surpluses in some countries and debt-financed consumption in others. The crisis has proved that both trends were unsustainable.

The crisis has shown not only that “employer-friendly” labour market regimes are not employment-friendly, but also that they are dangerously pro-cyclical. In the United States and Spain, two countries characterized respectively by under-developed labour market protection and massive precarious employment, the economic downturn rapidly translated into massive employment and wage losses. These two countries actually account for two thirds of all crisis-related job losses in the advanced countries (see Figure 1).

***The crisis has shown ... that “employer-friendly” labour market regimes are not employment-friendly***

Labour legislation has the double function of (a) protecting workers against hazardous working conditions and the abuse of market power and (b) acting as an automatic stabilizer against the volatility and overshooting of under-regulated labour markets. In recent decades, however, there has been a regulatory race to the bottom. Deregulatory “successes” in one country created parallel pressures 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 a few individual countries managed to maintain and sometimes extend protective regulation under the current globalization regime, all felt the pressure

Figure 1 Change in number of unemployed people in advanced countries: 15.3 million



Source: IMF-ILO, 2010, Oslo.

to reduce labour costs by weakening employee rights and protection. 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 policy-making circles ignored or forgot what had been common sense 90 years ago when the ILO was founded.

“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.”<sup>1</sup>

Multinational companies and the global financial sector have undermined the capacity of democratic societies to ensure the sovereignty of the people and of law over the logic of the market. Profit-seeking at the expense of the public good becomes an unavoidable reality when irresponsible business practices become legally possible. Sustainable enterprises based on the principles of collective bargaining, fair wages, non-discrimination, taxation and respect for labour standards are outcompeted by those who do not hesitate to employ children, ignore minimum wages, evade taxation, circumvent labour legislation, save on health and safety and environmental protection, and abuse the open global economy to demand evermore preferable conditions for investment and externalize as many costs as possible to society.

Universally applicable national labour legislation is necessary to avoid unfair competition within countries. It steers the economy towards a growth

model based on innovation and product competition instead of exploitation. International labour standards complement and reinforce actions at the national level. They are based on the understanding that, in a global economy, national regulation must be harmonized 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 only be maintained when regulatory arbitrage is limited. If countries strive for export surplus by keeping wage growth systematically below productivity growth, they build up huge global imbalances and an overcapacity that are not sustainable. Such strategies will either trigger a global race to the bottom or force other countries to adopt protective countermeasures.

*In a global economy,  
national regulation must be  
harmonized and  
coordinated through an  
international labour  
standard-setting process*

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 towards 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 organize, the right to non-discrimination, the right to consultation with workers and employers, the right of workers to refuse work under hazardous conditions, the right to the safe handling of health-threatening chemicals and pesticides, and the right of workers' organizations to access enterprises. Other standards – such as maternity protection, protection against excessive hours of work, and minimum annual vacation – are essential for workers' health and should not be undercut under any circumstances. Moreover, many standards provide for flexibility by recognizing different levels of development: for example, coverage of a limited number of risks such as unemployment, sickness, old age or invalidity for a certain percentage of the population is sufficient for ratification of the ILO Social Security (Minimum Standards) Convention, 1952 (No. 102).

In 2009, ILO member States identified a set of labour standards for recovery as part of the Global Jobs Pact. They reiterated the importance of the core labour standards as human rights, but also recognized that, for a regulatory response to the crisis, a much more comprehensive labour standards package was required. The standards identified in the Global Jobs Pact can be grouped into five areas:

- *Empowering* workers to represent their interests by guaranteeing and promoting the right to organize and to bargain collectively as outlined in ILO Conventions Nos. 87 and 98;<sup>2</sup>
- *Protecting* employees at the workplace against all forms of discrimination (Convention No. 111) and abuse of force by employers (Convention No. 29), against unjustified dismissal (Convention No. 158) and against the loss of wages in the event of bankruptcy;<sup>3</sup>
- *Guaranteeing* minimum wage levels (Convention No. 131) and social transfers that provide an adequate income floor (Convention No. 102) and responsible public procurement policies (Convention No. 94);<sup>4</sup>
- *Enforcing* the application of labour laws and collective agreements for all workers through full recognition of the employment relationship and effective labour inspections (Convention No. 81);<sup>5</sup>
- *Focusing* all financial and economic policies on the objective of full, freely chosen and productive employment (Convention No. 122);<sup>6</sup>

International labour standards are potentially a powerful lever for improving global governance and creating the trust among nations that all countries apply labour standards – adapted to their level of development – in order to avoid a race to the bottom. This crisis is the moment to strengthen governments' commitments to labour standards, which can help lead to a globalization that respects workers' rights and results in greater equality in countries and among nations. Universal ratification of existing ILO standards would be a major contribution to coordinated global governance.

The current ILO supervisory mechanism of regular reporting and independent assessment by a Committee of Experts is one of the most elaborate supervisory mechanisms in the United Nations system, but it has nevertheless not been strong enough to achieve the universal (or even close to universal) application of labour standards, a desire expressed by member States when they founded the ILO. Nearly all governments voted for the adoption of most Conventions at the International Labour Conferences. However, they have very often not followed up with ratification, let alone implementation.

The previous decades of deregulatory irresponsibility have made a minority much richer and more powerful, but this regime did not serve society-at-large so well. Continuing the push for the deregulation of labour markets will lead to a further increase in inequality, declining wage shares and unsustainable imbalances. If governments fail to provide credible international policy

coordination, including minimum labour standards, a re-nationalization of economies will take place sooner or later. This might turn out as one of the ironies of history that those who continue to press for uncontrolled markets despite the bitter lessons of the Great Recession will be much more successful in destroying globalization than the anti-globalization campaigners of the last decades.

Convincing governments and overcoming the resistance of market fundamentalists will crucially depend on the work of trade unions at both national and international levels. Trade unions have more influence in the ILO than in any other UN body, as they form part of the ILO's decision-making structure. This is the time to campaign vigorously and to call on governments to consider a new ILO instrument with the sole objective of increasing the commitment to ratify and the capacity to implement existing labour standards. Moral persuasion and public exposure have proven to be insufficient incentives. The new mechanism should create a stronger pressure on governments to submit non-ratified Conventions to their parliaments and to create financial obligations for all member States (except the least developed countries) that fail to do so or that fail to implement ratified conventions. These contributions should form a global fund for the promotion of international labour standards and help member States to create efficient and protected labour markets.

A universal application of labour standards would be a major contribution to a well-regulated global economy. Moral hazard and free-riding are the enemies of all universal regulations. Whenever governments have been genuinely committed to mutual obligations, they have also been serious about enforcement. Demanding financial compensation from those who want to profit at the expense of others is necessary in order to level the playing field and to ensure that international labour standards do what they are supposed to do: commodify labour.

*If governments fail to provide credible international policy coordination, including minimum labour standards, a re-nationalization of economies will take place sooner or later*

## Notes

<sup>1</sup> Preamble, Constitution of the International Labour Organization.

<sup>2</sup> The Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87), and the Right to Organise and Collective Bargaining Convention, 1949 (No. 98).

<sup>3</sup> The Discrimination (Employment and Occupation) Convention, 1958 (No. 111), Forced Labour Convention, 1930 (No. 29), and Termination of Employment Convention, 1982 (No. 158).



<sup>4</sup> The Minimum Wage Fixing Convention, 1970 (No. 131), Social Security (Minimum Standards) Convention, 1952 (No. 102), and Labour Clauses (Public Contracts) Convention, 1949 (No. 94).

<sup>5</sup> The Labour Inspection Convention, 1947 (No. 81), and the Protocol of 1995 to the Labour Inspection Convention.

<sup>6</sup> The Employment Policy Convention, 1964 (No. 122).

*Frank Hoffer is Senior Research Officer at the Bureau for Workers' Activities of the ILO.*

# Precarious work makes for a precarious recovery

Ronald Janssen

In autumn 2010, trade unions in Europe staged massive protests against the sharp turn economic policy in Europe has taken. After having saved the banking system from total collapse, governments throughout Europe are not just cutting public services and social benefits. On top of this harsh fiscal austerity, several Member States also intend to inject an even greater dose of flexibility into their labour markets. These governments adhere to the conventional wisdom that, by allowing business to get rid of workers more easily, employers will advance in time the decision to (re)hire workers. In turn, the additional purchasing power coming from the frontloading of jobs would support aggregate demand and accelerate economic recovery.

Meanwhile, business is certainly more than ever interested in easy firing or flexible labour contracts and this for two reasons in particular. Having in mind the sudden and spectacular collapse of demand and activity that companies faced at the end of 2008, management is now reluctant to hire workers on the basis of open-ended contracts. Another motive for business to turn to short-term contracts is the credit squeeze that many companies have been or still are facing as a result of the financial crisis. To reduce dependency on bank lending, business is now keen to maximize profits as a source of new capital and one way to cut wages and increase profits is to hire temporary workers who tend to be cheaper than regular labour (see below).

By engaging in this flexibility crusade, policy-makers are making a big mistake and are running the risk of accomplishing the opposite effect of stalling and weakening economic recovery. To understand this, one needs to understand the nature and extent of the damages temporary contracts inflict upon workers.

First of all, temporary contracts come with a high wage discount. A recent study by the IMF

**Temporary contracts come with a high wage discount**

finds that, even when correcting for factors such as education and tenure of permanent contracts, temporary workers systematically receive lower wages than workers in open-ended contracts (IMF 2010). For

most European countries, the wage gap is around 15 to 25 per cent, with one country (Sweden) recording a wage gap as high as 44 per cent. While the size of the wage gap between temporary contracts and regular work contracts is casting doubts on whether the principle of “equal pay for equal work” is being respected around Europe, the fact that there is such a wage gap is in itself not so surprising: temporary workers are vulnerable workers. Employers have the power not to prolong the temporary contract or, alternatively, employers become “invisible” to their own workforce by using agency work. This makes temporary workers willing to do the same job for lower wages. And with employers hiring workers on a temporary basis instead of on the basis of open-ended contracts, the additional purchasing power that is injected into the economy is seriously reduced.

**Workers in temporary  
contracts ... consume less  
and save more**

Second, not only do workers in temporary contracts gain lower wages, they also tend to consume less and save more. One reason is the insecurity that is inherent in the nature of these contracts and which drives workers to increase precautionary savings. There is also a “Ricardian” effect at work here: with rates of transition into regular contracts sometimes as low as 12 per cent even after a period of one year (IMF 2010), temporary contracts often work as a “bad job” trap. When hiring, employers often discriminate against workers having a history of temporary contracts. Business also tends to provide temporary workers with less access to continuous training. Facing the possibility of remaining stuck in a chain of insecure and low-paid fixed-term contracts for years to come, these workers will discount the prospect of future depressed revenue flows into lower consumption at present.

Third, and in contrast to the widespread view that core workers are too protected to be affected by flexibility, there are spillover effects on the rest of the workforce. The sheer use of temporary contracts functions as a severe threat to workers under open-ended contracts to be careful not to lose their jobs and find themselves in a situation in which they in turn would be forced into precarious contracts when re-entering the labour market. This makes the workforce more inclined to accept wage cuts, longer working hours and other degradations of their rights in order to preserve their present job situations.

In short, “flexibility” all too often boils down to “flexploitation”. This raises a key question: Can flexibility compensate for its negative impact on wages and aggregate demand by generating sufficient new jobs? The answer to this is negative. In fact, the illusion that flexibility improves an economy’s job performance has been shattered by the same institution which has been

relentlessly pushing the case for flexible labour markets for more than a decade. In 2006, when examining the outcomes of its so-called “Jobs Strategy”, the OECD itself was forced to admit that the evidence to support the claim that flexible labour markets are good for jobs simply was not there (OECD 2006).

Moreover, the analysis should be taken a step further. Since the beginning of the 1990s, reforms of labour law in rich countries have systematically provided business with several alternatives to hiring workers under open-ended contracts. As a result, the share of temporary contracts in dependant employment has seen a structural increase, from 12 per cent in the mid-1990s to 14 per cent in 2008. The rising incidence of temporary work, combined with the OECD’s conclusion that flexibility does not create jobs, implies that there have been important substitution effects: Thanks to more flexible labour laws, “bad jobs” have driven out “good jobs”. Business is now able to turn jobs which are basically stable and which would have been created anyway into short-term labour contracts. The economic reality is often that the same worker has been doing the same job for the same company for many years, whereas the legal reality is that this worker is caught in a chain of fixed-term contracts.

The bottom line is that labour market flexibility does not result in “job-rich growth”, but in “job-destructive stagnation” instead. Any potentially positive effect that might arise because employers would hire workers in a somewhat earlier phase of the business cycle simply pales against the negative

*Labour market flexibility does not result in “job-rich growth”, but in “job-destructive stagnation” instead*

effects on aggregate demand coming from the spread of temporary work practices (serious wage discount, rising precautionary savings, more acceptance of wage moderation by core workers and, last but not least, the transformation of regular jobs into precarious contracts). Flexibility therefore represents an important downwards risk for the present recovery: If the initial and fragile recovery of demand, which is now mainly coming from exports to the rest of the world, evaporates into the black hole of an increasingly flexible, insecure and underpaid workforce, any hope of moving the economy into a process of strong and self-sustaining growth will disappear with it.

The irony is that, by resorting to temporary work practices, business itself is shaping the hesitating and weak recovery companies are afraid of in the first place. So instead of once again giving in to the short-sighted wishing list of European business, governments need to do the opposite and intervene to keep individual companies from imposing precarious labour relationships on their workforces. To save the recovery, labour law in Europe needs to be strengthened instead of being weakened. A strict implementation of the new agency work

directive and the principle of equal pay for equal work would be a first step forward. Another step would be to upgrade existing social directives and agreements by seeing to it that the principles of these directives are respected to the letter, with particular emphasis on the principle that atypical jobs should remain the exception and not become the rule.

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*Ronald Janssen works as an economic adviser in Brussels.*

# Global wage trends: The great convergence?

Patrick Belser

## *Average wages*

The financial and economic crisis has roughly cut global wage growth by half in 2008 and 2009. Based on a sample that covers a large chunk of the world's 1.4 billion wage-earners, the *Global Wage Report 2010/11*<sup>1</sup> finds that the global growth in real monthly wages slowed from 2.7 and 2.8 per cent in the two years before the crisis (2006 and 2007) to 1.5 and 1.6 per cent in 2008 and 2009. If China – where data coverage is limited to fast-growing “urban units” – is excluded from the sample, the average wage growth drops from 2.1 and 2.2 per cent before the crisis to 0.8 and 0.7 per cent in 2008 and 2009. In 2010, preliminary results suggest that wages have started to recover, but not as fast as profits and not yet to pre-crisis levels. Generally, wages have taken a bigger hit in developed than in developing countries.

This short-term cost of the crisis to workers must be understood in the context of a longer-term trend towards wage convergence across regions. Table 1, taken from the *Global Wage Report 2010/11*, shows that, while average wages more than doubled in Asia since 1999 and more than tripled in Eastern Europe and Central Asia (which partly reflects the depth of the wage decline in the 1990s), wages stagnated in advanced countries, increasing by just about 5.2 per cent in real terms over the full decade. This is less than the rate at which Chinese wages grow in one year. The base from which Chinese wages are growing remains, of course, much lower. The average American worker still earns in about one month what a Chinese worker in the private sector earns in one year. The point, however, is that the gap is closing and that the economic and financial crisis – as well as the slow recovery of wages in the West – has accelerated this convergence.

One factor that contributes to the convergence is the faster growth in labour productivity in developing regions. Another factor is the apparent decoupling between productivity and wage growth in advanced countries. According to one calculation, while average wages in advanced countries grew by 5.2 per cent over

Table 1 Cumulative wage growth by region since 1999 (1999 = 100)

	1999	2006	2007	2008	2009
Advanced countries	100	104.2	105.0	104.5	105.2
Central and Eastern Europe	100	144.8	154.4	161.4	161.3
Eastern Europe and Central Asia	100	264.1	308.9	341.6	334.1
Asia	100	168.8	180.9	193.8	209.3*
Latin America and the Caribbean	100	106.7	110.3	112.4	114.8
Africa	100	111.2*	112.8*	113.4**	116.1**
Middle East	100	101.9*	102.4*	...	...
Global	100	115.6	118.9	120.7	122.6

\* = provisional estimate; \*\* = tentative estimate; ... = no estimate available

Source: ILO Global Wage Database.

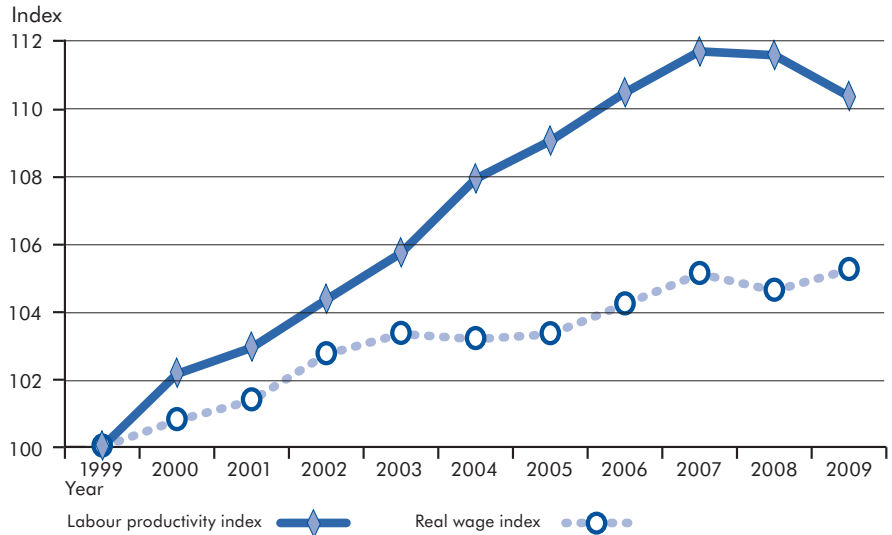
the last decade, labour productivity increased by 10.3 per cent (see Figure 1). In other words, wages grew only half as fast as labour productivity. One simulation indicates that, if wages had grown as rapidly as productivity, average wages in advanced countries could have gone up from roughly US\$2,864 per month in 1999 to \$3,158 in 2009 instead of only \$3,012 (figures are expressed in 2009 PPP dollars). Distributed over all paid employees, this decoupling may thus have cost workers in advanced countries hundreds of billion dollars in forgone wages over the full decade. These resources have not exactly been lost to everyone – since they went into profits and investment. But this redistribution has certainly limited non-credit-based household consumption, and at least partially explains the low interest rates that were needed in some countries before the crisis to keep consumption going.

*The low-pay crisis*

**The long-term losses to labour have not been equally distributed between all workers**

The long-term losses to labour have not been equally distributed between all workers. Those who have suffered most from the decoupling are the workers at the middle and the bottom of the wage distribution. Those at the top have fared better, as indicated by the increasing gap between mean and median wages in many countries and epitomized by the ongoing bonus-bonanza among the world’s CEOs. While the highly educated elite has transformed into global “superstars”, workers with average skills have become the victims of the global compression in labour costs.

Figure 1 Annual wage and productivity index in advanced countries, 1999–2009



Note: Since the indices refer to a weighted average, developments in the three largest advanced economies (United States, Japan and Germany) have a particular impact on this outcome.

It is at the bottom of the wage distribution that things have deteriorated the most. This is revealed by the steady increase in the share of workers on “low pay”, defined as the proportion of workers whose hourly wages are less than two thirds of the median wage across all jobs.

*It is at the bottom of the wage distribution that things have deteriorated the most*

The latest figures show that, since the second half of the 1990s, relative low pay has increased in about two thirds of countries (25 out of 37 countries). In advanced countries, low pay now afflicts about one in every five workers, or about 80 million people. At the country level, the incidence of low-wage employment still shows considerable variation. When full-time workers are considered, the incidence of low-wage employment varies from less than 10 per cent in Sweden and Finland to about 25 per cent in the United States and the Republic of Korea.

But low pay is not just a problem in developed economies. Case studies show that in recent years low-paid wage work has also increased in a number of developing countries, for example China, Indonesia or the Philippines. What differs, of course, is the context, which is much more dynamic in emerging economies. While low pay in advanced countries is often the outcome of stagnating or decreasing incomes at the bottom, low pay in rapidly growing



developing countries has more to do with the rapid progress of the middle class. This, however, does not mean that low pay is not a policy issue in emerging economies. The labour unrest in Chinese factories in 2010 showed that low-paid workers expect their conditions to improve in line with overall social and economic progress.

### *Policy options*

Wage trends seem to point towards the complex process of global integration, where average wages converge towards the (stagnating) levels of advanced countries and where inequality between top and median, and median and bottom, wage-earners increase almost everywhere. There are exceptions, of course. This trend nonetheless points towards the importance of international coordination on wage-related matters. The collective action problem is particularly acute in the Eurozone, where any country's attempt to link wages more closely to productivity growth immediately leads to a decline in external competitiveness relative to Germany – the star-performer where average wages actually declined by 4.5 per cent over the last 10 years despite a (modest) increase in labour productivity. Outside of the Eurozone, wage compression in China similarly limits the room for wage increases in other emerging economies.

At the national level, countries should be encouraged to support low-paid workers through a combination of minimum wages and income transfers. Minimum wages have the potential to make a major contribution to social justice. In the United Kingdom, for example, the minimum wage was identified in 2010 as the most successful government policy of the past 30 years in a survey of British political experts. In this survey,<sup>2</sup> a successful policy is defined as one which is successfully implemented, has a positive social and economic impact, and can be sustained over time. Perhaps most importantly, the much-feared negative impact on UK jobs failed to materialize. The positive effect of the minimum wage has been compounded by the working tax credit, a system of so-called “in-work benefits” that reduces taxes for the low paid who work for a minimum of 16 hours per week. Both minimum wages and “in-work benefits” are complementary, for without the former, companies may feel that they may quite simply shift some labour costs onto tax credits.

The minimum wage can have a positive impact in developing countries too. In Brazil, a country with a large informal economy, the two policies that are most frequently credited for the sharp reduction in poverty and inequality over the last decade are the Bolsa Família – a programme of cash transfers conditional upon children attending schools – and the national minimum wage

that has been revived since 1995. Even *The Economist* now recognizes that “by boosting domestic demand, these policies have also contributed to economic growth”.<sup>3</sup> In countries such as India, minimum wages are being implemented along with employment guarantee schemes that set the floor for wages. One simulation shows that, if the coverage of minimum wages was extended to all wage-earners in India instead of a select group, it could lift the incomes of 76 million low-paid salaried and casual workers.<sup>4</sup>

## Notes

<sup>1</sup> ILO. 2010. *Global Wage Report 2010/11*, available at: [http://www.ilo.org/travail/areasofwork/lang-en/WCMS\\_DOC\\_TRA\\_ARE\\_WAGE\\_EN/index.htm](http://www.ilo.org/travail/areasofwork/lang-en/WCMS_DOC_TRA_ARE_WAGE_EN/index.htm).

<sup>2</sup> See [http://www.instituteforgovernment.org.uk/pdfs/PSA\\_survey\\_results.pdf](http://www.instituteforgovernment.org.uk/pdfs/PSA_survey_results.pdf).

<sup>3</sup> “Lula’s legacy”, 30 September 2010.

<sup>4</sup> Belser, P.; Rani, U. 2010. *Extending the coverage of minimum wages in India: Simulations from household data*, ILO Conditions of Work and Employment Series No. 26, 2010 (Geneva, ILO).

*Patrick Belser is the principal editor of the ILO Global Wage Report. Before working on wages, he spent five years with the ILO programme on fundamental principles and rights at work and co-edited Forced Labor: Coercion and Exploitation in the Private Economy (Lynne Rienner, 2009). He received his PhD from the Institute of Development Studies in Sussex. Before joining the ILO, he worked at the World Bank in Viet Nam and at the Swiss Secretariat for Economic Affairs in Berne.*

# Reversing a history of exclusion through international labour law

Claire Hobden

Although domestic workers provide crucial care services that make all other work possible, their labour too often is not seen as real work meriting legal protections. This view has resulted in 100 million women and girls left unprotected by national labour law in nearly half the world's countries. Until recently, domestic workers were excluded even from international labour laws, which is symbolic of the slow evolution of social perceptions of women's work generally and of domestic work in particular. Reducing the exploitation of domestic workers will therefore require both normative change to reverse the history of exclusion, and social change to actualize their rights. An international labour standard on the rights of domestic workers is essential to achieve both.

Whether it takes the shape of a binding convention or just a recommendation, an international labour standard for domestic workers is not a stand-alone answer. First, it would provide a *minimum* standard that purports to provide universal coverage; it would constitute a basis on which campaigns could seek more rights. Second, it would gain effect only through implementation, monitoring, enforcement and cultural change. Its use domestically as a campaign tool can increase its usefulness as a labour standard. If won, a binding convention is possibly the most effective way of holding States accountable by providing a baseline standard against which the promotion and protection of the rights of domestic workers can be monitored and enforced.

This article argues first that an international labour standard would extend necessary protections to domestic workers. Second, the standard-setting process provides a compelling campaign tool to mobilize domestic workers and raise awareness among governments and civil society. Domestic workers are then empowered through their participation in drafting international law, and their input helps ensure the relevance of the standard. By virtue of their participation in the policy-making process, domestic workers are exercising their civil and

***By virtue of their participation in the policy-making process, domestic workers are exercising their civil and political rights***

political rights, gaining traction and increasing dialogue with their respective governments at the national level. Finally, their engagement provides an accountability mechanism, as international labour standards provide a role for civil society actors in the implementation of their rights.

### *Inclusion*

The legislative exclusion of domestic workers is arguably one of the more egregious oversights in labour history. Even when arguing that domestic work is the product of global inequality, and that only structural change can transform the industry, we cannot deny that the culture of disrespect and undervaluing of domestic work is supported by legislative silence at the state and international levels. Despite provisions in existing human rights instruments and ILO Conventions that address some of their concerns,

***The culture of disrespect and undervaluing of domestic work is supported by legislative silence***

domestic workers have been left out of labour legislation in about 40 per cent of countries (ILO 2010) and excluded from many ILO Conventions via a flexibility clause that allows governments to exclude certain limited categories of workers upon ratification of a Convention. Such exclusionary practices underline the need to establish domestic worker rights through an international instrument that comprehensively addresses their specific concerns.

The lack of protection demands an international effort to identify good practices and establish a clear human rights framework. When there are no standards, the normative belief is that anything goes, and that there are no repercussions for abuse. Human rights reports denouncing abuses such as unpaid wages, long working hours without rest, insufficient provision of often inadequate food, substandard accommodation, forced labour, confinement, and emotional and sexual abuse provide ample evidence that such practice is the norm, not the exception (Human Rights Watch 2006). Establishing fair labour standards makes a statement to both governments and societies about the value of labour, setting a minimum benchmark for employers and governments.

### *A campaign tool*

Negotiating an international standard is an opportunity for domestic workers to build their movements, to raise awareness and to increase their policy influence nationally and internationally.

Labour movement history shows that a strong campaign builds movement, increases union membership and raises consciousness. In some countries, domestic workers have been organizing locally for decades, using local and

regional policy campaigns to encourage worker participation, to build cross-sector alliances and to alter the discourse around domestic work through the media. Where domestic worker movements gained less traction locally, the ILO discussion on domestic work legitimized their struggles, drawing government and media attention.

Increased buy-in from these stakeholders then guides constituents to shift their perceptions of domestic work, furthering the fundamental social change that must accompany policy change to ensure effective implementation. Global multimedia dissemination of campaigns stimulates thinking about a topic that has remained invisible for centuries. Governments, and international and domestic actors, thus learn about domestic work, and are more likely to address the issues domestically.

The international standard-setting process also catalysed transnational domestic worker organizing by providing a common platform. Such collaboration is imperative to protect migrant domestic workers in particular, providing worker organizations in both sending and receiving countries with information of use to migrating domestic workers.

To be clear, the campaign for an ILO Convention for domestic workers has not been a campaign for the sake of having a campaign. Although it serves to engage members and build networks, the goal remains establishing and implementing robust labour laws. Moreover, a successful campaign lifts the overall energy of a movement, inflating its power as a domestic force to be reckoned with.

### *Empowerment*

Including domestic workers in negotiating an international labour standard serves to empower historically disenfranchised women and to ensure that the standard is relevant to the sector. Moreover, an ILO instrument would grant domestic workers the right to form or join trade unions, which is still denied to them in many countries.

Where historically they lacked access to international legislative processes, domestic workers had the rare opportunity to bring their demands directly to the international negotiating table at the International Labour Conference (ILC) through the organizing efforts of working women, mostly migrants from the South, via the International Domestic Worker Network (IDWN) and in partnership with the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Association (IUF). Although the ILO standard-setting process is tripartite, providing voting rights to governments, employers' associations and national trade union centres, domestic workers are not yet unionized in most countries, and therefore are not

always represented in national trade union centres with voting rights. However, thanks in part to the lobbying efforts of the IUF and IDWN, a number of trade union centres included domestic workers in their delegations, giving them a voice in the deliberation.<sup>1</sup> Shaping the international legislative agenda and participating in the discussion was a huge success for domestic workers and is a testament to the movement they have built. Their alliances with trade unions and other actors also strengthened their movement, building a strong foundation from which to implement and expand the standards achieved.

The ILC campaigns also empowered domestic workers domestically. Once added to the ILC agenda, domestic workers met with their respective labour ministries to sensitize government officials to their specific concerns and to provide guidance on what rights they needed. Domestic workers in, among other countries, Brazil, South Africa and the United States<sup>2</sup> began consulting with their Governments months before the ILC, arguably shaping the stances of these Governments that led the argument for a robust instrument.

Domestic worker participation had six results: it raised their profile at the national and international levels; substantiated the ILC debate; amplified their voices; increased their knowledge of international instruments; and built their movement through collaboration with trade unions. Finally, it empowered domestic workers locally to dialogue and cooperate with governments in implementing domestic worker rights. To take just one example, as a result of the partnerships forged in the preparatory phases of the ILC, the US Department of Labor is collaborating with domestic worker organizations on regulatory reforms to improve domestic worker rights and protections.<sup>3</sup>

### *Accountability*

Input from domestic workers leads not only to relevant legal standards, but also structures a role for domestic workers to hold employers and States accountable. International labour and human rights law evolved in part to protect individuals within a State's borders, and to provide guidance to States in enacting laws and regulations. In turn, States are expected to ensure that employers remain compliant. The vulnerable status of domestic workers in most countries underlines the role of international law and accountability. International labour standards allow international institutions and domestic non-State actors to monitor the conditions of domestic workers, and, in cases of non-compliance, the ILO supervisory mechanisms provide workers' (and employers') organizations with the right to comment, make representations and lodge complaints against their governments. As such, an international instrument is an important implementation tool for domestic workers.

## Conclusion

Let us momentarily take the perspective that, in a world free from inequality, there would be no need for domestic workers. The vast majority of the world sadly is far from such a utopia. Structural and economic overhaul is not likely to occur soon; and the social change needed to shift perceptions of domestic work will take generations to evolve. Meanwhile, 100 million women and girls worldwide suffer from a lack of protection. This is the immediate unjust reality that we must begin to address through international labour standards.

## Notes

<sup>1</sup> Such was the case for the delegations of Brazil, Jamaica, the Netherlands, Peru, South Africa, Trinidad and Tobago, the United Kingdom and the United States.

<sup>2</sup> Such consultations also took place in Indonesia, Jamaica, Mexico, Namibia, Nepal, Peru, Philippines, Trinidad and Tobago, and the United Republic of Tanzania, with varying results.

<sup>3</sup> <http://www.nationaldomesticworkeralliance.org/>.

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*Claire Hobden is a junior project officer at the Bureau for Workers' Activities of the ILO. She was previously the organizational development coordinator at Domestic Workers United.*

# Talking about an energy and jobs revolution

Kumi Naidoo

Creating decent new jobs, fighting poverty and curbing catastrophic climate change have historically been seen as three distinctive challenges, pursued by a trio of different movements: trade unions, development organizations and environmentalists. This should no longer be the case. In the past few years, as climate change has become ever more of a pressing issue and the international financial institutions have once again proved incapable of creating employment or fighting poverty, people and organizations have realized that it is in our collective interest as citizens of the world to pursue a green industrial policy. This should start with a re-evaluation of the way we produce and distribute energy.

*It is in our collective interest as citizens of the world to pursue a green industrial policy*

Greenpeace's Energy [R]evolution, developed in conjunction with over 30 scientists and engineers worldwide, proposes a radical shift in the way the world produces, distributes and ultimately consumes energy. It is a roadmap for moving energy production closer to the point of use. Under the current system, we produce large amounts of energy at a few centralized locations and send that energy over very long distances to where it is consumed. This system is inflexible, often wasteful and leaves large swathes of the world's population unserved and without access to any energy.

In addition to being centralized geographically, energy production is also centralized in terms of influence, with control lying in the hands of a few very powerful energy companies. All too often, these companies operate as monopolies, dictating availability, prices and access. Because energy corporations do not cater to the poor, about a third of the world's population (over 2 billion people) lives with little or no access to reliable energy services. For cooking and heating, many people must depend almost exclusively on burning biomass, a labour-intensive process often detrimental to health and a scourge for the environment.



Bringing energy to these parts of the developing world would not only help us address the ongoing issue of poverty but, if done in the right way, we would also be a big step closer to a fairer and more sustainable future. Such a move would also help curb global warming and create millions of new jobs along the way.

The good news is that an Energy [R]evolution is well within our grasp. If we make the right changes over the next 10 years or so, we will be able to redesign the outmoded energy system we rely on in most parts of the world – and move to a future powered in most part by the sun, the wind and the natural forces of the Earth. This would create benefits not just for the environment, but for workers as well.

The Energy [R]evolution calls for decentralized energy, which comes wherever possible from renewable sources such as wind or solar energy and is connected to a local distribution network system. This local “micro-grid” supplies homes and offices, rather than the high-voltage transmission system. The scenario would see a huge proportion of global energy produced by such decentralized energy sources – supplemented, as needed, by large offshore wind farms, concentrating solar power (CSP) plants in the sunbelt regions of the world, and other renewable sources of energy by 2050. Creating a closer proximity of electricity-generating plants to consumers will allow any waste heat from combustion processes to be piped to nearby buildings, a system known as cogeneration or combined heat and power. This means that nearly all the input energy is finally put to use.

***The Energy [R]evolution ...  
could create up to 12.5  
million jobs by 2015***

monopolies. Properly implemented, the Energy [R]evolution would also create millions of new jobs starting with the global power supply sector, which could create up to 12.5 million jobs by 2015 (4.5 million more than the current projection). A significantly increased uptake of renewable energy would create over 8 million jobs by 2020 in that sector alone, four times more than today.

The potential boost in employment can only occur with aggressive renewable energy policy and targets. Greenpeace calls for a range of measures from governments to safeguard against detrimental changes to the employment balance by providing jobs and retraining in communities affected by this transition. Doing nothing means we will see significant losses in employment in the fossil fuel sector, and there will not be an expansion in clean energy production to compensate. With renewable energy investment, it is possible to

provide more replacement jobs to counteract the losses, in areas such as wind turbine and solar PV manufacturing, geothermal drilling, solar thermal plant constructions, wave energy installations, energy efficiency, and many other cleaner employment alternatives.

If we look at the power sector as a whole, the picture is equally encouraging: if we radically redesign our energy systems as outlined above there will be 3.2 million (or over 33 per cent) more jobs by 2030 in the global power supply sector. In Asia, we would see 650,000 power sector jobs by 2015, as compared to 610,000 under a business-as-usual scenario. In India, we would see around 1 million power sector jobs – compared to 710,000 under a business-as-usual scenario. In addition to quantity, the quality of many of these new jobs is impressive. Employment in the sectors that would come to exist, or would considerably expand, through an Energy [R]evolution will often be of a much higher standard than those created by the oil industry, for example. They will be a world away from the risks and dangers emanating from the nineteenth century technology so much of the world still relies on for its energy production. By shifting away from dirty, deadly energy sources such as fossil fuels and nuclear energy, we will create many new jobs that are clean, safe and healthy.

For developing countries, this presents a great opportunity to catch up both financially and technologically with the more developed world. By implementing new forms of energy, these countries could leapfrog the era of dirty energy that the world's developed countries are just emerging from – and move straight to clean and sustainable energy, thereby avoiding rising oil prices, dwindling fossil fuel reserves and the ongoing dangers that come with these types of energy. By embracing the technologies of the twenty-first century, they would not only be able to reduce their CO<sub>2</sub> emissions drastically and play an important part in the global fight against climate change; they could also set themselves on a pathway of economic growth, decoupled from a dependence on fossil fuels and respecting the natural limits of the planet we all share.

The timing couldn't be better: many power plants in industrialized countries, such as the United States, Japan and those of the EU, are nearing the end of their proposed lifespan, with more than half of all operating power plants already over 20 years old. At the same time, countries such as Brazil, China and India are looking to satisfy the growing energy demand created by their expanding economies.

But the Energy [R]evolution won't happen by itself. We need governments and industry around the world to implement the right policies to make substantial structural changes in the energy and power sector. Unfortunately,

few of our current leaders – political or business – have seen any advantages for themselves of promoting a revolution in the way we treat the planet.

Given that change is in the interest of the people and the planet and not necessarily of Big Business, it is going to take the will of millions of us around the globe to force those in power to create the political infrastructure for change. We are going to need an international movement of honest men and women that encompasses environmental organizations, trade unions, development organizations and many others who haven't actively thought about how the environment touches all of our lives.

## Note

More information about Greenpeace's proposal for an Energy [R]evolution is available at <http://www.greenpeace.org/energyrevolution>.

*Kumi Naidoo is the Executive Director of Greenpeace International. He began his career as an activist as a youth leader in South Africa's battle against apartheid. He then became founding Executive Director of the South African National NGO Coalition (SANGOCO) before heading CIVICUS: World Alliance for Citizen Participation from 1998 to 2008. He was the founding Chair of the Global Call to Action against Poverty (GCAP), and served as Chair of the civil society alliance "Global Campaign for Climate Action" (GCCA), of which Greenpeace was a founding member, and as a board member of the Association for Women's Rights in Development.*



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For any further questions,  
please contact Nicolas Pons-Vignon  
([Nicolas.Pons-Vignon@wits.ac.za](mailto:Nicolas.Pons-Vignon@wits.ac.za))

*There is an alternative* and the Global Labour Column perform an invaluable service in enlightening those of us not blessed with recondite economic expertise. They offer ways to understand how a crisis of global proportions seems to have only benefited the perpetrators, and, far from generating resistance, has further dismantled the laboring classes.

*Michael Burawoy, Professor, University of California Berkeley, and author of The extended case method*

The mainstream economics discourse has failed workers north and south. Nevertheless, thanks to the strength of vested interests and ideological beliefs, it is still there dominating public debate and policy choices. *There is an alternative* challenges these misguided policies, analyses the shortcomings of the current system, and provides new ideas and proposals for the necessary changes. A valuable source of inspiration for trade unionists around the world.

*Leroy Trotman, General-Secretary of the Barbados Workers' Union*

**S**ince the start of the global economic crisis, economists and trade unionists have sought to engage in dialogue with government and business, hoping to arrive at the adoption of balanced policies that would deliver an equitable and sustainable recovery. But some years on, countries have failed to break with the economic regime that caused the crisis, and in many, austerity programmes are being adopted and social and labour rights are under attack.

Achieving a meaningful reduction in inequality and the power of finance requires both the formulation of convincing policy alternatives and the determination to see them realized. The short articles here, from the Global Labour Column, show that one-dimensional thinking has been a major reason for the severity of the crisis. The contributions give an insightful overview of current labour struggles around the world as well as the institutional measures that have proven successful. The programme the authors propose is ambitious, as it implies reversing deep trends such as the exclusion of many workers from wage negotiations, growing casualization and increasing wage inequality, but such ambition is necessary if there is to be an alternative.