Chapter 9

Responding to the Underlying Causes of the Crisis: Why Labour Should Not Pay

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Introduction

The International Labour Office (ILO) estimates that after three years of continuous crisis conditions in global labour markets and against the prospect of a further deterioration of economic activity, there is a backlog of global unemployment of 200 million.[2] There are an added 27 million unemployed people in the global economy, thanks to the crisis.[3] The outlook for global job creation has been worsening. ILO's baseline projection shows no change in the global unemployment rate between now and 2016. In light of these employment conditions, it would seem logical that measures would be undertaken at national and international levels to ease the consequences of the crisis for workers. Instead, austerity measures implemented in Europe in particular are increasing the burden of the crisis for labour.

The current GFC can be thought of as a three-stage crisis. The first stage was the initial shock, beginning in the US and spreading quickly thanks to the interconnectedness of financial markets. This was met by coordinated fiscal and monetary stimulus in many countries around the world. In some cases, up to 90 per cent of additional public spending went into bailing out banks.[4] In the second stage, higher public deficits and sovereign debt problems – seen especially in Europe – led to increased austerity measures in an effort to buoy capital markets. Fiscal stimuli began to diminish, and advanced economies concentrated on quantitative easing monetary policies. The combined impact appears to have been a weakening of both GDP growth and employment. The third stage might be thought of as a labour market crisis. Although growth has occurred in many countries, unemployment persists. Labour market imbalances are becoming more structural, and therefore more difficult to eradicate. This is associated with an increased risk of a second dip in growth, intensifying the labour market distress that has deepened since the onset of the crisis. In this third stage of the crisis, policy space has been significantly restricted, making it difficult to halt, or even slow, the further weakening of economic conditions. Weak economic conditions in Europe and the US are putting pressure on economies worldwide, and threatening the gains made in developing countries in recent decades in the reduction of poverty.

This chapter makes three arguments. The first is that labour is incorrectly carrying responsibility for the debt crisis. There are numerous explanations for the US-led financial crisis of 2007 and the sovereign debt crisis of 2009/10 in Europe. None focuses on labour as the cause. Yet labour has been targeted in austerity measures that aim to re-balance national budgets and reduce indebtedness. The second

1 Shelley Marshall, Monash University
2 ILO, 'Global Employment Trends 2012' (Geneva, ILO 2012), 9.
3 *Ibid.*
4 *Ibid*, 12.

argument is that given that inequality is seen by some to be a cause of the crisis, and increased inequality has certainly been an outcome of the crisis, measures should be put in place to increase equality. Labour law is an important tool for reducing inequality, and if designed appropriately, this can occur in a reflexive and responsive manner. Instead of using labour law to this end, conditionalities currently associated with EU bailouts are demanding greater labour market flexibilities using blunt tools, together with harsh austerity measures, which are likely to intensify long-term unemployment and inequality rather than reduce it. The third argument is that the reason that austerity is being chosen over other policy options is due to the dominance of financial markets. So much economic policy today is focused on 'restoring confidence in the markets', yet, as Wolfgang Streeck has recently commented, it is now impossible to restore the confidence of the financial markets and the majority of citizens at the same time.[5] Until financial interests dominate nations less, it seems likely that labour will continue to carry the burden of a crisis it was not responsible for. If commentators who argued that inequality is one of the causes of the crisis were right, current trends would indicate that continued instability in the future is likely.

The argument is made in a number of stages. Part 1 of the chapter examines contrasting views about the causes of the 2007 US financial crisis, and the 2009/10 European sovereign debt crisis. Part 2 presents data on the effects of the crisis on labour. It shows that inequality has increased, although the wealth of the top quintile was reduced by financial market losses. Unemployment and informal work have also increased dramatically. Part 3 briefly assesses what role labour law might play in promoting equality, employment growth and a shift from the informal to the formal labour market. Part 4 concludes by examining why these tools are not being employed by nation states following the crisis, and why other measures have been preferred.

Part 1: Causes of the 2007 and 2009/10 financial crises

The re-globalisation of capital markets since the 1970s has been painful, pockmarked by periodic crises spanning at times a multitude of countries. These include the inflation crisis of the 1970s, the public debt crises of the 1980s, the private debt crises of the 1990s and early 2000s, finally exploding in the US private debt crisis of 2008 and rolling into the European sovereign debt crisis of 2010.[6] Explanations for crises vary, and different understandings of the causes of crises lead to different policy prescriptions regarding how to lift a national economy out of the crisis. This section examines various explanations for the current financial crisis.

Certain new dimensions played important roles in the severity and global scale of the ongoing crisis, compared with previous crises, particularly with respect to its transmission and amplification. Although the crisis is not unusual for having been preceded by financial liberalisation, the extent of financial liberalisation and the failure of financial regulation are particularly stark. The primary trend that preceded the crisis was the expansion of the financial sector, along with widespread use of complex and opaque financial instruments. This factor could be responsible not only for the bust, but also for the extraordinary character of the current recession in both the US and Europe. Over time, financial markets grew ever larger relative to the non-financial economy. Important financial products became more complex, opaque and illiquid, and system-wide leverage exploded.[7] In mid-2008, the Basel-based Bank of International Settlements estimated that the global outstanding derivatives reached US$1.14 quadrillion: US$548tn in listed credit derivatives plus US$596tn in notional/OTC derivatives.[8] By comparison, the GDP of all the countries in the world was only US$60tn.[9] Derivative financial instruments designed to hedge risk, became themselves the source of volatility.

The interconnectedness among financial markets, nationally and internationally, with the US at the core, had increased in a short period before the crisis.[10] Capital account openness and financial market

5 W Streeck, 'Markets and Peoples: Democratic Capitalism and European Integration' (2012) New Left Review, 62.

6 *Ibid*, 64.

7 J Crotty 'Structural causes of the global financial crisis: a critical assessment of the "new financial architecture" (Essay)' (2009) Cambridge Journal of Economics.

8 Derivatives are financial products with value that stems from an underlying asset or set of assets; what some call 'bets on bets'.

9 V Popov, 'Why Transition Economies Did Worse than Others in 2008-09 Recession' 1 March 2011, available at: dx.doi.org/10.2139/ssrn.1893789 accessed 23 October 2012.

10 S Claessens, M A Köse and M E Terrones 'The Global Financial Crisis: How Similar? How Different? How Costly?' (2010) Working Paper 1011, March 2010, Tüsiad-koç University Economic Research Forum working paper series.

reforms led to massive increases in cross-border gross positions, especially among OECD countries. The household sector also played a central role. Most previous episodes of financial distress stemmed at least partially from problems with state borrowing (eg, Latin America's debt crisis of the 1980s) or the corporate sector (eg, the Asian crisis). The 2007 US crisis, however, largely originates from overextended households, in particular with respect to subprime mortgage loans. These new elements combined to create unprecedented sell-offs in the autumn of 2008 and resulted in the GFC.

Evidence shows that past crises often followed credit expansions triggered by financial liberalisation that lacked necessary regulatory and prudential reforms to control the liberalisation. The poor sequencing of regulatory reforms has also been blamed for past crises.[11] What is unusual about the current crisis is the breakdown in the effectiveness of financial regulators because of unhealthy turf competition between various supervisory agencies in some countries. Conflicts of interest by rating agencies, who were relied on by state agencies and private investors also exacerbated problems.[12] In other respects, the crisis was like others. Relative wages in the financial sector (after controlling for education, experience and other usual determinants) in recent years were equally unusually high – as high as they were only in the 1930s.[13] The exuberant pattern of asset prices in the US and other advanced countries prior to the current crisis is reminiscent of those observed in earlier major financial crises episodes in the post-war period. The housing price boom in the United States ahead of the current crisis was, however, unusual both in its strength and duration.[14] The house price boom was partly fuelled by low (short and long-term) interest rates resulting from abundant global liquidity and large demand for safe assets. The pricing of derivative instruments was often based on a continuation of increasing house prices that facilitated the refinancing of underlying mortgages.

Governments around the world responded to the financial crisis with stimulus packages and massive bailouts of banks, costing great amounts of taxpayer funds. The total amount of stimulus in the G20 was estimated to cost around US$692bn for 2009, which was about 1.4 per cent of their combined GDP and a little over 1.1 per cent of global GDP.[15] These bailouts and stimulus packages put many countries into great debt. This debt was often funded through the purchase of bonds. Between 2009 and 2010, international bond markets began to price in the growing risks associated with the debt of Greece, Ireland, Italy, Portugal and Spain (GIIPS). Bond markets required increasingly higher interest rates to buy debt. Eventually, these interest rates reached such high levels that they became no longer sustainable. The governments in question were forced to ask for support from the EU and the IMF. These organisations obliged but made their support conditional on tough austerity programmes that would enable these countries to rebalance their budgets. Under EU agreements, GIIPS countries cannot address these problems by devaluing their currencies (the value of the euro is determined at a eurozone level, not a national level) and have few alternative tools to revamp economic growth. International financial markets are unwilling to lend to them, except at very high interest rates, because they doubt their ability to produce the economic growth necessary to repay the loans. Instead, the GIIPS are left with 'internal devaluation' strategies aimed at reducing prices relative to other countries, in order to make the countries more competitive and boost growth.

Except in the case of Greece, fiscal deficits are not seen to be the consequence of excessive welfare state spending or of over-regulation of the labour market within countries most affected by the crisis. This begs the question, then, why the favoured way out of it is the retrenchment of the welfare state and removal of the floor of social rights.[16] It cannot be justified based on factors that are understood to have caused the crisis. The answer would appear to lie in political economy dynamics rather than sound policy analysis based on explanations for the crisis and subsequent recession.[17]

11 *Ibid.*

12 *Ibid*; see Crotty 2009 (n 7 above), for a detailed description of key structural flaws in the financial institutions and practices of the neoliberal era that helped generate the current crisis.

13 *Ibid* 9, 6

14 See n 10 above.

15 A comparative table of 2009 spending can be found at www.brookings.edu/~/media/Research/Files/Articles/2009/3/g20%20stimulus%20prasad/03_g20_stimulus_prasad_table.PDF, last accessed 27 March 2013.

16 S Deakin, 'The Sovereign Debt Crisis and European Labour Law' (2012b) Industrial Law Journal 41, 251–253.

17 K Armingeon and L Baccaro, 'Political Economy of the Sovereign Debt Crisis: The Limits of Internal Devaluation' (2012) Industrial Law Journal 41, 254.

Explanations for the crisis based on income inequality

A number of commentators blame rising inequality and the decline of labour's share of GDP for various policy decisions that fuelled the crisis. In his 2010 book, *Fault Lines*, Raghuram Rajan, former chief economist at the IMF, argued that rising inequality in the past three decades led to political pressure for redistribution.[18] For reasons of political expedience, this was delivered in the form of subsidised housing finance rather than through increases in real wages or other transfers. Low-income households, which otherwise would not have qualified, received improved access to mortgage finance. The resulting lending boom created a massive run-up in housing prices and enabled consumption to stay above stagnating incomes. The boom reversed in 2007, leading to the banking crisis of 2008. Other commentators have come out in support of this thesis. Nobel Laureate Joseph Stiglitz argues inequality has led to a concentration of power in the hands of the few.[19] This powerful minority use their leverage to make gains at the expense of the majority, through 'rent seeking'. Concentration of power in private hands can be just as damaging to the functioning of markets as excessive regulation and political control. It was this concentration of power that resulted in financial regulations being reformed in such a way that allowed imprudent investment and the creation of asset bubbles.

Another thesis is that rising inequality contributed to the crisis because it led to unsustainable consumption and debt in households whose disposable income was dropping or growing slowly. The OECD observes that growing inequality was a common trend across the advanced economies between the mid-1980s and late 2000s.[20] Labour's share of national income has fallen across most major advanced economies in the last 20 or so years.[21] Although in some countries, for example, China, India and Brazil, consumption increased thanks to the sustained growth in household income and savings, in the US and elsewhere, it increased thanks to the growth in household debt.[22]

This increased inequality was accompanied by a decoupling of profits and investments, as shares of GDP. In the US since the 1980s, for example, non-residential private investment has been decreasing while profits have been increasing (with an opposite trend in 2003). Business has not been reinvesting profit at the same rate as occurred in the post-war period. In 2006, the year before the crash, the share of recorded profits as percentage of GDP was more than four times non-residential investment.[23] Instead of being invested, it is speculated that the profits were paid to top income earners in the form of capital income such as shares. This contributed to inequality, with top quintile wealth increasing at a far higher rate than other quintiles.

Against this thesis, some argue that the rise in inequality and pro-business policies that resulted in the deregulation of the financial industry may have been a reaction to the slowdown of economic activity, rather than its cause.[24] Empirical studies also throw doubt on the theses that inequality caused the crisis. Michael Bordo and Christopher Meissner[25] used data from 14 advanced countries between 1920 and 2000 to test the hypothesis that inequality causes crises. They find very little evidence linking credit booms and financial crises to rising inequality. Bordo and Meissner conclude that while inequality often ticks upwards in the expansionary phase of the business cycle, this factor does not appear to be a significant determinant of credit growth once they condition on other macroeconomic aggregates.

This part of the paper has found that there is broad consensus that the crisis was in large part caused by financial liberalisation, the spread of financial markets into previously unmarketised areas, the use of increasingly complex and risky instruments and a failure of financial regulation. The evidence on whether inequality is a cause of the crisis is mixed. Regardless of the causes of the crisis, it is clear that the crisis and the subsequent recession have had dire consequences for labour. The evidence concerning the effect of the crisis and the recession on labour is presented in the next section.

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18 R Rajan, *Fault Lines* (Princeton University Press 2010).

19 J Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (WW Norton, 2012).

20 OECD, 'Growing Income Inequality in OECD Countries: What Drives and How Can Policy Tackle It?' Forum 2011.

21 M Florio, 'The Real Roots of the Great Recession' (2011) International Journal of Political Economy 40, 5–30.

22 *Ibid.*

23 *Ibid.*

24 D Ben-Ami, 'Inequality a symptom not a cause' (2012) Fund Strategy 24.

25 M Bordo and C Meissner, 'Does Inequality Lead to a Financial Crisis?' (forthcoming) Journal of International Money and Finance.

Part 2: The effect of the crisis on labour

This part of the paper shows that the crisis has had harsh consequences for workers around the world. Unemployment has grown dramatically, particularly among younger people and low-skilled workers. Precarious and informal work has increased, leaving workers more vulnerable to economic shocks. Globally, the convergence between poor countries and rich countries has slowed down. Although growth and poverty reduction have continued at a fast rate in Asia, other parts of the world have not fared as well. There are signs that Asia's economies may now be slowing down, as the effects of stimulus wear off and the slow global economy impacts negatively on growth.

Unemployment increases and labour force participation decreases

The ILO has voiced alarm over the extent of unemployment following three years of crisis conditions: it estimates that there 200 million unemployed people globally, an increase of 27 million since the start of the crisis. The number of unemployed around the world increased by 5.8 million in 2008 and then surged by more than 21 million in 2009, an increase from a rate of 5.5 per cent to 6.2 per cent.[26]

The outlook for global job creation is worsening, rather than improving. According to the ILO's baseline projections, no change in the global unemployment rate is likely between now and 2016, suggesting that it will remain at six per cent of the global labour force. This would lead to an additional three million unemployed around the world in 2012, or a total of 200 million, rising to 206 million by 2016. If downside risks materialise and global growth falls to below two per cent in 2012, global unemployment would rise more rapidly to more than 204 million in 2012, at least four million more than under the baseline scenario, with a further increase to 209 million in 2013, six million more than under the baseline scenario.[27]

One reason the global unemployment rate continues to increase is because unemployment is a 'lagging indicator'. When there is an economic downturn, it usually takes several months before the unemployment rate begins to rise. Once the economy starts to pick up again, employers usually remain cautious about hiring new staff and it may take several months before unemployment rates start to fall.

The unemployment rate differs considerably from country to country, and between regions. In the current European debt crisis, the countries that have preserved employment include Austria, Germany and the Netherlands. In contrast, Estonia, Ireland, Latvia and Spain have experienced extreme employment loss. The Spanish market has been one of the hardest hit in the European crisis: in December 2009, unemployment rose to almost 20 per cent.[28] In March 2012, Eurostats showed the lowest unemployment rates were recorded in Austria (four per cent), the Netherlands (five per cent), Luxembourg (5.2 per cent) and Germany (5.6 per cent), and the highest rates in Spain (24.1 per cent) and Greece (21.7 per cent in January).[29] Currently, some 35 per cent of all jobseekers in the developed economies and EU region have been unemployed for 12 months or longer.[30] The longer people are unemployed, the more their job chances are eroded. Qualifications and skills erode over time, making it harder for firms to find the right people. This presents considerable policy challenges for reducing unemployment. Reactivating long-term unemployed and inactive workers entails considerable fiscal costs, and is hard to achieve.

When people have been unemployed for a long time, they often stop seeking work and stop participating in the workforce, creating a gap between unemployment figures and workforce participation figures. In many countries there is evidence of an accelerated decline in labour force participation. The ILO estimates that in the five years from 2002 to 2007, the global labour force participation rate declined from 65.1 per cent to 64.8 per cent, a drop of 0.3 percentage points. In the four years from 2007 to 2011, the rate dropped to 64.1 per cent, a decline of 0.7 percentage points. The pace of decline in labour force participation at the global level since 2007 has been two and-a-half times greater than in the five years leading up to the crisis.[31] In the world as a whole, there were nearly

26 See n 2 above, 31.
27 *Ibid.*
28 W Vaughan, Work Inequalities in the Crisis: Evidence from Europe (Geneva, ILO 2011), 5.
29 http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics, last accessed 27 March 2013.
30 See n 2 above, 47.
31 *Ibid*, 33.

29 million fewer people in the labour force in 2011 than would have been expected based on pre-crisis trends.[32]

Age dimensions of unemployment

Unemployment is not experienced equally across populations. In general, during crises, unemployment affects youth and low skilled workers to the greatest extent. Globally, young people are nearly three times as likely as adults to be unemployed. There are various reasons for high youth unemployment. This may in part reflect the principle of last in, first out – the 'seniority principle' – that has generally been applied by employers in their efforts to shed part of their labour force during recessions. In some countries, such as Sweden, it is even stipulated in the Labour Code. It also reflects the propensity of youth to be employed on temporary contracts, and the fact that employers have found it easier not to renew such contracts or to shed temporary workers.

In 2011, the ILO estimates that 74.8 million youth aged 15–24 were unemployed, an increase of more than four million since 2007.[33] The global youth unemployment rate, at 12.7 per cent, remains a full percentage point higher than the pre-crisis level. In addition, an estimated 6.4 million young people have given up hope of finding a job and have dropped out of the labour market altogether. Even those young people who are employed are increasingly likely to find themselves in part-time employment and often on temporary contracts. In developing countries, youth are disproportionately among the working poor.[34]

Interestingly, while older workers – between 50 and 60 years of age – are traditionally a vulnerable group in the labour market, they have been less affected by employment adjustments in a number of countries. This may reflect the lower reliance on early retirement schemes, due to changes in legal retirement ages in a number of countries.

Gendered dimensions of unemployment

Women are normally worst hit by unemployment during financial crises, but the figures are mixed for the current crisis in Europe. The annual average unemployment rates for 2009 and 2010 were slightly higher for men (9.1 per cent and 9.7 per cent respectively) than for women (nine per cent and 9.6 per cent); in 2011 however, unemployment for males slightly declined in the EU-27, while that of women continued to increase such that the rate for males was again lower at 9.6 per cent than that for females (9.8 per cent).[35]

An explanation for these mixed results is that the initial impact of the crisis was felt on male-dominated sectors such as construction and manufacturing. On the other hand, women employed in male-dominated sectors have often been the first to be dismissed. The reduction in employment for women later in the crisis can be explained by the fact that the second wave of job losses has been in female-dominated sectors such as the public sector.[36]

Inequality increases

Today in advanced economies, the average income of the richest ten per cent of the population is about nine times that of the poorest ten per cent.[37] A sustained period of strong economic growth has allowed emerging economies to lift millions of people out of absolute poverty. But the benefits of strong economic growth have not been evenly distributed and high levels of income inequality have risen further. Among the BRICs, only Brazil managed to strongly reduce inequality, but the gap between rich and poor is still at 50 to one, five times that in the OECD countries.[38] Although the largest part of this increase in inequality was due to top earners 'flying away' from the majority, another part was due to the so-called 'collapsing bottom', where the distance between median workers and

32 *Ibid*, 34.
33 *Ibid*, 9.
34 *Ibid*, 9.
35 http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics, last accessed 27 March 2013.
36 See n 28 above, 7.
37 OECD, Divided We Stand: Why Inequality Keeps Rising (Paris, OECD 2011).
38 *Ibid.*

low-paid workers has increased.[39] Various studies have found that financial crises are followed by rising inequality, compared with crisis related to collapse in consumption or GDP.[40] The author was unable to find reliable data to show the effect of the current crisis on inequality. One reason for this is that different stages of the crisis have had different effects. Initial financial shocks resulted in losses for the top quintile, promoting equality. Employment losses and wage losses in the later stage of the crisis and recession have once again resulted in increases in inequality, with considerable differences between countries.

Informal and temporary work increases

The crisis has led to an increase in the number of workers in informal work. The share of informal employment remains high, standing at more than 40 per cent in two-thirds of emerging and developing countries for which data are available.[41] The ILO estimates that the number of 'own-account workers' and unpaid family workers increased by 136 million since 2000, with 1.52 billion vulnerable workers of this type in 2011.[42] The increase in informal work has been worst in Sub-Saharan Africa, accounting for nearly 70 per cent of all employment growth in the region since 2007.[43] Informal work is also high in parts of Central and Eastern Europe. According to World Bank estimates based on the latest available labour force survey in Kazakhstan, informal employment represented 33.2 per cent of total employment in 2009.[44]

Evidence from previous crises suggests that once individuals move to the informal sector it is difficult for them to return to regular employment.[45] In some countries, informality returns to pre-crisis levels after two to three years, while others experience increased informality levels persisting even after five years.[46]

Incomes are generally much lower in the informal economy than the formal economy, and informal economy workers generally receive no health benefits, work-related childcare, sick leave or pensions. If treated unfairly by employers, they have no recourse to the courts, because the employment relationship is rarely documented.[47] The most undesirable of work practices are disproportionately found in informal economies.[48]

The crisis in Europe has further polarised the workforce. Workers at the periphery of the workforce have been the first to be affected by employment cuts, with the core labour force remaining protected, at least in the short term. For instance, nearly 50 per cent of employment losses in France concerned temporary workers, and about 90 per cent of them in Spain.[49] At the same time, part-time contracts have increased for both men and women, as a number of countries and enterprises have encouraged reductions in working hours, leading to a shift of workers from full-time to part-time work to adjust to the economic slowdown.[50]

Slow in convergence in living standards across the world

A further impact of the GFC is that the catch-up in terms of living standards and productivity between the developing and developed world is slowing. As global economic growth is slackening, so too is

39 See n 2 above.
40 A B Atkinson, and S Morelli, 'Economic Crisis and Inequality' (2011) Human Development Research Paper, 2011/06, UNDP.
41 ILO and International Institute for Labour Studies, 'World of Work Report 2012' (Geneva, ILO 2012).
42 See n 2 above, 42.
43 *Ibid.*
44 J Rutkowski, 'Promoting Formal Employment in Kazakhstan' The World Bank, 2011.
45 C Williams and J Windebank, *Informal Employment in the Advanced Economies: Implications for Work and Welfare* (Routledge, 1998).
46 R Torres, 'World of Work Report 2009: The Global Jobs Crisis and Beyond' (Geneva, ILO and International Institute for Labour Studies 2009).
47 K Sankaran, 'Labour Standards and the Informal Economy in South Asia: Need for a Rights Centred Approach' (2003) Delhi Law Review 24, 10; and K Sankaran, 'Legislating for the Informal Economy: The Challenges for Labour Law' (2008) Africa IIRA Congress 2008, Cape Town.
48 Cid, J D T S A M D, 'Decent Work and the Informal Economy in Central America' (2003) In, Department ILOPI (ed); S Freije, 'Informal Employment in Latin America and the Caribbean: Causes, Consequences and Policy Recommendations' In: Inter-American Development Bank S D D, Social Development Division (ed) Labor Markets Policy Briefs Series, 2001; ILO, 'ILO: Women and Men in the Informal Economy: A Statistical Picture' (Geneva, ILO 2002).
49 See n 28 above, 5.
50 *Ibid.*

the convergence of living standards across countries. One significant reason for this is productivity differences between the developing and developed world. Outside Asia, developing regions have lagged behind developed economies in labour productivity growth, raising the risk of a further divergence in living standards and limiting prospects for poverty reduction. Adjusted for differences in prices across countries, the average worker in a developing country produces less than one-fifth of the output of the average worker in a developed country.[51] Asia accounted for all of the catch-up in levels of labour productivity between the developing and developed world between 1991 and 2011, with other developing regions lagging behind.[52]

While working poverty has been on the decline, there has been a marked slowdown in progress since 2008. The ILO's projection based on pre-crisis (2002 to 2007) trends in the incidence of working poverty shows that the reduction of poverty has slowed, with a difference of 1.6 percentage points. This amounts to 50 million more working poor in 2011 than projected based on pre-crisis trends. Similarly, there are an estimated 55 million more workers in 2011 living with their families below the US$2-a-day poverty line than expected on the basis of pre-crisis trends.[53] Global aggregate is heavily influenced by the dramatic decline in extreme working poverty in the East Asia region, where, owing to rapid economic growth and poverty reduction in China, the number of poor workers has declined by 158 million since 2000 and by 24 million since 2007. Nearly 30 per cent of all workers in the world – more than 910 million – are living with their families below the US$2-a-day poverty line.[54] These workers and their dependants remain highly vulnerable to further economic shocks.

Part 3: Policy measures to address these problems

What can be done to address the effects of the crisis on workers and promote job growth? This part of the paper will focus on labour market regulation measures, and comment briefly on two other policy areas that require attention. Rather than focus on specific policies, this part of the paper discusses the role of institutions at the level of principle, or 'function'. It does not engage in debates about specific policy measures.

Labour market regulation and policy responses

Labour market regulation and policy responses to financial crises ought to counteract the broad negative trends within the labour market outlined in Part 2 of this chapter. Labour market policy tools should be harnessed to produce job growth, to ease the effects of job shedding on the new and long-term unemployed, and to assist with job seeking.

Labour market regulation is often viewed only in terms of its 'protective' functions, for instance, limits on firing people. As a consequence, labour laws are often blamed for creating labour market rigidity. However, 'regulation' is not just about setting rules – although this remains essential – it is more broadly about how best to bring about changes in behaviour: to shape market behaviour. Institutions are bundles of norms and conventions of varying degrees of formality and rigidity, which function to guide the behaviour of agents.[55] Because labour regulations can be seen as 'devices for regulating the expectations of actors under conditions of uncertainty',[56] they are particularly important for smoothing the effects of economic shocks. The impacts of regulations are heavily dependent on the labour market model. Societies can suffer from regulations that are either too high or too low, but it is difficult to predict which will be the case on the basis of modelling, since labour laws are both endogenous and implementation-dependent.[57]

51 See n 2 above, 11.
52 *Ibid.*
53 *Ibid*, 42.
54 *Ibid.*
55 S Deakin, and F Wilkinson, *The Law of The Labour Market: Industrialization, Employment and Legal Evolution* (Oxford University Press 2005).
56 See n 16 above.
57 S Lee and D McCann, 'New Directions in Labour Regulation Research' In: S Lee and D McCann (eds), *Regulating for Decent Work: New Directions in Labour Market Regulation* (Geneva, ILO 2011).

An important function of labour market regulation is risk distribution.[58] This occurs through social insurance as well as rules regarding hiring and firing that distribute risk by stipulating who bears the cost of financial downturns for an organisation. Where the ease of firing is high, workers may bear the risk of a financial downturn as labour can be shed quickly rather than drawing upon other resources such as financial reserves or withholding dividends to owners. Where the ease of firing is low, the risk of financial downturns is distributed to other stakeholders. In practice, societies balance this risk in a variety of ways, and buffer the risk of job loss as a consequence of hiring and firing rules with a range of social security schemes. There are a range of mechanisms that can be used to distribute risk that are particularly important during recessions and in the aftermaths of financial shocks.[59]

Measures for employment and social protection

Stimulate employment generation by:

1. investing public resources for infrastructure of all types;
2. providing additional support through credit facilities, tax reductions and technical guidance to small enterprises in particular;
3. granting subsidies and reductions in social security contributions to enterprises to lower the cost of retaining workers in jobs and facilitating new hires; and
4. retaining workers in jobs through working time reductions, partial unemployment benefits, labour cost reductions and training schemes.

Provide income support to workers and families through:

1. extension of unemployment benefits;
2. extension of and adjustments in health benefits and old-age retirement benefits; and
3. expansion of cash transfer programmes and social assistance programmes.

Support unemployed and jobseekers through:

1. strengthening of public employment services; and
2. expansion of training programmes and facilities.

Stimulate social dialogue and consultations with business and labour on measures to counter the crisis through:

1. national and sectoral consultations between business and labour and with governments;
2. national and sectoral agreements between business, labour and with governments; and
3. enterprise consultations and agreements.

Targeting spending measures on the labour market can be highly effective. Estimates for advanced economies regarding different labour market instruments following the crisis show that both active and passive labour market policies have proven very effective in stimulating job creation and supporting incomes, in contrast with blunter stimulus measures.[60] Spending should therefore be on employment-rich instruments, which return revenue to governments in the mid-term.

Bargaining over wages and conditions is also a flexible way of distributing risk. Rather than using blunt tools to reduce wages, bargaining could occur at an enterprise and industry level to reduce either wages or hours of work to reflect the market conditions of the firm, conditional upon wage increases when economic conditions improve. Not all industries or enterprises are suffering from economic downturn at the same rate. Therefore blanket wages increases are not called for. Bargaining allows wage increases to be linked to productivity increases, ensuring that the gap between productivity increases and wages does not become larger.

The crisis presents an opportunity for developing countries to introduce or improve their weak

58 S Deakin, 'The Contribution of Labour Law to Economic and Human Development' In: S Marshall (ed) Labour Law and Development (Oxford, Hart/ILO forthcoming).
59 ILO, 'Protecting People, Promoting Jobs' (Geneva, ILO 2009).
60 *Ibid.*

or non-existent social security and expand on their limited capacity for information-gathering and programme evaluation. Crises also allow countries to reduce or remove ineffective policies in favour of equitable ones that promote long-term growth and better risk management. In the past, many countries have capitalised on this opportunity and successfully exited from their crises while also improving their policy frameworks in the long term. During the current crisis, in Singapore, Malaysia, the Philippines and Indonesia the governments have relied on the traditional adjustment strategies of their welfare regimes. This has resulted in a shift of the social burden to the family. In contrast, after the crisis, South Korea, Taiwan and Thailand began to expand their state social security systems.[61]

The *maintenance of demand for goods and services* is another function of labour market regulation. Low wages, for example, generate low aggregate demand, stifling local demand for new industrial products. This is one of the reasons that blanket wages decreases can be harmful for growth. It further undermines the extent to which the local economy is integrated or internally interlinked.[62] When an economy is not integrated, and imports outstrip exports, it can suffer from current account imbalances and precarious access for existing manufacturers to the goods and services required to produce, due to currency fluctuations and trade access issues. There are other means of stimulating demand. Fiscal policy is currently favoured. However, fiscal policies such as lowering interest rates have very little impact upon the poor in developing countries. Increasing income has a far greater impact upon the poor's ability to purchase goods and services.

Over the last 20 years there has been a decline in the real wages of the middle and bottom quintiles of income earners in many countries around the world. The share of wages in GDP has fallen further since 2010–2011 in all the large developed countries along with a further shift of income towards those in the managerial professions. For instance, in the eight decades before the recent recession, there was never a quarter when wage and salary income amounted to less than 45 per cent of the economy. Now the figure is below 44 per cent.[63] This produces low demand, contributing to a deepening of the recession.

The promotion of *empowerment* and *social cohesion* associated with rules that aim to promote economic opportunity and higher levels of equality is a further important function of labour market regulation.[64] Labour market regulation's contribution to redistribution of wealth also reflects this function. There are a number of other institutions that can also play a role in redistributing power and income and contributing to egalitarianism within societies. However, labour market institutions have generally taken forms that make them particularly well placed to perform this function. One reason that labour market institutions have been particularly good at playing a redistributive function is because they can operate independently of predatory or corrupt states. Labour market institutions, such as collective bargaining and wage-setting institutions often involve only labour and capital, or labour and capital alongside government. Where they are constituted democratically, they are a long-standing example of the deliberative and participatory decision-making forms, which have been trumpeted in the development literature as mechanisms for overcoming capture by elite groups and predatory states.[65] Labour market institutions need to be constituted so as to increase the bargaining power of workers in order to play a power and income redistributive role.[66]

The role of income redistribution to produce greater social cohesion is particularly pressing currently. A recent study conducted by the ILO found that in 57 out of 106 countries, the Social Unrest Index increased in 2011 compared to 2010. Europe, the Middle East, North Africa and Sub-Saharan Africa show the most heightened risk of social unrest. On average, Latin America – where there has been a degree of employment recovery and, in a few cases, improvements in job quality – has experienced a decline in the risk of social unrest.[67] This index suggests that there are considerable dangers in continuing with austerity measures at the cost of social cohesion and the promotion of equality.

61 K Busch, 'World Economic Crisis and the Welfare State' (2010) International Policy Analysis, Friedrich Ebert Stiftung.
62 B Sutcliffe, '100 Ways of Seeing an Unequal World' (Zed Books, 2001).
63 F Norris, 'For Business, Golden Days; For Workers, the Dross' *The New York Times* 25 November 2011.
64 See n 58 above.
65 J Elster, (ed) *Deliberative Democracy* (Cambridge University Press 1998), M A Melo and G Baiocchi, 'Deliberative Democracy and Local Governance: Towards a New Agenda' (2006) International Journal of Urban and Regional Research 30, 587–600.
66 A Santos, 'What Kind of "Flexiblity" in Labor and Employment Regulation for Economic Development?' 2007.
67 See n 41 above.

Financial regulation reform

National level financial regulation

Prospects for employment creation could improve substantially if current problems in the financial sector were properly addressed. The ILO recommends, in particular, a quick implementation of financial sector reforms and the setting up of an operational framework that encompasses both domestic and international financial market reforms to substantially help in reducing financial market volatility and stimulating employment growth.[68]

International financial regulation

The policy space available for responding to the third stage of the crisis is now limited. Deficit-financed public spending and monetary easing simultaneously implemented by many advanced and emerging economies at the beginning of the crisis is no longer a feasible option for all of them.[69] The large increase in public debt and ensuing concerns about the sustainability of public finances in some countries have forced those most exposed to rising sovereign debt risk premiums to implement strict belt-tightening.[70] Borrowing further in order to fund further stimulus that might spur jobs is therefore not an option for most countries.

Instead, further action needs to be taken to improve international financial regulation. The Basel guidelines were changed in response to deficiencies revealed by the crisis; however, more needs to occur. Under the third of the Basel Accords banks must triple the size of the capital reserves that they hold against losses. Yet as Martin Wolf says, 'This sounds tough, but only if one fails to realise that tripling almost nothing does not give one very much'.[71] Others have criticised requirements for bank equity holdings not only for being low but also for being imprecise, creating the risk of avoidance.[72] And banks continue to exert countervailing political pressure, arguing that any big changes would impede economic growth. Many also said that the Basel club's timetable, which was to have the proposals implemented by late 2012, was unrealistic. Clearly, such political dynamics still have a long way to travel.

One of the more significant developments in the financial arena is the increasing political support for the 'Robin Hood' or Tobin tax idea. This is a tax on financial transactions, which would serve the purpose of dampening financial speculation and reducing the size of the financial sector, while helping to finance important development objectives and/or insuring against future crises. For example, a tax at a rate of 0.1 per cent would be insignificant in relation to the transactions costs associated with international trade or long-term investments. On the other hand, daily transactions of US$3tn would yield revenue of US$30bn per day, or nearly US$1tn per year. The idea is that since this amount exceeds the total profits of the financial sector, an effective Tobin tax would imply a drastic reduction in the volume of short-term financial flows. On the other hand, revenue from a Tobin tax, while significant, would not be sufficient to replace the main existing sources of taxation such as income tax or company tax.

For many years, discussions of the Tobin tax have largely been the preserve of academics, or activist organisations such as the Paris-based Association for the Taxation of Financial Transactions and Aid to Citizens. Following the crisis, however, then French President Nicolas Sarkozy and several other government leaders endorsed the idea. In October 2012, the EC agreed to a eurozone 'coalition of the willing' to go ahead with a financial transaction tax, likely to be levied at 0.1 per cent on shares and bonds, and at 0.01 per cent on derivatives. This will provide a useful experiment, but for the tax to operate effectively it requires the participation of a far larger number of countries. Ideally, it would include all nations in the world, so as to avoid the creation of perverse incentives to set up Tobin tax

68 See n 2 above, 28–29.
69 *Ibid*, 13.
70 *Ibid.*
71 M Wolf, 'Basel III – too soft, not enough' Business Spectator, 15 September 2010.
72 A Admati, P Demarzo, M Hellwig and P Pfleiderer, 'Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not 'Expensive' (2010) Rock Center for Corporate Governance at Stanford University Working Paper No 86, Stanford Graduate 'School of Business Research Paper No 2,065'.

havens. Nevertheless, the tax may provide funding for much-needed pro-employment policies. And if it is seen to be a success, more countries will likely join the scheme.

Part 4: Conclusion

Before boarding a plane on Saturday 18 October 2008 to meet President George W Bush, French President Nicolas Sarkozy proclaimed, 'Europe wants it. Europe demands it. Europe will get it.' The 'it' here is global financial regulation reform, which was seen to be necessary to stave off the spread of the US financial crisis. Almost four years later, we have no new global financial order, the crisis is still raging in Europe and it threatens the global economy once again.

Instead of tighter financial regulation, austerity policies and across-the-board cuts in public spending programmes are observed in Europe. These are likely to compound the problems in the labour market outlined in this paper. Past experience suggests that, in particular, labour market policies with income-support schemes have the potential for large and positive job creation effects. In contrast, cutting down on such programmes will further entrench problems in labour markets, making it more costly to reduce unemployment rates and creating a substantial drag on the recovery. Recent cuts in schemes that support jobseekers and the unemployed are likely to come with substantial long-term adverse consequences for labour market prospects.

Why hasn't reform, beyond small reforms to the Basel Accords and the introduction of a European Tobin tax experiment, been forthcoming? Perhaps the most significant reason that reform of the type needed to stem the boom and bust cycle has not occurred is simply because of the power of banks and financial institutions. This power is direct, in the form of lobbying and through representation where it matters. It is also indirect, and is related to fear. At a national level, the power of financial institutions has been well documented. In 2009 and early 2010, for instance, financial firms in the US spent US$1.3bn to lobby Congress during the passage of the Dodd-Frank Act.[73] This lobbying is seen to be responsible for the weakening of legislation in the areas of derivatives trading and shareholder rights. It is more difficult to trace the lobbying activities of banks and financial institutions at an international level, where there is no transparency required on expenditures of this type. However, we can assume that vast sums have been spent.

The fear of further instability may be more significant than the influence gained through lobbying activities. In some ways, indeed, it is the perception of instability that gives financial markets negotiating leverage. Nations must carry out austerity measures so as to pay debts or international deposit-protection agreements must be put in place 'or else' the markets will crash, devastating local economies. Governments are fearful of regulating finance or 'punishing' the banks in case it jeopardises fragile economic growth. As one former Fannie Mae official was quoted as saying in *The New York Times*, 'I am afraid that we risk pushing these guys off a cliff and we're going to have to bail out the banks again'.[74]

Streeck, for example, has argued that 'democratic capitalism' involves a fundamental contradiction between the interests of capital markets and those of voters or citizens. In the past, this tension has been put to one side by borrowing from the future, either in the form of public debt or private debt. The problem, according to Streeck, is that states have two sovereigns; their people *and* global markets. Politicians are increasingly being selected for their capacity to appease financial markets, rather than for their democratic credentials. According to Streeck:[75]

> '"People whisperers" are succeeded by "capital whisperers" who, it is hoped, know the secret tricks needed to ensure that investors receive their money back with compound interest. Since investor confidence is more important now than voter confidence, the ongoing takeover of power by the confidents of capital is seen by centre left and right alike as not a problem, but as the solution.'

This view may sound radical, but financial analysts share it. The highly influential Cheuvreux Crédit Agricole Group's political analysis section dismissed as unlikely François Hollande's claim that he

73 D Igan and P Mishra, 'Making Friends' 2011 Finance and Development 48.
74 N Schwartz, 'US Is Set to Sue a Dozen Big Banks Over Mortgages' The New York Times, 1 September 2011.
75 See n 5 above, 64–65:

would stand up to 'faceless' financial markets[76] and would put in place pro-growth policies instead of austerity measures:

> 'While shrewd from an electoral point of view, Hollande's strategy is sure to backfire once elected… François Hollande will have to displease either financial markets or voters right after the end of the 2012 electoral cycle, as he is sure to be unable to reconcile both'.[77]

Rather than expect individual countries to make stands of this nature, in the knowledge that they risk demoted Standard and Poor ratings, capital flight and sustained litigation, it would be simpler to put in place international and global policies and institutions that promote global economic stability. Otherwise, we risk further financial shocks and a deepening of the labour market crisis that the world is currently experiencing.

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76 F Hollande 'Hollande Campaign Speech' Le Bourget, 22 January 2012.
77 Doisy, 2012.

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