European Trade Union Confederation (ETUC)
Confédération européenne des syndicats (CES)

ETUC Economic Discussion Paper 2010/4

WORSE THAN BUSINESS AS USUAL

Economic crises are usually followed by an offensive against wages and workers' rights. In the aftermath of the crisis in the first half of the nineties for example, the OECD Jobs Strategy heavily emphasized the presumed 'disincentives' of unemployment benefit systems, giving birth to the slogan of 'make work pay'. Reforms reducing the level and the duration of benefit systems subsequently spread throughout Europe. Half a decade later, after the bursting of the dot com bubble and the collapse of 'Enron style' crony capitalism', mainstream economics also turned its attention to job protection systems. Easy firing of workers at no or low cost became seen as urgently necessary so as to facilitate structural adjustment and to modernise the economy.

This time around the situation is similar but at the same time also different. The situation is similar in the sense that the crisis generates the same type of strategy as observed in the past: High unemployment numbers are abused to demand even more business friendly policies and corporate welfare so that economies would become more competitive. At the same time the situation is different: The intensity of the crisis and the devastating impact it is having on jobs and unemployment present the opportunity to declare total 'war on labour'.

The OECD's Economics Department view.

One clear indication of how this offensive against workers' rights is prepared can be found in the first chapter of the latest OECD's Economic Outlook (autumn 2009, nr 86).

After describing the economic situation, the risks to the recovery and financial sector reforms, the OECD warms itself up by tackling fiscal exit strategies. The OECD estimates that, if recovery goes ahead as planned, a consolidation effort of 5% of GDP would still remain necessary for the entire OECD region. The OECD's economists do not waste much time to get to the heart of things by claiming that 'empirical analysis suggests that cuts in primary current expenditures such as government consumption and social transfers, have been more successful in reducing deficits than consolidation based on tax increases'. Taxes, or so the traditional

OECD view has it, represent ‘distortions and should only be used if necessary and in that case limited to taxes on immovable property, followed by consumption taxes’. This body of thinking represents a vicious attack on public services, public employment and social benefit systems.

Unfortunately the OECD’s attack does not end here. On labour market issues, the Economic Outlook applies the traditional trick of turning what is basically a demand shock into a supply side problem by warning that potential output will be dragged down by the crisis and that ‘structural’ unemployment will increase. By using this intellectual trick, demand policy to stabilise the economy at a high(er) level of economic activity is swept of the table and the focus is instead on structural reforms to increase potential output.

The ‘devil is in the detail’ and it comes in the form of a table at the end of the chapter describing those forms of structural reform which would reduce unemployment. To reduce the unemployment rate in the average OECD country by 1 percentage point, policy would need to:

- reduce unemployment benefit replacement rates by 8 percentage points,
- or reduce the tax wedge on labour by 3,5 percentage points,
- or liberalise product markets at the same pace as the OECD region did on average over the last ten years.

Reforms of employment protection systems are not taken up in this table, probably because the econometric work from the OECD’s 2006 Employment Outlook failed to find any negative effect of job protection on unemployment. However, this lack of econometric evidence does not prevent the OECD to state that ‘reforms of employment protection systems would also tend to reduce the persistence of current high unemployment’.

To be fair, the OECD does refer in its table to the possibility of OECD countries increasing investment in active labour market policies to the level of Sweden, in that way also reducing unemployment by 1 percentage point. This, however, is about the only concession the OECD’s economic orthodoxy is prepared to make.

The IMF: Cut wages

Surprisingly, there is one issue the OECD's Economic Outlook does not touch upon and that is the issue of wages. No worries however, this dimension is taken care of by the IMF which is actually advocating cuts in wages to save jobs. Or as the WEO of September 2009 says: 'Limiting the extent of job destruction will require slower wage growth or even wage cuts for many workers' (page 49). And although the IMF, different to the OECD, does plea in favour of 'generous' unemployment benefits (to prevent hardship and to stabilise demand), the WEO immediately adds that benefit duration Should not be too long.

Europe : 'Il faut que tout change pour que rien ne change'?

What about Europe? The signs coming from the European policy debate are not so reassuring either. Whether it concerns the more general strategy of 'EU 2020' or the more specific discussion at the Macro Economic Dialogue, the message is similar: It is all about structural reforms, increasing the growth potential, making labour markets in Europe more flexible and more efficient. Europe seems to be of the opinion that the strategy that was being pursued before the crisis simply needs to be continued after the crisis, only in a more vigorous way.

The 'Washington/Paris/Brussels' consensus: Two big errors.

So it seems that the Washington/Paris/Brussels consensus is still alive and kicking, certainly when it concerns labour markets deregulation and downsizing welfare systems. There are at least two problems with this.

First of all, policy needs to keep in mind that the only thing in 2009 standing between the economy and a repeat of the Great Depression has been the welfare state. It is thanks to public sector employment and social security benefits that the economy was prevented from falling into the abyss of an even bigger recession. High public debt and deficits resulting from this action now present conservatives with the opportunity of a lifetime to finally kill the European Social Model. They would however do well to keep in mind that without these 'social' stabilizers, the economy will be extremely vulnerable when the next crisis and the next negative demand shock arrive.

To make matters worse, political Europe is not capable of organising a discretionary fiscal policy change with the same speed and in the same assertive way as is the case for the US. There are several reasons for this: The European budget is limited to less than 1,25% of GDP, the European Treaty does not allow Europe to indebt itself and European member states always find themselves in a 'Catch 22' situation in which each member state leaves it to the others to re launch the European economy and pay for it by carrying higher debt burdens.

Secondly, pretending that the crisis has come 'out of the blue' is not serious. The crisis is not an 'unfortunate incident', it was an accident waiting to happen. The crisis is actually the direct result of the sort of structural reform policies that have been pursued over the last decades. Alan Greenspan, former president of the Federal Reserve, once summarized this chain of events leading us into the financial crisis by saying that 'if wages of workers can't increase, then they need to take up more debt'. Indeed, labour market deregulation and financial market deregulation are basically two sides of the same coin: Waging a 'war on labour' gives rise to high and rising income inequalities. However, with 5% of the population capturing up to 20 to 30% of GDP, there is a serious demand leakage in the economy. Financial innovation to push households into debt and trigger speculative asset price bubbles is then necessary to keep demand dynamics going. Sooner or later however, the dream becomes a nightmare. Debt becomes unsustainable, speculative bubbles burst and the whole system collapses.

The implications are clear: If policy pushes for the same forms of labour market reforms as in the past, thereby weakening the position of labour and increasing inequalities even further then the stage is set for the next financial crisis and the next Great Recession to happen.

Rj/ETUC/Economicdiscussionnotes/feb.2010