# THE GLOBAL CRISIS

*CAUSES, RESPONSES AND CHALLENGES*

# The global crisis

*Causes, responses and challenges*

INTERNATIONAL LABOUR OFFICE • GENEVA

*The global crisis: Causes, responses and challenges*
Geneva, International Labour Office, 2011

ISBN: 978-92-2-124579-7 (print)
ISBN: 978-92-2-124580-3 (web pdf)

economic recession / economic recovery / employment / employment creation / social dialogue / wages / social security / trade / role of ILO / Arab countries / developing countries / Europe / USA
03.04.3

*ILO Cataloguing in Publication Data*



ILO publications and electronic products can be obtained through major booksellers or ILO local offices in many countries, or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. Catalogues or lists of new publications are available free of charge from the above address, or by email: pubvente@ilo.org

Visit our website: www.ilo.org/publns

Photocomposed in Switzerland JMB
Printed in Switzerland SRO

# PREFACE

A key lesson from the global financial and economic crisis is that policies for economic growth which have prevailed over the past three decades need a rethink. For one thing, even before the crisis, economic growth was not creating enough decent work opportunities. The global employment rate did not increase despite high economic growth. The vast majority of jobs were precarious or informal and did not offer adequate opportunities for women and men to realise their legitimate aspirations. In many countries, young women and men experience great difficulties in securing a job, and when they do, it is often low skilled. Access to social protection has improved only slowly, even in countries with high economic growth. And the application of fundamental principles and rights at work has remained uneven.

These trends have led to a significant widening of income inequalities, unprecedented in recent economic history. They also went hand-in-hand with significant environment degradation. In short, economic growth has not enabled the majority of people to move on in life.

Another lesson from the crisis is that growth was unsustainable from the point of view of the economy itself. The crisis erupted in the financial system. It revealed that growth relied on weak foundations: too much recourse to debt in some countries, excessive reliance on exports in others.

Interestingly, in order to tackle the crisis, policy makers moved away from the conventional approach as documented in this volume. Jobs were protected in sustainable enterprises, social policy was used to boost domestic demand, and an effort was made to avoid cuts in wages and rights. Rather than applying one-size-fits-all policies, many countries – especially emerging and developing ones – acquired self-assurance and tailored crisis responses to their specific needs. This policy approach, consistent with the ILO Global Jobs Pact, was instrumental in stimulating the economy and reducing job losses.

Many challenges lie ahead, however. There is a risk of a return to business-as-usual. The financial system remains largely unreformed. Unemployment and job precariousness decline slowly, especially among youth, even though the economy is growing again. A growth-cum-inequalities path is in motion once again, with unpredictable social and political consequences. And new risks have emerged, notably as a result of the sovereign debt crisis in some European countries.

This volume, which assembles ILO staff research carried out since the start of the global crisis, provides key insights into policies that have worked and the challenges ahead. My thanks to Raymond Torres, Director of the International Institute for Labour Studies, for coordinating this ILO research and to Uma Rani for the help in putting the papers together; and thanks to ILO staff who contributed to this. The volume assembles valuable ILO research further consolidating the knowledge base required for the forging of policies based on ILO values. Let us build a new era of social justice with decent work.

Juan Somavia
ILO Director-General

# CONTENTS

**Figures**

**Tables**

**Boxes**

# ABBREVIATIONS

| | |
|---|---|
| ABDI | Agencia Brasileira de Desenvolvimento Industrial (Brazilian Agency for Industrial Development) |
| ACPR | Alliance of Romanian Employers' Confederations |
| ADB | Asian Development Bank |
| AFP | Agence France Presse |
| ALMP | active labour market policies |
| ASEAN | Association of Southeast Asian Nations |
| BIS | Bank for International Settlements |
| BLS | Bureau of Labor Statistics |
| BNDES | National Economic and Social Development Bank (Brazil) |
| BPC | Prestação de Benefício Continuada (Brazil) |
| BPS | Badan Pusat Statistik |
| CAGED | General Register of Employment and Unemployment |
| CAPP | Committee on the Application of Standards (ILO) |
| CCP | central-counterparty |
| CDS | credit default swap |
| CEACR | Committee of Experts on the Application of Conventions and Recommendations (ILO) |
| CFA | Committee on Freedom of Association (ILO) |
| CGE | computable general equilibrium |
| CIS | Commonwealth of Independent States |
| CLT | Consolidação das Leis do Trabalho (labour code, Brazil) |
| DIEESE | Inter Trade Union Department of Statistics and Socio-Economic Studies (Brazil) |
| DySAM | Dynamic social accounting matrix |

| | |
|---|---|
| EAP | economically active population |
| EC | European Commission |
| ECLAC | Economic Commission for Latin America and the Caribbean |
| EFSF | European Financial Stability Facility |
| EIRO | European Industrial Relations Observatory |
| EPL | employment protection legislation |
| ESC | Economic and Social Council |
| ESEE | National Confederation of Hellenic Commerce (Greece) |
| ESRB | European Systemic Risk Board |
| EU | European Union |
| FAO | Food and Agriculture Organization |
| FDI | foreign direct investment |
| FSP | fiscal stimulus package |
| FTE | full-time equivalent |
| GCC | Gulf Cooperation Council |
| GMM | General Method of Moments technique |
| GSEE | General Confederation of Greek Workers |
| GSEVEE | Hellenic Confederation of Professionals, Craftsmen and Merchants (Greece) |
| HIPC | Heavily Indebted Poor Countries |
| IBGE | Instituto Brasileiro Geografia e Estatistica |
| IFI | international financial institution |
| IIF | Institute of International Finance |
| IILS | International Institute for Labour Studies |
| IMF | International Monetary Fund |
| IOE | International Organisation of Employers |
| IPEA | Instituto de Pesquisa Econômica Aplicada (Brazil) |
| IPI | industrial products tax (Brazil) |
| IRA | individual retirement account |
| ISI | import-substitution industrialization |
| ITUC | International Trade Union Confederation |
| LAS | League of Arab States |
| LDC | least developed countries |
| LIC | low-income countries |
| LDDK | Employers' Confederation of Latvia |
| LVL | lats (Latvian currency) |
| MDG | Millennium Development Goal |
| MDRI | Multilateral Debt Relief Initiative |

| | |
|---|---|
| ME | manpower equivalence |
| MFI | microfinance institution |
| NAIRU | non-accelerating inflation rate of unemployment |
| ODA | overseas development assistance |
| OECD | Organisation for International Co-operation and Development |
| OTC | over-the-counter |
| PAC | Programa de Aceleração do Crescimento (Growth Acceleration Programme, Brazil) |
| PCS | Public and Commercial Services Union (United Kingdom) |
| PMC | Pequisa Mensal de Comércio |
| PNAD | Pesquisa Nacional por Amostra de Domicílios (Brazil) |
| PRS | poverty reduction strategies |
| PSD | Social Democratic Party (Romania) |
| QIZ | Qualifying Industrial Zones |
| RAIS | Relação Anual de Informações Sociais (Brazil) |
| RGPS | Regime Geral de Previdência Social (general pension system, Brazil) |
| SAM | social accounting matrix |
| SME | small and medium-sized enterprise |
| SOFE | state-owned financial enterprises |
| UAE | United Arab Emirates |
| ULC | unit labour costs |
| UNCTAD | United Nations Conference on Trade and Development |
| UNECE | United Nations Economic Commission for Europe |
| UNDP | United Nations Development Programme |
| WTO | World Trade Organization |

# ACKNOWLEDGEMENTS

The essays in this volume were presented at the ILO Research Conference "Key Lessons from the Crisis: The Way Forward', 16–17 February 2011. The Conference brought together colleagues from the ILO, other international organizations and academic institutions.

We are especially grateful to the discussants – Scott Barklamb (IOE), Alfredo Calcagno (UNCTAD), Georg Fischer (European Commission), Detlef J. Kotte (UNCTAD), Eddy Lee (ILO), Robert C. Shelburne (UNECE) and Etienne Wasmer (OFCE Sciences Po) – for their thoughtful and challenging comments. Thanks are also due to the participants of the Research Conference for their constructive participation.

The continuous support of the Office, without which this task would not have been achieved, is duly acknowledged. Our thanks to José Garcia and team who ensured efficient printing of this book, Laurel Dryden and Charlotte Beauchamp for their guidance towards the publication, and the ILO Human Resources Director for financial support.

# INTRODUCTION

*Uma Rani and Raymond Torres**

The crisis which erupted in the financial systems of developed countries in the autumn of 2008 quickly affected all economies throughout the world. The result was job losses, enterprise bankruptcies and cuts in the incomes of millions of people. Quickly after the start of the crisis, the ILO engaged in a research programme in order to shed light on its origins, help devise policy remedies and assess crisis responses at both national and international levels. One of the outcomes of this research was to provide analytical background to the Global Jobs Pact endorsed by ILO constituents in June 2009.

The purpose of this collection of essays is to put together the main lessons from ILO research since the start of the global crisis. It first presents assessments of crisis responses in different parts of the world, with a view to shedding light on the measures that worked and the circumstances under which they worked (Part I). Another stream of research has focused on political economy issues, including the role of social dialogue in supporting the adoption and implementation of recovery strategies which address the root causes of the crisis, as advocated by the Global Jobs Pact (Part II). The book then discusses research on two of the most controversial policy questions: How to reduce the lag between job recovery and economic recovery, without compromising on job quality (Part III)? And to what extent can strategies that support incomes and social protection also boost economic growth and job creation (Part IV)? Finally, the book includes novel analysis on the imbalanced globalization process that was taking place before the global crisis. It identifies the source of the imbalances and examines possibly remedies, including as regards better respect for international labour standards and trade and financial reform (Part V).

* The authors are Senior Development Economist and Director, International Institute of Labour Studies, ILO, Geneva, respectively.

## I. Crisis responses: Global and regional perspectives

Immediately after the crisis efforts were made to put in place stimulatory macroeconomic policies. These measures were synchronized and, to some extent, job-centred, thereby putting a floor on the economic crisis and kick-starting a recovery. However, responses were less successful in tackling the root causes of the crisis, notably income imbalances – both within countries and between them – and a dysfunctional financial system. The result has been excessive public debt burdens in advanced economies where the crisis originated, the adoption of austerity measures and associated risks of social unrest. It is therefore crucial to move ahead with a deeper, socially-inclusive reform agenda (Chapter 1).

Within this global picture, the book demonstrates that some emerging and developing economies gained policy space for the adoption of decent-work-friendly crisis responses. Latin America and Asia compensated for the fall in their export revenues through the implementation of effective countercyclical policies – including the strengthening of innovative social policies, the launch of employment-intensive public investment programmes and minimum wage policies which in many cases supported domestic demand (Chapters 2 and 3). In addition, an effort was made to promote regional economic integration. This too helped mitigate the collapse in trade and investment flows with advanced economies. The result is that the crisis was short-lived in those regions. Despite these significant achievements, major decent work deficits remain, notably as regards income inequalities, informal employment and the need to strengthen domestic sources of growth.

By contrast, some Arab countries – though less affected by the global crisis than others – were in a less favourable position (Chapter 4). Before the global crisis, these countries faced significant income inequalities, largely the outcome of a growth process which benefited only certain groups. Youth unemployment was also a problem and the sign of a chronic shortage of decent jobs. The problem was only partly inadequate education, insufficient social protection or a lack of employment programmes. Deficiencies in product markets and a lack of social dialogue seem to have played a more important role in reducing the ability of these countries to respond to the crisis and avert social unrest.

## II. Political economy of crisis responses

While Part I examines the kind of strategies that can promote job-rich, socially-inclusive recovery, Part II looks at the conditions and factors that favour the adoption of those strategies.

One such factor is greater confidence among the policy-makers of developing countries. Conventional wisdom was that the policy was too limited to permit the implementation of the Decent Work Agenda. It was claimed that the main goal for these countries should be to ensure low inflation, limited fiscal deficits and moderate social policy within the context of light taxation. However, the crisis has demonstrated that these countries have more policy space than is often claimed (Chapter 5). Innovative policy approaches have been launched, including with respect to the strengthening of labour market institutions, support of a favourable business environment, and building social protection systems consistent with work incentives. What is more, if the Millennium Development Goals are to be achieved, it is crucial to embrace a pro-decent work agenda, avoid an ill-conceived liberalization of capital accounts and promote regional integration in order to ensure broad-based growth.

Social dialogue can be a powerful driver of job-centred policy change, even in times of austerity such as is the case in several European countries (Chapter 6). Social dialogue provides policy-makers with all the necessary information for effective policy design. It improves the chances of buy-in (ownership) and therefore effective implementation of such policies. And it helps achieve balance in such policies by mitigating their adverse effects on the most vulnerable groups.

But social dialogue alone is not enough. In the early 2000s, Romania had adopted a new labour law which was the outcome of negotiations between the social partners. The law proved successful in promoting job-rich growth and avoiding a deterioration of job quality. And yet this law has been recently changed in favour of a deregulation approach as part of the IMF-supported structural adjustment package. Chapter 7 explores the factors that could explain the policy shift adopted in the absence of evidence on its positive effects.

## *III. Employment recovery with quality jobs*

The current economic recovery has raised the issue of whether policy-makers should focus on raising employment levels even if this means greater job precariousness and informality. Many enterprises remain in a fragile situation and precarious work is on the rise in many of the advanced countries. In some regions, weak job creation has resulted in discouraged workers and increased long-term unemployment. It is also argued that in most developing countries employment generation has not been productively distributed. The global crisis gives an opportunity to rethink the pattern of global growth that would lead to employment recovery, which is productive. Chapter 8 makes an attempt to address the problem of the distribution of productive employment opportunities, inherent in both "employment-led" and "growth-led" labour markets. It suggests that addressing distributional issues would support employment recovery with "quality" jobs, while also leading to sustained economic growth.

Labour market institutions are often regarded as a useful instrument for promoting job quality. It is sometimes claimed that these institutions may at the same time affect job creation and therefore employment levels; however, an analysis of output–employment patterns in developed countries since the start of the crisis provides little support for this claim (Chapter 9). True, there is considerable cross-country variation in output–employment patterns. In Spain and the United States, for instance, the employment impact of falling output was greater than in countries such as Germany and Italy. But this differentiated pattern cannot be easily ascribed to labour market institutions.

Finally, Chapter 10 provides an interesting example of how crisis responses can help improve both the quantity and quality of jobs. The programme described included well-designed investments in public infrastructure, agriculture and rural areas. The analysis in this chapter shows that this policy boosted employment and helped rebalance the economy towards broader-based growth (crucial to compensate for falling exports to developed countries), thereby also addressing distributional concerns.

## *IV. Achieving income-led growth*

It has often been claimed that wage moderation is a pre-condition for job creation and economic growth. The fact is that, in most parts of the world during the two decades that preceded the global crisis, real wages tended to rise less than justified by productivity developments (Chapter 11). According to some analysts, this could be a factor behind the growing recourse to debt among low-paid households in some advanced economies, leading to unsustainable debt-led growth. Wage moderation was also advocated as a tool for overcoming the global crisis. However, some countries decided to ignore to avoid wage deflation, and in most cases they were rewarded with greater domestic demand, thereby boosting recovery. The chapter considers conditions under which "wage-led" economies have the potential to achieve more sustainable growth at both national and global levels than is the case with the "wage moderation" approach.

The global crisis has underlined the vulnerabilities of the millions of workers who lost their job and, with it, access to any source of income or health coverage. In the majority of developing countries there are no unemployment benefits. Even in developed countries, many unemployed workers have limited access to benefits – reflecting short contribution periods, strict eligibility criteria or other factors. In general, however, countries have used the global crisis as an opportunity to strengthen social protection. This responded to social concerns, but also to the need to reinforce "automatic stabilizers", thus boosting the recovery. In advanced economies, this took the form of, inter alia, benefit extensions, active labour market policies and job-sharing schemes. In emerging and developing countries, innovative conditional cash-benefit programmes, employment guarantees and other systems adapted to the specific labour market situation of these countries were adopted. More generally, much has been learned regarding the good design and funding of social protection, in order to ensure both adequate coverage and strong work incentives. Good design is crucial for making social protection a factor of growth and development. A key issue is whether these gains can be maintained in the new context created by fiscal austerity (Chapter 12).

Brazil provides an important case in point (Chapter 13). In response to the global crisis, the country allowed real minimum wages to increase, reinforced innovative social protection and housing schemes and made sure that the sustainable enterprises could seize the new demand. This, coupled with earlier reforms to improve social dialogue, tackle informal employment and rationalize taxation was crucial for stimulating the economy and avoiding significant job losses. The lesson is that a job-centred approach, consistent with the Global Jobs Pact, works.

## *V. Rebalancing globalization*

The global crisis also revealed the imbalances that have characterized the globalization process. Some developing countries were strongly hit because their growth model overly relied on exports of few products to advanced economies. Given the collapse of demand in the latter countries, the export sector of some emerging economies such as India and South Africa faced a sudden reduction in production, leading to job and income losses. The impacts were even larger in non-tradeable sectors, as Chapter 14 shows. This is because of the indirect and income-induced effects originating from export sectors. In the face of these vulnerabilities, there is growing interest in regional economic integration among emerging and developing countries. Regional integration is regarded as a source of trade diversification and broader-based development. Indeed, the evidence suggests that regional integration tends to be associated with more intra-industry trade and closer backward linkages between export sectors and the rest of the economy.

While much of the action to support jobs and incomes has taken place at the national level, better enforcement of international labour standards has become an integral part of the debate on crisis responses. In particular, the G20 Pittsburgh Summit recognized the importance of promoting core labour standards so as to make globalization fairer. ILO supervisory bodies have played an important role in this respect (Chapter 15). They have reiterated that the crisis should not be used as an opportunity to downgrade labour standards. They have also emphasized the centrality of better enforcement of crisis-relevant labour standards for boosting confidence and avoiding a counterproductive race to the bottom, thereby paving the way for a balanced recovery.

Financial reform is crucial for rebalancing globalization. The crisis originated in the deregulated financial systems of advanced economies and its spread was facilitated by volatile international capital flows. Reform should therefore address both the functioning of financial systems of advanced economies and the international financial linkages. Various reform proposals have been made in this regard, but little consideration has been devoted to the impacts on the real economy and jobs. ILO research has attempted to fill this gap (Chapter 16). In particular, various scenarios can be developed, depending on whether they combine domestic reforms with international ones, or whether only one of the two areas is addressed. The findings suggest that most scenarios lead to better employment outcomes over the medium term than the status quo. Domestic financial reform comes out as especially effective. The favourable effects of reforms are likely to be larger than estimated: the scenarios do not capture the real economy effects of lower volatility entailed by reforms. Even so, the chapter suggests that the gradual recovery from the crisis and opposition from the financial professions have weakened the pressures for reform.

PART I

# CRISIS RESPONSES: INTERNATIONAL AND REGIONAL PERSPECTIVES

# RESPONDING TO THE GLOBAL CRISIS: ACHIEVEMENTS AND PENDING ISSUES 1

*Raymond Torres* *

## 1.1 INTRODUCTION [1]

The global financial and economic crisis, which erupted in the wake of the collapse of Lehman Brothers in 2008, led to a reconsideration of earlier policy approaches based on the self-regulating ability of markets. In particular, the role of anti-cyclical macroeconomic policies in sustaining the economy and jobs was widely acknowledged (IMF, 2009a). In addition, unlike in earlier crises, social protection was reinforced and, in particular, the level and duration of unemployment benefits were improved – thereby departing from the view that higher benefits automatically aggravate market distortions (Howell, 2010). The initial results of this new approach were positive. Indeed, another Great Depression has probably been avoided, due to the anti-cyclical monetary measures and socially inclusive fiscal stimulus packages adopted in 2008 and 2009.

However, as from 2010 a change has come about in the policy stance without addressing the factors that provoked the crisis. The economic imbalances resulting from inefficient and unequal income distribution have not been properly addressed (IILS, 2008; Rajan, 2010), nor has enough progress been made in regulating the financial system. As a result, the scope for stimulatory macroeconomic policies to revive the world economy has progressively become very narrow. This chapter starts by highlighting the causes of the crisis and their interlinkages. It then examines the extent to which fiscal and monetary policies – remedies

* Director, International Institute of Labour Studies, ILO, Geneva.

[1] This chapter draws heavily on an article published recently in the *International Labour Review* (Torres, 2010a).

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

## 1.2 ECONOMICALLY INEFFICIENT INCOME INEQUALITIES

While the crisis originated in the financial system, a more fundamental trend was the inefficient distribution in the gains from growth during the pre-crisis period. In most countries, wages grew less than would have been justified on the basis of productivity developments during the two decades preceding the crisis. This is why wages as a percentage of GDP declined in the majority of countries (see table 1.1), while the share of gross profits in GDP correspondingly increased. In many countries, wage moderation meant stagnant real incomes for low-paid workers and their families. In the United States, for example, median real wages grew by a mere 0.3 per cent per year between 2000 and 2006. During the same period, labour productivity increased by 2.5 per cent per year. Simultaneously, the revenue share that goes to the richest 10 per cent of households has been on the rise, suggesting that the moderation in wage growth of low- and middle-income households was even more pronounced than indicated by the fall in the wage share.

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

Second, in the case of emerging economies where the financial system was more tightly regulated, wage moderation had a direct impact in weakening domestic demand (Ghosh, 2010). In these countries, domestic demand was further depressed owing to the weak social safety net. In the absence of adequate pension and health systems, households tended to hold large precautionary savings, thereby depressing spending. So if these countries were to see economic growth, they needed to gain wider access to the markets of advanced economies, especially those where domestic demand was especially dynamic – partly fuelled by debt

Table 1.1 Wage moderation around the world: Wages as a percentage of GDP, selected countries, 1995, 2000 and 2008

| | 1995 | 2000 | 2008 |
|---|---|---|---|
| Brazil | 42.6 | 40.5 | 47.6 |
| Canada | 63.0 | 61.3 | 60.8 |
| China | 52.3 | 51.9 | 39.7 |
| France | 68.8 | 67.4 | 66.1 |
| Germany | 69.8 | 70.0 | 64.9 |
| Italy | 70.4 | 66.2 | 67.5 |
| Japan | 63.7 | 61.7 | 56.9 |
| Republic of Korea | 83.0 | 76.6 | 76.5 |
| United Kingdom | 68.7 | 69.9 | 68.5 |
| United States | 67.5 | 68.7 | 66.7 |

Note: Expressed as percentages of GDP, the shares of total compensation of employees are adjusted for the self-employed (except in Brazil and China). This adjustment assumes that labour compensation per hour or per person is equivalent for both the self-employed and employees, and is necessary to control for the mechanical impacts of wage shares of changes in the composition of employment.

Source: Author's estimates based on national accounts.

creation. This is how several emerging economies as well as resource-rich countries generated growing external surpluses and a global "savings glut" that allowed interest rates to reach historic lows in the early 2000s, providing cheap financing conditions even to high-risk borrowers and fuelling housing bubbles (Bernanke, 2005).

For a while, the coexistence of debt-led growth in certain developed economies with export-led growth in large emerging economies seemed sustainable. The surpluses of the latter served to finance the deficits of the former. And the world economy was expanding fast. Between 2000 and 2007, excess demand in advanced economies taken as a whole represented US$193 billion per year, or 9.5 per cent of the average yearly increase in domestic demand (table 1.2). In 2008, the year of the crisis, the figure reached 13 per cent.

However, debt-led demand proved to be the Achilles' heel of the growth process. As US monetary authorities raised interest rates in 2006–07, the relatively small increase in borrowing costs that resulted from this measure was enough to provoke a cascade of failures in loan repayments. These quickly spread throughout the financial system as a result of both the complexity of financial products – which made it

Table 1.2 From demand imbalances to global rebalancing, 1990–2010

| | 1990–2000 | 2000–2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| *Average annual increase in domestic demand (trillion US$)* | | | | | |
| World | 1.0 | 3.4 | 5.6 | –3.3 | 5.0 |
| Advanced economies | 0.8 | 2.0 | 2.4 | –2.7 | 1.7 |
| Emerging and developing economies | 0.2 | 1.3 | 3.2 | –0.6 | 3.2 |
| *Average annual excess demand in advanced economies* | | | | | |
| In billion US$ | 72.8 | –193.0 | –308.2 | 58.0 | –6.3 |
| Percent of domestic demand in advanced economies (%) | 8.9 | –9.5 | –13.0 | 2.1 | –0.4 |
| *Average annual demand shortage in emerging & developing economies* | | | | | |
| In billion US$ | –72.8 | 193.0 | 308.2 | –58.0 | 6.3 |
| Percent of domestic demand in emerging and developing economies | –38.8 | 14.7 | 9.6 | –9.1 | 0.2 |

Source: Author's estimates based on IMF statistics.

difficult to assess the degree of risk – and the close international connections among financial institutions.

Finally, it is important to note that wage moderation and the associated increase in profit shares did not support real investment. The share of real fixed capital formation in GDP has tended to decline in advanced economies – as well as for the world as a whole (table 1.3; IMF, 2010a). This vividly illustrates the failure of wage moderation and debt-led growth to boost potential growth. Reflecting the sluggish performance of real investment before the crisis, studies have shown that productivity has tended to decline in advanced economies since the early 2000s (Brackfield and Oliveira Martins, 2009). In short, growing income inequalities have proved to be economically inefficient.

Table 1.3 Real fixed capital formation, 1988–2010 (percentage of GDP)

| | 1988–1995 | 1996–2003 | 2004–2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| World | 23.4 | 22.1 | 23.1 | 21.7 | 22.9 |
| Advanced economies | 22.7 | 21.3 | 21.2 | 17.8 | 18.6 |
| Emerging and developing economies | 26.2 | 24.9 | 28.5 | 30.3 | 31.3 |

Source: Author's estimates based on IMF data.

## 1.3 RESPONDING TO THE CRISIS WITHOUT PROPERLY ADDRESSING ITS ROOT CAUSES: BENEFITS, LIMITATIONS AND COSTS

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

Second, in the face of the paralysis of interbank credit and the risk of a systemic collapse of the financial system, monetary authorities reduced interest rates to historically low levels. They also provided massive support to banks in the form of loan guarantees, capital injections and outright nationalization of ailing banks, among other measures.

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

### *1.3.1 Benefits of curing the symptoms without treating the causes of the crisis*

Overall, the measures succeeded not only in supporting the economy but also in avoiding further significant job losses (IILS, 2009a). This relatively favourable outcome reflects, first, the rapidity of the policy response. By adopting stimulus measures soon after the start of the crisis, countries could expect a significant positive impact on employment by mid-2010. By contrast, a postponement of the measures by three months would have delayed employment recovery by six months – illustrating the disproportionate costs of inaction for employment (ibid.).

Second, the fall in employment was cushioned by the nature of the policy response itself (Torres, 2010b), which also benefited from evidence of socially inclusive employment policies gathered before the crisis (OECD, 2006). In the majority of the cases, crisis responses focused on stimulating aggregate demand. In particular, efforts were made to enhance social protection (Brazil, India); extend unemployment benefits

(Japan, United States); avoid cuts in minimum wages; and adopt other support measures for low-income groups. Spending on infrastructure also featured prominently in many stimulus packages. This too boosted aggregate demand, while also enhancing productive capacity over the longer term. In countries such as France, Germany and the Netherlands, short-time working was promoted, aided by government subsidies. In other countries such as Australia and the United States, part-time employment surged. These interventions, by sustaining the purchasing power of low-income groups, effectively boosted aggregate demand while also somewhat alleviating the social costs of the crisis.

### *1.3.2 Limitations of partial remedies*

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

In its *80th Annual Report*, the BIS noted progress towards international agreement on the direction of the reforms (BIS, 2010). For instance, there is recognition among the most important central banks that the capital base of banks needs to be improved in both quantitative and qualitative terms. Guidelines have been presented to "reduce the perverse incentives that drive managers to increase short-term profits without regard to the long-term risks imposed on the firm and the system" (ibid., p. 15). New monitoring tools have been developed. Improvements in the regulation of the perimeter of bank operations – to avoid excessive off-banking – have been discussed. Beyond these much-needed guidelines and promised reforms, however, little action has been taken.

A first consequence of the gradualism of financial reform is that banks do not trust each other. Inter-bank credit remains anaemic and the volume of credit to the real economy in the developed countries has declined as a result. The situation is of particular concern for small businesses. In the European Union (EU) for example, many enterprises – especially small and medium-sized enterprises – continue to experience difficulty in accessing credit (IILS, 2009b).

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

Third, in an unreformed financial system, international capital flows will remain highly volatile. There is evidence that in the era of financial globalization international capital flows have become much more volatile than they were before, and that the result of this is a higher incidence of financial crises. There was a series of financial crises even before 2008 – the Asian crisis at the end of the 1990s is well-known, and in Latin America there were several, provoked in part by a mismanagement of the macroeconomic system but also by volatile capital flows.

Fourth, a more fundamental problem is that the financial sector has developed beyond reasonable boundaries and its practices have spread throughout the non-financial economy. It has long been claimed that today's profits would be tomorrow's investments and the day-after-tomorrow's jobs. But reality has failed to substantiate that claim. A large share of the increase in profits has accrued to the financial sector itself, whose share of total corporate profit reached 42 per cent before the crisis, up from about 25 per cent in the early 1980s (IILS, 2009b). During the 2000s, less than 40 per cent of profits of non-financial firms in developed economies were invested in physical capacity – 8 percentage points lower than during the early 1980s.

### *1.3.3 Costs and social implications*

The exceptional measures adopted in the wake of the crisis have come at a significant cost to the public purse. Government debt has increased markedly, mechanically offsetting the decline in private debt which has taken place since the start of the crisis – the so-called deleveraging process (table 1.4). In addition, the role of monetary policy has been pushed to the limit. With nearly nil interest rates and significant increases in liquidity, central banks have approached the limits of how far they can compensate for the credit crunch. As a result, since 2010 governments have begun to shift from stimulus to austerity.

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

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

Table 1.4 Percentage point change in the ratios of household/government debt to GDP, 2002–2009

| | Household debt (change between 2002 and 2007) | Government debt (change between 2007 and 2009) | Household debt (change between 2007 and 2009) |
|---|---|---|---|
| Canada | 18.3 | 5.6 | –8.5 |
| France | 14.0 | 13.7 | –3.4 |
| Germany | –10.4 | 5.9 | –10.4 |
| Italy | 12.1 | 12.0 | –4.8 |
| Japan | 14.1 | 14.7 | –6.4 |
| Spain | 28.0 | 19.1 | –12.9 |
| United Kingdom | 24.0 | 23.5 | –34.3 |
| United States | 19.1 | 16 | –8.5 |
| *Average* | *14.9* | *13.8* | *–11.2* |

Note: The changes in household debt for Japan and the United Kingdom are calculated over the periods 2002–08 and 2002–06, respectively. The change in government debt is calculated over the period 2008–09 for Japan and 2006–09 for the United Kingdom.

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

Fiscal austerity will also exert a direct impact on employment, in the immediate future as well as in years to come. Many workers are employed in enterprises that benefit from shorter hours and other partial unemployment support which, if withdrawn, will provoke new job losses. For those already unemployed, it is essential to maintain well-designed social protection systems as well as programmes to support job search and update skills. Otherwise the unemployed will tend to become discouraged and leave the labour market – depriving the economy of valuable resources and eroding social cohesion.

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

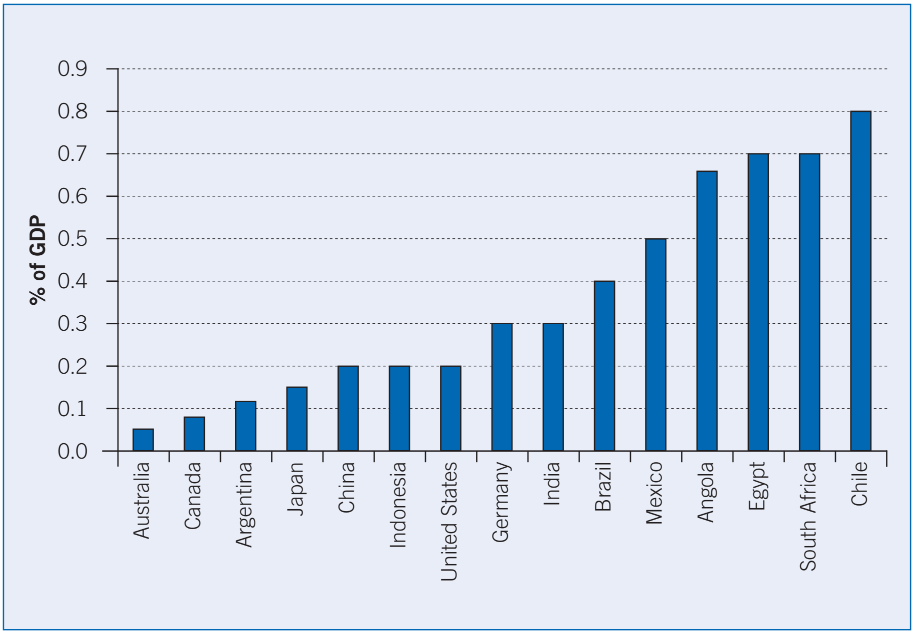
It is hardly surprising that perceptions of social injustice are spreading fast in nearly all developed economies. The youth unemployment rate, now nearly 2.5 times higher than for adults, will only aggravate such perceptions. Confidence in government is on the decline. Among the advanced economies it has fallen by over 10 percentage points over the course of the crisis. In short, the shift to austerity measures without treating the causes of the crisis have created a fertile ground for social discontent.

## 1.4 KEY POLICY PRIORITIES

In many advanced economies the risk of persistent unemployment can be addressed through well-designed activation policies and job-search support. Evidence suggests that such policies are effective and also relatively cheap to the public purse (figure 1.1; OECD, 2006). Special attention needs to be devoted to vulnerable unemployed groups, including youth and single parents.

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

Figure 1.1 Budgeted cost of crisis-related labour market measures, selected countries (percentage of GDP)




Source: IILS estimates.

Table 1.5 Policy options for rebalancing the world economy, short-term impact on unemployment

| | United States | China |
|---|---|---|
| Yuan appreciation | 0.0 | 1.8 |
| Asia rebalancing | –0.1 | –1.4 |
| Aggressive cut in US deficit | 3.1 | 0.7 |

Source: IILS (2010).

Several authors have already remarked that economic growth in emerging economies needs to rely more on domestic demand, thereby moving away from the export model that prevailed before the crisis (Blanchard and Milesi-Ferretti, 2009). The strengthening of social protection could play an important part here, and would not only serve social goals but also reduce excess savings, boost domestic demand and contribute to the alleviation of global imbalances. There are encouraging signs that such a rebalancing process may have already begun. In China, for instance, the fiscal stimulus package adopted in the wake of the crisis included a major component of social assistance and retirement income transfers. This is likely to contribute to making domestic demand a greater engine of economic growth in China and support sustainable recovery worldwide.

Of course, exchange rate changes would also help to reduce global imbalances. But the impact on the real economy of a revaluation of currencies in surplus countries vis-à-vis deficit countries will take time. By contrast, a boost to domestic demand in surplus countries will act quickly while addressing some of the root causes of the crisis (see table 1.5; von Arnim, 2009).

The tax and benefit system needs to be more supportive of employment and fair income distribution. There are good examples available, for instance in Nordic countries where it has been possible to facilitate job creation and at the same time avoid too much income inequality. Social protection systems exist that both protect people and provide adequate work incentives.

The tax system itself should be more progressive. Over the past two decades, top marginal income taxes have declined in the majority of countries and as a result the tax system has become less redistributive (IILS, 2008).

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

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

## 1.5 CONCLUSIONS

The global crisis led to an exceptionally comprehensive job-centred policy response. Unlike in earlier crises, macroeconomic policies were used as an anti-cyclical device and many employment and social protection measures were reinforced or introduced. This approach helped recovery in emerging and developing countries and attenuated the recession in advanced economies. However, as this chapter has shown, the main income and financial imbalances which led to the crisis have not been properly addressed. This partial approach may constrain job recovery in advanced economies and compromise balanced growth worldwide.

# EXPLAINING LATIN AMERICA'S ROBUST RECOVERY FROM THE CRISIS 2

*Andrés E. Marinakis**

## 2.1 INTRODUCTION

The 2008 global financial and economic crisis put an end to the five-year cycle of sustained economic growth in Latin America of 4.8 per cent per annum, equivalent to a 3.8 per cent increase in average per capita per annum. At the same time, the unemployment rate dropped from 11.2 per cent in 2003 to 7.3 per cent in 2008 (figure 2.1). The 1.9 per cent drop in GDP recorded in 2009 for the region as a whole is comparable in size to the debt crisis unleashed in 1982 (Ocampo, 2010, p. 2). The 2008 global crisis, however, stands out for its short duration in the region, as well as its relatively limited impact on employment and the significant recovery experienced in 2010 both in the economy and the labour market.

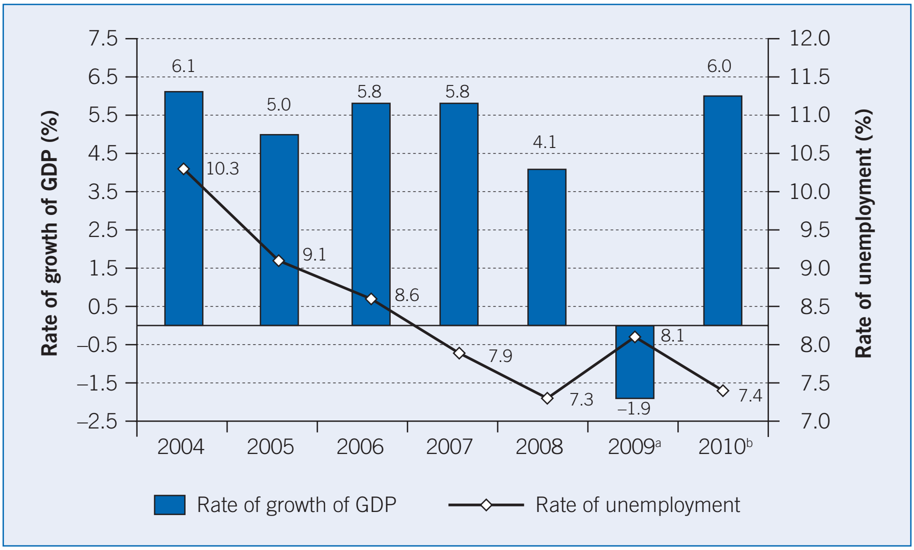
The first estimates of early 2009 considered that, depending on the scenario, the unemployment rate could rise to between 8.7 and 9.1 per cent (ECLAC, 2009a, p. 1). Instead, the unemployment rate grew to 8.1 per cent only.

This striking performance, however, is largely due to Brazil's fast recovery, which represents 40 per cent of regional economic active population (EAP). On the other hand, the impact of the crisis on Central American countries, Mexico and much of the Caribbean region is still being felt.

For 2011, GDP is expected to grow by about 4.2 per cent in Latin America. According to a "moderately optimistic" outlook, the

* Expert in labour market policies and institutions, ILO Decent Work Team (DWT) for the South Cone of Latin America, Santiago, Chile.

Figure 2.1 Latin America: GDP growth and unemployment rates, 2004–2010 (percentages)




Notes: [a] estimated. [b] projected.

Source: ILO-SIALC based on official information from the countries in ILO: *Panorama Laboral* (2011a).

unemployment rate would fall slightly to between 7.2 and 7.3 per cent in 2011 (ILO, 2011a).

The positive reaction to the crisis in the region is due to sound pre-crisis macroeconomics foundations; a number of favourable external factors; and the implementation of policies to sustain economic activity, employment and wages. This chapter analyses each of these factors.

## 2.2 PRE-CRISIS MACRO-FOUNDATIONS

The global financial crisis brought to light various situations of insolvency, in successive phases, in parts of the international financial system. After the Lehman Brothers bankruptcy came the crisis of confidence in banks, major mortgage loan corporations, insurance companies and even in certain countries with high fiscal deficits and debt. The reactions of Latin American countries throughout this process were rather positive.

The Latin American debt risk premium initially rose, as in the rest of the world. In low-risk countries such as Brazil, Chile, Colombia, Mexico, Panama and Peru this premium stood at 25 to 125 basis points in early 2007, whereas by the first quarter of 2009 it had peaked to a range of 250 to 460 basis points. This surcharge gradually returned to normal in a few months, as the banking system in the region was shown to be sound, the fiscal situation was fairly balanced, and the foreign debt-to-GDP ratio implied no major risks. A year later, this risk premium stood between 80 to 150 basis points, above pre-crisis levels, and was hardly affected by the European crisis of confidence in mid-2010 (ECLAC, 2010, p. 91).

On the fiscal side, the economic growth cycle recorded in the region made it possible for most countries to achieve a primary surplus during those years. In the period 2003–2008, 15 out of 19 Latin American countries had a primary surplus. And, the total budget balance (taking into account interest payments) came close to equilibrium for the country average during the same period (ibid., pp. 40 and 97).[1]

In 2009, the average primary fiscal deficit for the region was 1.1 per cent of GDP, whereas in 2010 it was estimated to be 0.6 per cent. During that year, only six of the 19 countries had a primary surplus. The total budget balance, on the other hand, was –2.9 per cent of GDP in 2009 and –2.4 per cent in 2010.

The debt situation of central governments in the region also improved during the growth cycle. Whereas in 2002 debt represented 58.2 per cent of GDP, by 2008 it had dropped to 28.5 per cent (ibid., p. 97). While the debt-to-GDP ratio dropped, countries in the region tripled their international reserves during this period, consequently reducing country vulnerability. Whereas in the early 2000s international reserves were insufficient to cover short-term debt (a year or less), towards 2008 reserves represented 3.7 times this debt. Likewise, international reserves represented 71 per cent of annual imports, over and above the three to six months coverage considered as the conventional benchmark (Jara et al., 2009, pp. 12–13).

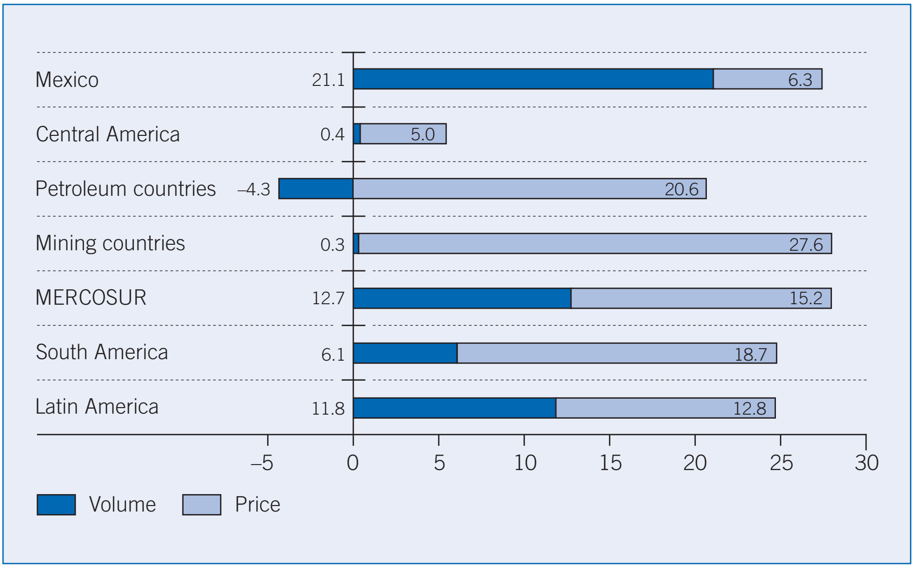
## 2.3 FACTORS EXTERNAL TO THE REGION

The global financial crisis had a dramatic impact on trade. The value of Latin American exports dropped by 22 per cent in 2009, as a result of both falling export prices and volumes. By 2010, however, most of the loss had been recovered owing to the recovery of both volumes and prices.

An essential factor in this recovery was demand from Asia – especially from China – for basic products of the region, exceeding

[1] Eight countries had overall balanced or surplus outcomes before the crisis: Argentina, Bolivia, Chile, Costa Rica, Mexico, Panama, Paraguay and Peru.

Figure 2.2 Latin America: Export value variation rates according to volume and price contributions, 2010




Notes: Mining countries: Chile and Peru. Petroleum (oil/gas exporting) countries: Bolivia, Colombia, Ecuador, Venezuela. MERCOSUR: Argentina, Brazil, Paraguay, Uruguay. South America: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela. Central America: Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama.

Source: ECLAC (2010, p. 22).

export levels before the crisis. This helped the export recovery, as well as boosting prices of the main commodities exported by the region. Mexico and MERCOSUR countries showed an important recovery in exported volumes, while in oil- and mining-product exporting countries recovery was mainly price-driven (figure 2.2).

Remittances and tourism were two other channels through which the global crisis spread to the region. Though the situation has improved, several countries such as Ecuador and Mexico are still being affected by a lower inflow of remittances than before the crisis.

Although the global financial crisis was initially comparable in size to the debt crisis of the 1980s, it was of much shorter duration, owing to the quick reversal of external factors described above and the policies applied. Of the 17 countries shown in table 2.1, Mexico and El Salvador recorded five quarters of output contraction (in the case of Mexico, recovery was already under way by 2010); three countries underwent recession during four quarters (Costa Rica, Paraguay and Venezuela); two countries showed contractions during three quarters (Brazil and Chile);

five countries showed contractions during two quarters only (Argentina, Colombia, Ecuador, Nicaragua and Peru); while five countries had barely any reduction in growth rates and never went into recession (Bolivia, Dominican Republic, Guatemala, Panama and Uruguay). So, aside from the dynamics of recovery, it is necessary to point out that the crisis was short-lived in most cases.

Table 2.1 Latin America: Gross domestic product (GDP), 2008–2010 (percentage variation in comparison to the same quarter of the previous year)

| | 2008 | | | | 2009 | | | | 2010[a] |
|---|---|---|---|---|---|---|---|---|---|
| | I | II | III | IV | I | II | III | IV | I |
| Argentina | 8.5 | 7.8 | 6.9 | 4.1 | 2.0 | −0.8 | −0.3 | 2.6 | 6.8 |
| Bolivia | 6.6 | 6.7 | 6.8 | 6.1 | 2.1 | 4.2 | 3.3 | ... | ... |
| Brazil | 6.3 | 6.4 | 7.1 | 0.8 | −2.1 | −1.6 | −1.2 | 4.3 | 9.0 |
| Chile | 3.7 | 5.1 | 5.2 | 0.7 | −2.1 | −4.5 | −1.4 | 2.1 | 1.0 |
| Colombia | 5.4 | 3.3 | 3.4 | -1.1 | −0.9 | 0.1 | 0.7 | 3.4 | 4.4 |
| Costa Rica | 6.5 | 3.6 | 3.1 | -1.8 | −4.5 | −2.4 | −0.2 | 2.9 | 5.1 |
| Dominican Republic | 5.7 | 9.6 | −0.6 | 6.5 | 1.0 | 1.8 | 3.4 | 7.5 | 7.5 |
| Ecuador | 6.6 | 9.5 | 8.9 | 4.0 | 2.8 | 0.5 | −1.2 | −0.5 | 0.6 |
| El Salvador | 3.3 | 3.0 | 2.1 | 1.3 | −1.7 | −3.5 | −4.1 | −4.9 | −0.5 |
| Guatemala | 2.8 | 2.0 | 1.3 | 2.7 | 1.4 | 2.3 | 2.7 | 1.5 | 3.1 |
| Mexico | 2.6 | 3.0 | 1.6 | -1.1 | −7.9 | −10.0 | −6.1 | −2.3 | 4.3 |
| Nicaragua | 3.2 | 4.1 | 3.9 | 0.3 | -3.0 | −3.8 | 0.8 | 0.1 | 4.0 |
| Panama | 11.1 | 13.9 | 10.2 | 8.1 | 3.3 | 2.1 | 0.8 | 3.5 | 4.9 |
| Paraguay | 6.9 | 9.0 | 2.2 | 5.3 | −5.4 | −7.0 | −2.4 | −0.7 | 10.9 |
| Peru | 10.3 | 11.7 | 10.7 | 6.4 | 1.9 | −1.2 | −0.6 | 3.4 | 6.0 |
| Uruguay | 7.7 | 10.0 | 9.1 | 7.4 | 2.5 | 1.1 | 3.0 | 4.6 | 8.9 |
| Bolivarian Republic of Venezuela | 4.9 | 7.2 | 3.8 | 3.5 | 0.5 | −2.6 | −4.6 | −5.8 | −5.8 |

Notes: [a] preliminary figures. ... not available.
Source: ECLAC, based on official figures.

## 2.4 ROLE OF LABOUR MARKET POLICIES

Unlike in earlier crises, policies to protect employment and the income of individuals have been implemented as part of a countercyclical strategy to overcome the global crisis. This includes a range of labour market policies, such as:

- countercyclical policies: public investment, emergency jobs, domestic consumption in lieu of exports (Argentina, Brazil), subsidized work sharing;
- automatic stabilizers: unemployment insurance, automatic activation of emergency employment programmes (Chile);
- extension of social protection: conditional transfer programmes, extension of non-contributory pensions; and
- an active minimum wage policy.

### 2.4.1 Countercyclical policies

To cope with the fall in private investment, many countries assigned additional fiscal resources for investment in infrastructure. An ILO study of the main measures applied in a worldwide sample of countries revealed that 87 per cent of countries surveyed had announced these initiatives towards mid-2009 (ILO, 2010a, p. 18). This was the case in 15 out of 18 Latin American countries, according to a study covering the same period (ECLAC, 2009b, p. 36).

The ILO report indicates that, in 33 per cent of cases, employment criteria were included in these additional infrastructure programmes. Partial on-site observations indicated that, although employment was the policy aim, it was deficient in practice. Some countries lacked statistical data indicating where unemployment was growing, which could serve to inform decisions about where to locate additional public works. In other cases, portfolio and ongoing projects had no detailed information about their impact on employment. Finally, the dynamics of activating additional public works are essentially slow, causing a significant lag between the time they are announced and actual implementation.[2]

Emergency employment programmes were also applied in the region, although to a lesser extent than in previous crises. In this case, significant efforts were made to retain workers in their jobs, in two ways. First, larger countries such as Argentina and Brazil implemented temporary programmes to promote domestic purchases of manufacturing goods originally intended for export (such as cars and household appliances) – especially important in view of the fact that international demand had suddenly dropped. Second, dialogue between workers and employers was promoted in enterprises undergoing difficulties, so as to reach agreement over work-time sharing with partial shortening of

[2] To illustrate the specific problem of public works in a country, see ILO (2010b).

the working day, and compensating part of the income loss of workers through subsidies. These job-sharing programmes were most significant in Argentina and Mexico. Although both countries had a prior history with these programmes, they were activated specifically to deal with the crisis. If such programmes are mainstreamed and become a stable component of public policy, they could become part of the automatic stabilizers of the labour market.

### *2.4.2 Automatic stabilizers*

Though automatic stabilizers are still at an embryonic stage in the region, they have received policy attention in response to the global crisis. For example, some of the countries that already had unemployment insurance extended the benefit payment period by a few additional months – which was justified by the fact that, in times of crisis there are few job offers. In the case of Brazil this was done on an ad hoc basis, applicable only to one specific sector of activity which was severly affected. Other countries incorporated this extended payment period in their unemployment schemes. The criteria defined for activation of the extended payment period were based on comparisons with past average unemployment rates (Chile), or on two successive quarters of negative output (Uruguay).

In Uruguay, unemployment insurance was used to support the temporary suspension of workers, thereby preventing a break in the employment relationship and facilitating their return to work. This formula was widely used during the recent crisis, and in many cases was implemented by rotating the affected workers in an effort to limit their suspension time, in agreement between employers and workers (see ILO, 2009a).

Among the automatic stabilizers it is appropriate to include Chile's implementation of emergency employment programmes, which are activated when the unemployment rate exceeds 10 per cent (at a regional or national level) using an Unemployment Contingency Fund (ILO, 2009b). An unemployment rate above that level is regarded as socially harmful, requiring emergency measures. One interesting feature of this programme is that its funding source is clearly specified, thereby reinforcing implementation criteria.

### *2.4.3 Extension of social protection*

A substantial difference between the instruments currently available and those called on in previous crises lies in the sphere of social protection, especially in the extension of existing conditional transfer programmes in the region. Although these programmes address a structural problem and should not, therefore, show substantial variations during the economic cycle, they constitute an income protection factor for poor families that is vital during a crisis period. In the context of the crisis, this instrument served to partly sustain the income of the poorest population, while discouraging young people from joining the labour market.

Conditional cash transfer programmes exist in nine countries of the region, with fairly significant coverage (see ILO, 2010c, p. 4). In some countries where these programmes were progressively being implemented at the onset of the financial crisis, the process of selecting beneficiaries for inclusion was speeded up. In a crisis context with greater unemployment, household heads were at a high risk of losing their jobs, exacerbating school attrition among under-aged students looking for informal income. In this sense, it can be said that these programmes were specifically used to combat the recent crisis.

### *2.4.4 Minimum wage policy*

The ILO's Global Wage Report 2010/2011 states that out of 108 countries studied worldwide, 51 – just under half of them – made no change to their levels of minimum wages (ILO, 2010d). In contrast, in Latin America only two countries (Panama and Peru) of the 18 countries studied made no adjustments in 2009; and majority of countries in the region tried to protect the lowest wage earners. The minimum wage simple average for the region shows 5.5 per cent real growth in 2009, whereas the EAP weighted average shows an increase of 6.2 per cent.[3] These increases were well above those recorded during 2008 (2.2 and 3.8 per cent respectively), largely due to the inflation rate dropping from 9.6 per cent in 2008 to 3.9 per cent in 2009.

When countries regularly adjust their minimum wages (usually once a year, always in the same month), it is possible to assess the intention of such an adjustment by comparing the nominal increase to past inflation and inflationary expectations at the moment of readjustment. Given the time that has now elapsed, nominal adjustments made during 2009 with respect to inflation can be compared with the previous effective period, as well as with actual inflation accumulated during the application of the 2009 minimum wage levels.

Brazil stands out as a country that, despite the crisis, continued the process of minimum wage appreciation by a significant percentage (6 percentage points above past inflation and also expected future inflation) (table 2.2). For the most part, the other Latin American countries made adjustments close to or slightly below past inflation. However, the

[3] Honduras was excluded from the calculation in both cases, since it doubled the minimum wage in 2009.

important drop in inflation recorded in all these countries permitted their minimum wages to record real improvements. The case of Venezuela is an exception to the rule, since the minimum wage increase was well below recorded inflation (see ILO, 2010a).

Table 2.2 Minimum wages: Nominal increases and inflation in countries with regular periodicity, selected Latin American countries, 2008–2009 (percentages)

| Country | Inflation during past effective period (%) | Minimum wage, nominal variation in 2009 (%) | Inflation during 2009 minimum wage effective period (%) |
|---|---|---|---|
| Bolivia | 11.8 | 12.0 | 0.3 |
| Brazil [1] | 5.4 | 12.0 | 2.5 |
| Chile [2] | 1.8 | 3.2 | 2.2 |
| Colombia | 7.7 | 7.7 | 2.1 |
| Costa Rica [3] | 6.9 | 9.1 | 6.2 |
| Ecuador | 8.8 | 9.0 | 4.2 |
| Guatemala | 9.4 | 7.2 | –0.3 |
| Honduras | 10.8 | 100.0 | 3.0 |
| Mexico | 6.5 | 4.6 | 1.5 |
| Uruguay [4] | 3.6 | 7.0 | 5.9 |
| Bolivarian Republic of Venezuela [5] | 27.7 | 10.0 | 30.4 |

Notes: Reference periods [1] March 2008 to February 2009. [2] July 2008 to July 2009. [3] July 2008 to July 2009, including two six-month adjustments. [4] July 2008 to January 2009. [5] May 2008 to May 2009.

Source: ILO, based on country data.

## 2.5 WHAT DO WE UNDERSTAND BY COUNTERCYCLICAL POLICY?

One differentiating factor in the response of each country to this crisis, compared to previous crises, was undoubtedly the implementation of countercyclical fiscal and monetary policies. Each country applied this approach ad hoc, as only Chile had a mainstreamed framework for such a policy. It is therefore worth discussing the margins necessary for the application of mainstreamed countercyclical policies in countries that still have major shares of poverty and marginalization, and many unmet demands, as well as which instruments are appropriate to use in applying such policies, especially labour market policies.

The main objective in establishing a structural countercyclical policy is to moderate the fluctuations to which every economy is exposed during periods of both growth and contraction. An analysis of the long-term evolution of economies in the region reveals great instability. As explained by Ffrench-Davis, aggregate demand has behaved like a "roller-coaster", with aggregate demand fluctuations rapidly followed by GDP fluctuations, by definition implying large variations in the utilization of available capital and labour. These variations are a clear disincentive for investment and result in greater unemployment and less capital utilization, implying that the economy is operating below potential (Ffrench-Davis, 2010). Therefore, moderating these fluctuations and establishing a more sustained growth pattern is a fundamental requisite for the region.

The previous sections clearly show that the responsible way in which fiscal accounts have been managed in recent years provided a reasonable margin of manoeuvre to implement countercyclical fiscal policies. In the monetary sphere, the fact that industrialized economies had very low interest rates enabled developing countries to reduce their own rates. After the first period of uncertainty passed, and after confirming the relative soundness of the financial system and the low relative exposure to external debt, in addition to the accumulation of reserves during the boom period, many Latin American countries applied an expansive monetary policy.

In looking at fiscal policy, Chile presents an interesting case, as it has been applying a structural balance rule since 2001. This rule establishes that public spending in each period must be equal to permanent fiscal revenue. In this way, through a mainstreamed criterion, Chile intends to isolate spending and social investment decisions from economic cycle fluctuations. Copper price forecasts play an essential role here, since copper represents a significant percentage of fiscal revenue. The budget considers the long-term price of copper, and not the market price. Applying this rule has allowed the span of economic cycles to be shortened, limiting expenditure in boom periods while facilitating spending in periods of crisis, as well as ensuring the sustainability of public policy (ILO, 2009b, p. 1).

Conversely, prevailing fiscal policies in the region tend to be essentially procyclical, albeit with certain lags. As explained by Ocampo (2010, p. 8):

> During the first year after the crisis, spending dynamics maintain the boom pattern (with some moderation) generating, together with falling revenues, an increase in the public sector deficit that has countercyclical effects. If the crisis continues, as it did in the late 1990s, rising deficits and debts soon lead to a procyclical policy aimed at correcting fiscal imbalances.

What sets the recent financial crisis apart from previous crises is that this time, the countercyclical lag produced by public spending inertia matched the short duration of the crisis. Hence, economic reactivation (recovery of commodity prices, as these represented significant fiscal revenue) permitted revenues to recover, while spending moderation contributed to achieving fiscal balance again.

Although the Chilean model presents a general framework for the consistent application of a countercyclical fiscal policy throughout all phases of the economic cycle, it is not pressure-free. The accumulation of resources during the boom years was challenged in light of so many unmet basic needs. But during the crisis general public opinion greatly appreciated the fact that these additional resources were available to face the adverse situation, thus validating the policy adopted.

Most countries in the region, however, relied on relative fiscal solvency to sustain spending, which was possible mainly due to the short duration of the crisis. This time around, such a combination of factors brought about a successful outcome to the countercyclical approach applied. It seems unlikely that the same circumstances will recur in a future crisis. Therefore, just as in the past the region incorporated into its thinking the value of balanced fiscal policies and price stability as a basis for sustainable development, it seems appropriate that following the current experience it should consider the possible basis for a long-term countercyclical fiscal policy.

## 2.6 REDISCOVERING THE DOMESTIC MARKET

The international character of this crisis – which also led to a significant drop in international trade – was a sufficiently important factor for countries to avoid implementing conventional adjustment programmes. The fall in exports due to lack of global demand made it pointless for countries to implement domestic adjustments and devalue their currencies in an effort to improve international competitiveness. What the crisis brought to light, instead, was the relevance of maintaining economic activity, based on various initiatives that sustained the domestic market. In a region where, in recent decades, the emphasis has been on export-driven development, this situation was a novelty and represented a challenge.

The most dynamic example in the region was undoubtedly Brazil, where specific programmes were implemented to address different segments of the population and various problems. For example, one programme aimed to spur domestic consumption of products previously exported, focusing on the middle class. Brazil also increased the lowest incomes by increasing the minimum wage (thus automatically also benefiting pensions) and expanded the conditional transfer programme. In addition, among other initiatives the Government increased public investment in infrastructure, thereby partially offsetting the contraction of private investment.

The application of this set of policies notwithstanding, Brazil experienced a recession in the first three quarters of 2009. However, two years after the onset of the crisis it can be said that these measures served not only to moderate its magnitude and social cost but also to speed up economic recovery through the creation of jobs.

The changes in the components spurring aggregate demand in 2009, in comparison to the pre-crisis period in several countries of the region, has recently been analysed (ILO, 2010e). The study shows that the domestic multiplier increased in Argentina, Dominican Republic, Guatemala, Honduras, Paraguay and Uruguay, but did not change in Mexico. In the case of Brazil, it shows that a substantial change took place after the crisis, with the country moving away from a situation where dynamism stemmed from external demand, to the extent that, by 2009, there was a predominance of domestic demand. (This issue is discussed in detail in Chapter 13 of this volume). In another six countries external demand was still predominant, in spite of measures implemented to spur domestic markets.

The case of Brazil is obviously very special. Its mere size and level of development open a range of possibilities that are simply non-existent in smaller countries. Even so, Brazil's experience points to the need for countries in the region to consider the domestic market as a development factor, which has to grow in a way that is compatible with a progressive international inclusion.

So far as the labour market is concerned, this discussion translates as the need to establish a closer link between the growth of productivity and wages.

## 2.7 CONCLUSIONS

The 2008 global crisis was very different from crises which had affected the region previously. It did not originate in the region. In addition, most countries did not suffer from major structural weaknesses which could have aggravated second-round effects of the global crisis. The crisis was also rather short-lived compared to previous ones, enabling most countries to implement an effective countercyclical strategy. The macro-economic context in the region in late 2008 undoubtedly restricted the propagation of financial instability. A relatively balanced fiscal situation, with low inflation and low levels of debt, supported in turn by high levels of international reserves, permitted the region to be rated as low-risk on this occasion. In this context, unlike previous crises, countries had more room to manoeuvre in the implementation of the policies required.

In view of the generalized and sudden collapse of exports, governments tried to sustain domestic consumption. For labour market policy, this strategy meant protecting employment and incomes through various policies and programmes whose implementation presented several novel situations.

With respect to countercyclical policies, what stands out is the increase in public investment with the aim of partly compensating the fall in private investment. Since in general the crisis was relatively short-lived, countries in the region had the resources to put this strategy into operation. A pending issue is how to make public investment more responsive (in terms of both timing and location of investment programmes) as well as more employment-intensive during recessions.

One novel aspect was the effort in larger countries of the region to maintain activity levels in manufacturing sectors, which was disproportionately affected by the drop in exports – through alleviating labour costs and/or fostering domestic demand of such products via aggressive loan policies. With the same aim of retaining employment, some countries implemented work-sharing formulas, by partially compensating wage losses with government subsidies. Here, too, it seems important to capitalize on this experience and mainstream these instruments.

Wage policies also took a countercyclical direction, without compromising employment or the viability of enterprises in difficult situations. With these two aims in mind, during 2009 a number of countries chose to adjust their minimum wage moderately. The important drop in inflation entailed higher-than-planned increases in real wages, thus undoubtedly sustaining family incomes and demand.

Another important difference between the recent crisis and previous crises lies in the sphere of social protection. Although several countries of the region recorded considerable coverage improvements in their social security systems, significantly through creating more wage employment, the greatest step forward was the implementation of conditional transfer programmes for highly vulnerable sectors of the population, and in some cases non-contributory pension systems for elderly individuals living in poverty. Although the aim of these programmes is to alleviate poverty, during the crisis they served to maintain minimum incomes for the most vulnerable. In some countries, where these programmes were in full development, implementation was speeded up and coverage increased, thus serving as an additional stimulus for the economy. These instruments, however, are not countercyclical but structural, so their implementation should be linked to sustainable funding sources.

Advances in labour market automatic stabilizers were modest, albeit demonstrative of what can be accomplished. Just before the financial crisis erupted, Chile and Uruguay were implementing reforms to their unemployment benefit schemes to extend their coverage, which proved to be very timely. Nevertheless, coverage continues to be low and benefits limited in these two countries, as well as in those others where this instrument exists. The implementation of emergency employment programmes in Chile can also be considered as an automatic stabilizer – indeed, the schemes are activated when the unemployment rate rises above 10 per cent, thereby establishing a clear parameter for implementation of the programme.

At a conceptual level, the crisis has raised a number of questions, of which two particularly stand out. First, it seems necessary to discuss further whether the countercyclical approach that has permeated many of the policies applied during the crisis should now be adopted as a core element in economic policy. The "stop and go" development model applied in Latin America has been very costly, causing the region to operate below potential. Applying a countercyclical approach systematically could limit the magnitude of economic cycles. Some automatic stabilizers should be developed as well as a set of ad hoc labour market policies to be applied during recessions. On the other hand, if the countercyclical approach is going to be circumstantial, countries should be aware of the minimum requirements to put it into practice in a future crisis.

A second issue concerns the role of integration with the rest of the world and the strengthening of domestic markets in the development strategies of countries. This requires harmonious development, notably through improving wages without compromising competitiveness. Clearly, in this case a closer relationship between productivity and wages is important, without overlooking a necessary coordination with macro policy, in particular the exchange rate policy.

# RECOVERY, JOB QUALITY AND POLICY PRIORITIES IN DEVELOPING ASIA

3

*Gyorgy Sziraczki, Kee Beom Kim, Nikhilesh Bhattacharyya, Sukti Dasgupta and Valerie Schmitt-Diabate* *

## 3.1 INTRODUCTION

In 2007 economic growth in developing Asia registered 11.4 per cent, the highest rate on record. This robust growth began to be threatened in 2008 as soaring energy and food prices weakened living standards, particularly of the poor, who spend a large share of their small incomes on food and fuel. In the second half of 2008 countries in the region began to bear the full brunt of the global financial and economic crisis, which quickly escalated into a global jobs crisis. However, the region rebounded quickly and strongly as economic growth in developing Asia accelerated to 9.3 per cent, compared with a resilient 7.0 per cent in 2009. This strong growth rate, driven by China and India, reflects robust domestic demand, supported by macroeconomic stimulus measures and the revival of private investment and external demand. The region's labour markets have also shown some positive signs. Yet creating more and better jobs to reduce the region's long-standing decent work deficits remains a challenge. This chapter highlights recent economic developments, examines labour market trends and identifies some emerging policy priorities in the post-crisis era, with a focus on job quality, social protection, infrastructure development and inclusive financial services.

* The authors are Senior Economist and Head of the Regional Economic and Social Analysis Unit at the ILO Regional Office for Asia and the Pacific (ROAP); Employment Specialist, ILO Decent Work Team (DWT) for East and South-East Asia and the Pacific (DWT-Bangkok); Economist, ROAP; Senior Specialist on Employment and Labour Market Policies, DWT-Bangkok; and Specialist on Social Security, DWT-Bangkok, respectively.

## 3.2 RECENT DEVELOPMENTS

The impact of the crisis on developing Asia was far less severe than in other regions, but still was disruptive enough to result in unemployment rising and employment quality deteriorating. In 2008 economic growth slowed to 7.7 per cent and moderated further to 6.9 per cent in 2009. These still respectable rates largely reflect the performances of China, India and Indonesia, where large domestic markets cushioned economies from collapsing global trade. In economies with smaller domestic markets and higher exposure to exports, recessions were recorded. In Cambodia, Malaysia, Singapore and Thailand, economic growth turned negative in 2009, while other nations recorded recessions based on the definition of two successive quarters of economic contraction.

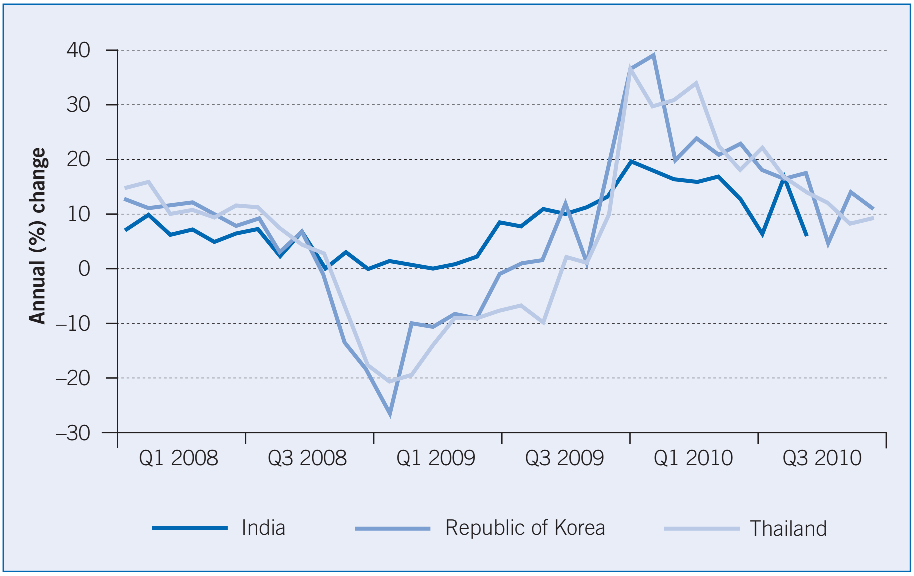
The economic crisis affected most Asian countries through the channels of foreign direct investment (FDI) and exports. Manufacturing production in Asia was largely export-driven and, as the crisis hit, industrial production and exports declined in a number of countries. The immediate impact of the crisis was therefore job losses and consequent declines in household incomes. In China, job losses from large factory closures – caused not only by the crisis but also by industrial restructuring to higher value-added production prior to it – forced more than 20 million retrenched workers to return to the countryside in pursuit of rural employment (for a detailed discussion see Government of Malaysia, 2009; CIDS, 2010; Huynh et al., 2010).

After steep contractions in late 2008 and early 2009, industrial production and exports began to pick up across Asia in mid-2009 (figure 3.1). Large fiscal stimulus packages supported domestic demand and led to a rapid recovery in intra-Asian trade. Inventory restocking was a major driver behind the industrial-led recovery, as producers had made large cuts to output and stock levels in anticipation of a prolonged downturn that did not materialize. Public works projects, low interest rates and in some cases improved access to finance also supported the recovery.

By late 2010 economic growth had begun to moderate in most developing Asian economies, following a year of rapid expansion. By the third quarter of 2010 China's growth had slowed to 9.6 per cent from 11.9 per cent in the first quarter, while over the same period growth in the ASEAN-5 declined to 7 per cent from 10.5 per cent.[1] Fading boosts from fiscal stimulus and inventory restocking moderated growth, as did slowing growth within the region and in the G3. Inflation had become a problem in many economies, prompting central banks to tighten

[1] Based on an unweighted average of the five Member States' growth rates.

Figure 3.1 Industrial production growth, selected countries, 2008–2010 (percentages)



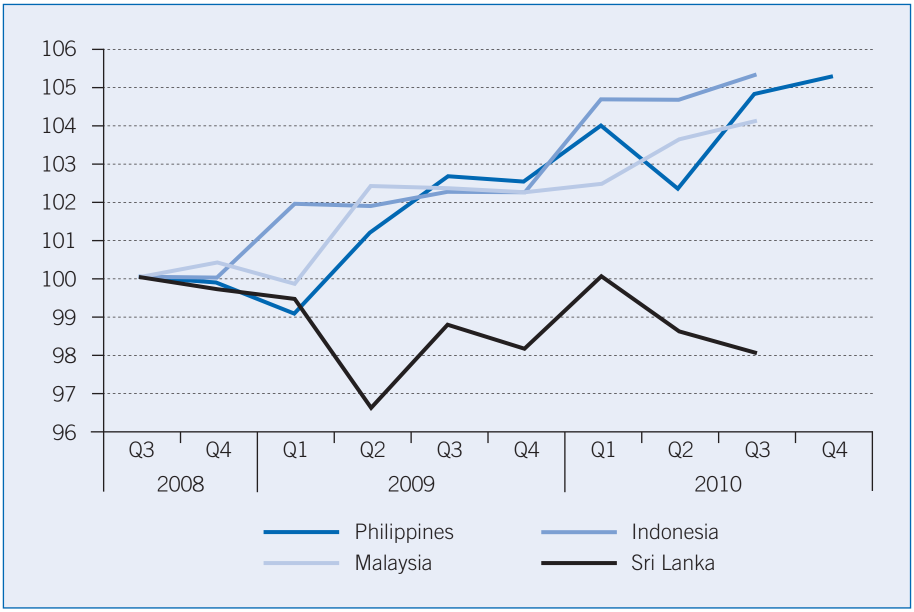

Source: National statistical offices.

monetary policy, which in turn weighed on business investment. Growth is expected to moderate slightly in developing Asia during 2011. In its January *World Economic Outlook Update* the IMF projected developing Asia to grow by 8.4 per cent in both 2011 and 2012, slightly slower than an estimated expansion of 9.3 per cent in 2010 and an average growth rate of 9.6 per cent between 2003 and 2007 (IMF, 2011). Smaller export-oriented economies that benefited strongly from rebounding Asian trade in 2010 are likely to experience the sharpest moderations in growth (Cambodia, Malaysia and Thailand). Economies with large domestic markets which are experiencing rapidly rising foreign investment inflows will probably experience a minor moderation in growth or possibly even a slight acceleration (China, India and Indonesia).

## 3.3 LABOUR MARKET RECOVERY

Labour markets in developing Asia were significantly affected by the global economic crisis, with widespread job losses, expanding informal employment and dropping household incomes (for a detailed discussion see Huynh et al., 2010). The available data so far indicates that some of the

Figure 3.2 Trends in employment, selected countries, 2008–2010 (Q3 2008 = 100)

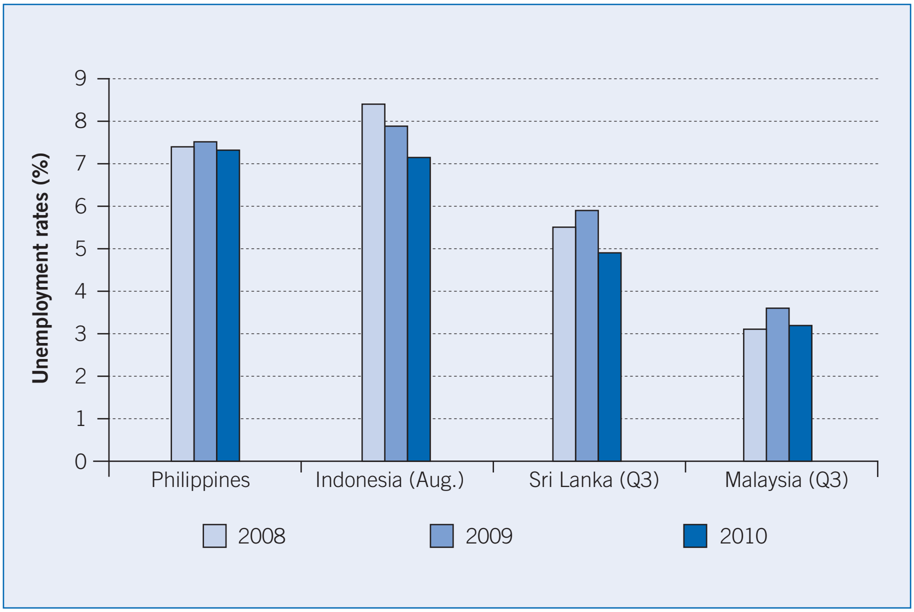



Source: National statistical offices.

region's labour markets are showing positive developments. In Indonesia, Malaysia and the Philippines, employment levels have continued to increase (figure 3.2). On the other hand, the employment level in Sri Lanka in the third quarter of 2010 was 2 per cent lower than in the corresponding period of 2008. Furthermore, developing countries continue to face longer-term labour market challenges that pre-date the crisis.

While employment growth in 2009 was insufficient to absorb the increasing labour force in Malaysia and the Philippines, leading to a rise in the unemployment rate in that year, employment growth has been stronger in 2010 and the unemployment rate has fallen to pre-crisis levels (figure 3.3). In Indonesia, the unemployment rate continued to decrease in 2008 and 2009. In Sri Lanka unemployment levels in the third quarter of 2010 were lower than the level in the same quarter of 2008, due largely to a steep decline in the labour force participation of women, which fell by 4.3 percentage points during this period (from 37.1 per cent to 32.8 per cent), aggravating even further the gender gap in labour force participation. Youth continue to face significant challenges in securing employment. While the adult unemployment rate fell between 2008 and 2010

Figure 3.3 Trends in unemployment, selected countries, 2008–2010 (percentages)




Source: National statistical offices.

in the Philippines and Sri Lanka, the youth unemployment rate (aged 15–24) increased in both nations.[2]

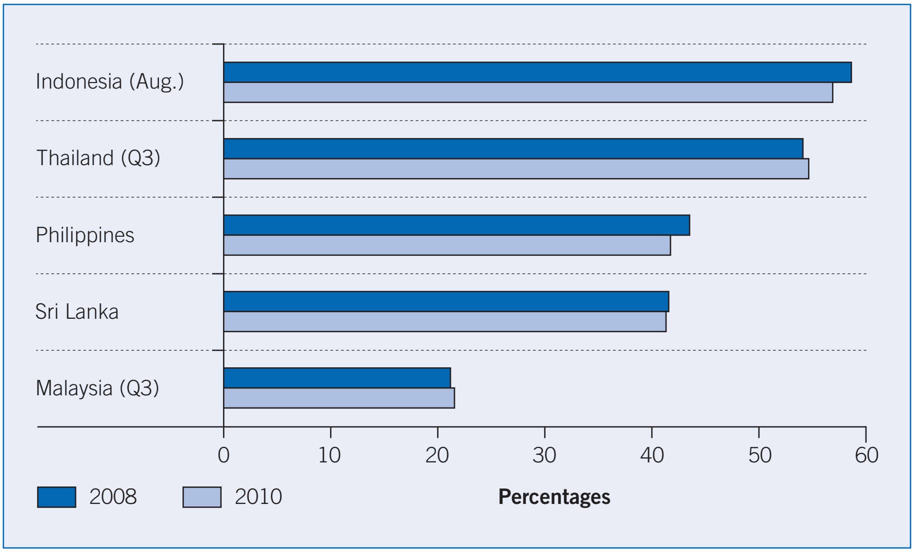
Progress on reducing vulnerable employment has also been mixed (figure 3.4). With recent strong growth in wage employment in Indonesia and the Philippines, the share of workers in vulnerable employment declined by 1.8 percentage points between 2008 and 2010 in both countries.[3] There is still a large number of workers in vulnerable employment, 56.8 per cent in Indonesia and 41.7 per cent in the Philippines. In Malaysia and Sri Lanka the share of workers in vulnerable employment has not fallen since 2008.

For most economies the majority of employment growth since 2008 has been in the services sector (figure 3.5). In Sri Lanka, while total employment decreased between 2008 and 2010, employment in services expanded, resulting in the share of services in total employment

[2] In the Philippines the youth unemployment rate rose from 17.4 per cent in 2008 to 17.6 per cent in 2010; in Sri Lanka it rose from 18 per cent in the third quarter of 2008 to 18.9 per cent in the same period of 2010.

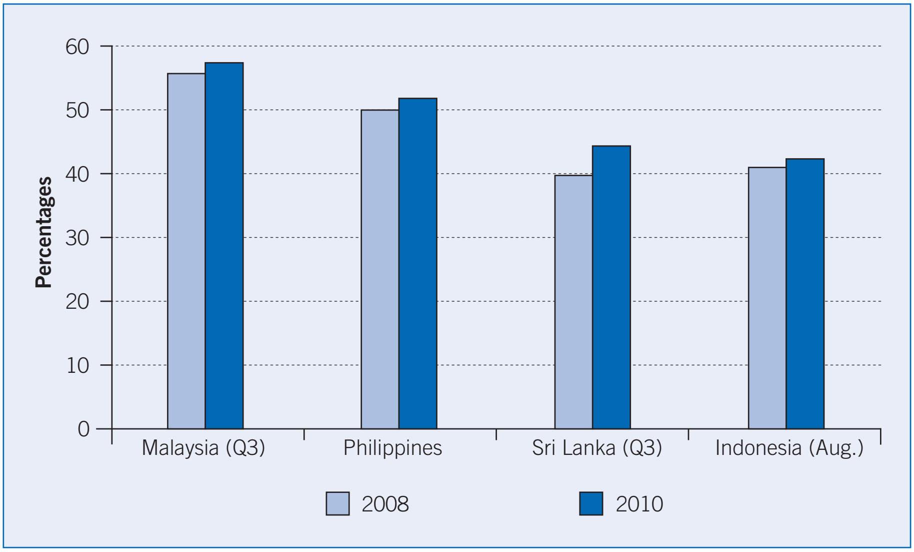
[3] Vulnerable employment is defined as the sum of own-account and contributing family workers.

Figure 3.4 Share of vulnerable employment in total employment, selected countries, 2008 and 2010 (percentages)




Source: National statistical offices.

Figure 3.5 Share of employment in services in total employment, selected countries, 2008 and 2010 (percentages)




Source: National statistical offices.

increasing from 39.7 per cent in the third quarter of 2008 to 44.3 per cent in the same period of 2010. A key challenge is to ensure that the employment expansion in the services sector takes place in higher value-added activities, given the heterogeneity of the sector. In Indonesia, the share of employment in services has grown from 40.9 per cent in 2008 to 42.3 per cent in 2010, but during this period the "community, social and personal services" subsector experienced the strongest employment growth, and as a consequence its share in total employment increased from 12.8 per cent to 14.7 per cent.

Although unemployment is falling and employment is increasing, improving the quality of jobs remains a challenge in developing Asia; around half of all employment is either of a vulnerable nature or on an informal basis, while youth unemployment rates are high (19.9 per cent in Indonesia). In many economies women's participation rates are very low (India 23.4 per cent, Sri Lanka 30.4 per cent). Another challenge pre-dating the crisis, and which may in fact have contributed to it, is rising income inequalities and a weak link between wage and productivity growth (for further discussion see IILS, 2008 and ILO, 2010d). In India, for example, the share of wages in output has continued to decline in the past two decades (IILS, 2010). While developing Asia has made a rapid recovery from the global economic crisis, it continues to face a number of critical challenges and policy-makers must put in place policies to ensure that high growth, equity and reductions in decent work deficits occur in tandem. Attention must also be paid to rapidly rising food prices, which have the biggest impact on the poor and have exacerbated the long-standing problem of wide inequality gaps. In South Asia food prices have risen at a particularly sharp pace. In India the food group component of the industrial workers' consumer price index increased by 31.4 per cent between January 2009 and January 2011.

## 3.4 POLICY PRIORITIES FOR THE RECOVERY AND BEYOND

This section discusses lessons learned from crisis responses in Asia and the Pacific region and presents some emerging policy priorities in the post-crisis era. It highlights the increasing emphasis on the quality of the workforce, efforts to strengthen social protection, the importance of infrastructure development and the promotion of financial inclusion, especially for small and medium-sized enterprises.

### 3.4.1 *Increasing emphasis on the quality of the workforce*

With the regional recovery under way by early 2010, education and training policies shifted from tackling short-term urgencies to addressing broader challenges, especially the quality of the workforce, in order to increase long-term growth potential. Many countries introduced major reforms to their education and training policies. The steps taken depended on national circumstances, but in most cases focused on increased public spending on human resources development, market orientation, private-sector involvement and quality-based training delivery.

Among higher middle-income countries, Malaysia provides a good example of how national priorities have shifted from crisis response to improving workforce quality and skills upgrading. Malaysia's New Growth Strategy, unveiled in March 2010, outlined a reform programme aimed at allowing the country to become a developed nation by 2020 (Gooch, 2010). The programme intends to support economic diversification and private-sector growth with measures such as boosting the quality of the workforce through improving the education system, especially higher education.

Singapore offers another example. Singapore's 2010 budget announced in March marked a dramatic shift from a more reactive crisis response in the previous two years to a new, more proactive budget, with policies centred on long-term productivity gains for sustained and inclusive growth. More than 10 per cent of the budget was earmarked for boosting productivity, upgrading skills and creating a National Productivity and Continuing Education Council to coordinate the nation's various productivity and training initiatives. In presenting the budget, the Finance Minister stated that "our priority during last year's global crisis was to keep jobs. Our priority must now be to improve the quality of jobs" (Government of Singapore, 2010; Wijaya, 2010).

Low-income and lower middle-income countries with employment shares dominated by agriculture and informal employment tended to focus on broadening access to secondary, technical and vocational education while improving service delivery. Some economies are yet to achieve even universal basic education, while large gender gaps are present in enrolment rates in a number of economies. India's recent education bill provides a good example of how to address this problem. In April 2010, the Government announced a landmark law which makes free education a fundamental right for all children aged between 6 and 14 (AFP, 2010).

Many countries in the region have encouraged public–private partnerships for planning, financing and modernizing training programmes. Bangladesh, Indonesia, Malaysia and Viet Nam have created mechanisms for close industry involvement. Measures implemented include the introduction of quality assurance and an accreditation process, training of trainers and improved management capacity that needs to be in place to achieve progress. Employability and core work skills are increasingly relevant.

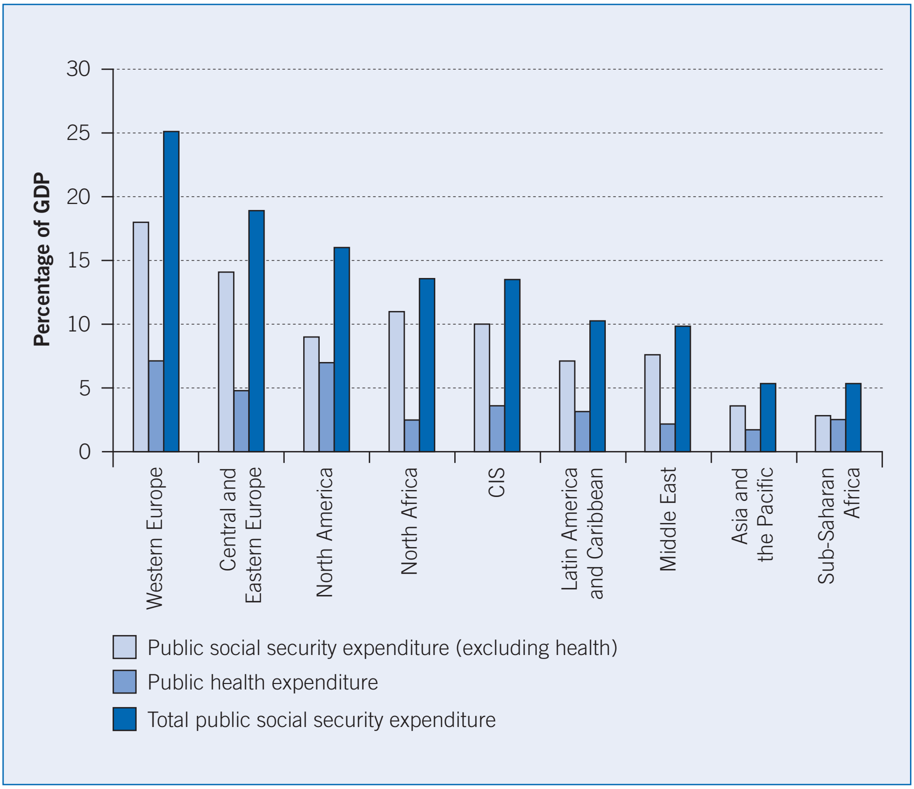
Core labour standards and social dialogue are not only central to enhancing the quality of the labour force through stimulating improved productivity, better working conditions and increased investment in the workforce, but can also ensure that labour incomes grow in line with productivity and hence contribute to a more sustainable and inclusive growth.

### *3.4.2 Strengthening social protection*

Many governments recognized the importance of social protection during the crisis and stepped up their efforts in their overall policy responses. Given the urgent need for action, policy-makers focused on scaling up existing schemes, including social transfer programmes and public works schemes. Some important lessons have been learned:

- *Improving the protection of the near poor.* Measures often failed to reach the group worst (and first!) affected by the crisis: the near poor who had escaped poverty in the good years prior to the crisis, now faced the prospect of slipping below the poverty line as they lost their jobs in urban export-oriented industries. Unemployment insurance could have slowed the transmission of the crisis from urban to rural areas. However, very few countries in the region have a proper unemployment insurance system.
- *The roles of self-targeting and automatic stabilizers.* Programmes with self-targeting components that encourage beneficiaries to enrol when in need, and drop out when better opportunities arise, have produced better outcomes and required lower costs than across-the-board measures, for example India's National Rural Employment Guarantee Scheme. Evidence suggests that self-targeting schemes and automatic stabilizers have a more prompt and consistent countercyclical effect than do discretionary policies (IMF, 2008a), and that their fiscal cost automatically declines when the number of beneficiaries falls back.
- *Protecting human capital.* In encouraging poor households to keep their children in education and out of work, the most effective programmes are those that combine measures to lower educational costs with incentives for parents to keep children in school,

Figure 3.6 Total public social protection spending as a proportion of GDP, by region (percentages, weighted by population)




Source: ILO, 2010f (p. 81, figure 8.1).

for example by giving affordable access to regular medical check-ups. Indonesia and the Philippines implemented this kind of conditional cash transfer in 2007 and scaled them up as part of their crisis response (Ravallion, 2008; Das et al., 2004).[4]

- *Investing more in social protection.* The crisis has brought to light how weak social protection in the region is, and how little governments spend on it, despite spectacular economic advances in the past decades. Out of all world regions, Asia and the Pacific and sub-Saharan Africa have the lowest levels of public spending on health and social security (figure 3.6).

[4] There is evidence from impact evaluations that conditional cash transfers bring real benefits to poor households in terms of both current and future income through increased investment in child schooling and health care.

There is now a growing recognition that increasing public spending on social protection is important in the post-crisis era for four main reasons. Building a social protection floor – which could include basic health care and minimum income support for families with children, the elderly, the working poor and vulnerable groups such as persons with disabilities, and other features that vary according to country needs and stages of development – could:

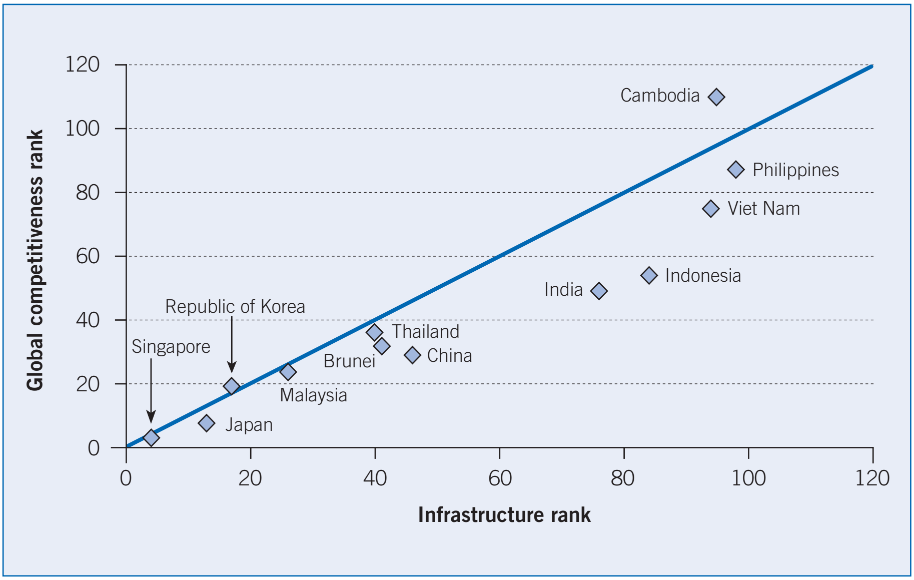
- reduce poverty;
- strengthen the resilience of societies to future economic shocks;
- reduce the cost of adjustment to changing economic conditions; and
- support consumption and domestic demand.

Providing a comprehensive social protection floor for all citizens is an affordable option for many developing economies (for details see Chapter 12 in this volume). In the post-crisis era, many Asian developing economies have introduced elements of a social protection floor, including universal or targeted health care (China, India, Indonesia, Thailand and Viet Nam), a minimum old-age pension (China and Thailand) and free education (Indonesia and Thailand). In Cambodia, the Government is developing and piloting a National Social Protection Strategy for the poor and vulnerable. There has also been growing interest in unemployment insurance, with feasibility studies under way in Malaysia and the Philippines.

### *3.4.3 Infrastructure development*

Investment in infrastructure was a major component of stimulus measures during the crisis – in many countries the largest. It played a key role in creating jobs and supporting consumption (for details see Chapter 10 in this volume), while, over time, increased infrastructure will improve competitiveness and expand markets. In addition, the quality and extensiveness of infrastructure networks could significantly reduce poverty and income inequality by enabling less developed communities to connect to product markets and social services. Infrastructure development therefore remains a priority in the post-crisis era, as the need for infrastructure is pronounced throughout the region for high-, middle- and low-income countries. Ten of the 12 countries for which data are available have a lower infrastructure ranking than their overall competitiveness ranking (figure 3.7). Poor infrastructure in energy, transport and telecommunications sectors remains an impediment to growth in many parts of developing Asia. The primary reason for this has been the low

Figure 3.7 Global competitiveness and infrastructure rankings, selected countries, 2009–2010




Source: World Economic Forum, Global Competitiveness Index Analyzer 2009–2010.

level of public spending on infrastructure over the past decades.

Improvement in infrastructure could not only place countries such as India, Indonesia and Viet Nam on a stronger growth trajectory but could support domestic demand, create millions of jobs and reduce inequalities and poverty. Better infrastructure is also a prerequisite for deeper regional integration driven by the ASEAN commitment to create a single market by 2015 and the prospect of slower economic growth in major markets in the medium term, especially in the G3 countries. The importance of infrastructure development was reaffirmed in April 2010, through the ASEAN Leaders' statement on sustainable recovery and development (ASEAN, 2010).

To meet infrastructure needs, a scaling up of public investment and improvements in the quality of spending are needed in many countries in the region. Public investment programmes can be stepped up where there is fiscal space, with budget reforms aiming to improve administrative capacity, spend efficiently and facilitate the implementation of capital projects. Although public funds are important, governments alone cannot meet the large funding requirements for the necessary infrastructure investment in the coming years.[5] Removing barriers to private investment and encouraging foreign investment can help to meet the infrastructure challenge. Public policy reforms that enhance competition and market-based regulation can encourage private investment in infrastructure. Greater use of public–private partnerships, if well managed, could potentially allow the public sector to take advantage of private-sector efficiencies.

### 3.4.4 Promoting inclusive financial services

Small enterprises typically do not have proper financial records and also often lack acceptable collateral. These factors tend to raise the costs of processing loan applications and reduce the attractiveness of the sector for financial markets. Such problems became particularly serious during the global economic and financial crisis, prompting policy-makers in many countries to introduce small and medium-sized enterprises (SME) support programmes with a special focus on improving availability of financing.

In the post-crisis era, there has been a growing interest in identifying lessons learned on how to enhance financial inclusion systematically to increase access to credit for the private sector, especially SMEs.[6] Enhancing financial inclusion is a key component of a pro-employment framework promoting balanced, sustainable and job-rich development (ILO, 2010g). Addressing the problem of access to finance for SMEs in a sustainable manner requires finding cost-effective channels for granting a large number of small loans to a heterogeneous set of small firms. Many countries have made progress. For example, in 2008 India announced a National Rural Financial Inclusion Plan, which set the target of providing financial services to all excluded rural households by 2015. And in Bangladesh the central bank has taken steps to increase the flow of credit to micro and small enterprises and promote the provision of financial services to groups lacking access (Reuters, 2010).

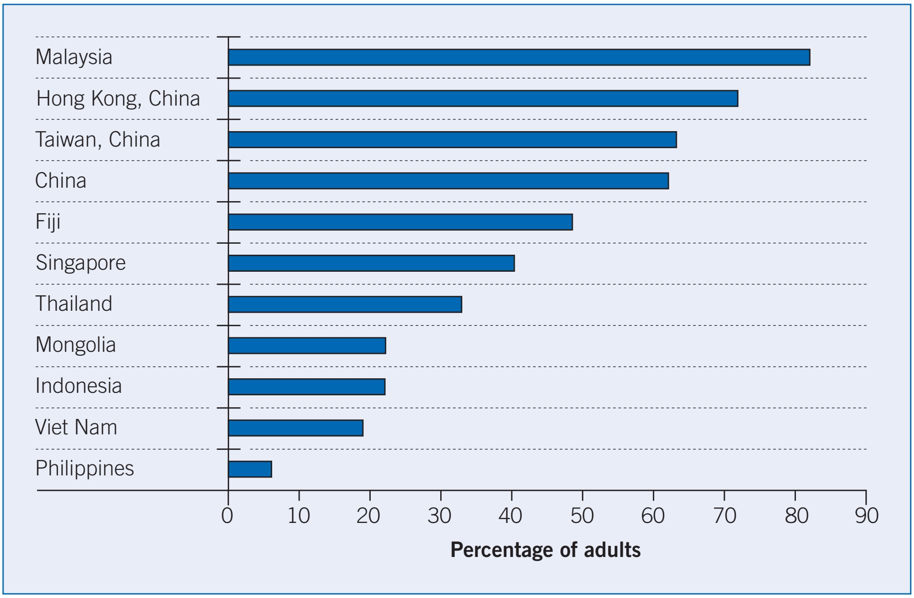
Some lessons learned in the region point to the role of specialized market institutions, such as credit information systems and collateral registers, coupled with adequate legal frameworks for secured transactions. Credit information registries that collect and make available data

---

[5] For example, it is estimated that India requires around US$150 billion for the creation and maintenance of infrastructure (Sahoo, 2010). This would amount to 62 per cent of total expenditure in the union budget for 2010–2011, as opposed to the approximately 16 per cent currently allocated for infrastructure.

[6] Financial inclusion is also important for micro enterprises that often cater to the needs of the poor and vulnerable households who seek durable self-employment. The issue of effective microfinance institutions is beyond the scope of this chapter.

Figure 3.8 Credit information coverage in East Asia and the Pacific (percentage of adults)




Source: Mylenko (2011).

on loan repayments help lenders to better assess risk and lower the costs of processing loan applications. Recent research suggests that the probability of lending to SMEs increases with the coverage of a credit information system in a country (Mylenko, 2011).

The availability of credit information is a particularly acute problem in South Asia, while a number of countries in East and South-East Asia have made significant progress. In China, credit information coverage has increased from zero to 62 per cent in recent years. Indonesia, Mongolia and Thailand have also made progress (figure 3.8).

As many developing economies in the region reform their financial infrastructures, these examples highlight the importance of enabling public policy in the implementation of innovative scaleable solutions in order to enhance inclusive access to finance for SMEs. But other measures are also critical, which include creating a regulatory and legal environment conducive to micro and small enterprises, helping small firms integrate into markets through trade and value chains, providing effective business support services catering to the needs of SMEs, extending adequate social protection to workers in small firms, supporting workforce education, addressing informality and promoting social dialogue and democratic governance.

## 3.5 CONCLUSIONS

The impact of the global economic and financial crisis on the economies of Asia and the Pacific was considerable, translating into squeezes on enterprises, widespread job losses, expanding informal employment and falling household incomes. Strengthening the recovery and ensuring growth with equity and reductions in decent work deficits very much depends on drawing lessons from the crisis, choosing the right policy priorities and enhancing policy coherence.

Four policy areas are likely to be of particular relevance for countries in the Asia and the Pacific region in this regard. The first is enhancing the quality of the workforce to increase long-term growth potential, including through adherence to core labour standards. The second is gradually building a social protection floor and other "automatic stabilizers" of social protection within a framework of fiscal sustainability, to strengthen the resilience of societies to future economic shocks and support consumption and domestic demand. The third is increasing investment in infrastructure, which can in the short term create jobs and in the longer term reduce poverty and income inequality by enabling less developed communities to connect to product markets and social services. The fourth is providing support to SMEs, with a special focus on improving the availability of financing.

# THE LABOUR MARKET IN THE ARAB STATES: RECENT TRENDS, POLICY RESPONSES AND FUTURE CHALLENGES

4

*Zafiris Tzannatos, Tariq Haq and Dorothea Schmidt**

## 4.1 INTRODUCTION

Relatively few new measures in the Arab region can be readily identified as policy responses to the global financial and economic crisis. This is unsurprising, because the direct effects of the crisis in the Arab economies were limited – at least at face value and given the quality of regional statistics. The United Arab Emirates (UAE) was a notable exception, primarily because of the financial and real estate bubble in one of its States, Dubai. Where there were policy responses, their focus was primarily on securing the viability of the financial and banking sectors.

Many measures taken in the Arab region after the crisis were planned before it struck (for example, the social security reform in Jordan or the expenditure package of the ongoing ninth Plan of Saudi Arabia). In other cases pre-existing reform plans continued in the areas of fiscal consolidation, liberalization of certain sectors and rationalization of their tax, subsidy and social protection regimes. Some of them may be reversed in the near future in view of the political developments in the region that started with the uprising in Tunisia at the end of 2010. For example, Egypt announced a 15 per cent increase in public-sector salaries and pensions in February 2011. In Tunisia some contracts of precarious nature were turned into permanent contracts. Inflation, in particular

* The authors are Senior Regional Adviser for Employment Policy and Macroeconomics, ILO Regional Office for the Arab States (ROAS), Beirut; Senior Economist, Employment Analysis and Research, Employment Sector, ILO, Geneva; and Senior Employment Specialist, ILO Decent Work Team for North Africa (DWT-Cairo), respectively. Research assistance by Noura Kamel and Hadi Assaf (ROAS) is greatly appreciated.

the recent hike in food prices, is creating an opportunity to increase or reintroduce food subsidies, as has been the case in the United Arab Emirates and Bahrain. And, in March 2011, Saudi Arabia announced a large package of 135 billion Saudi Riyals (SR) (US$36 billion) to support citizens through unemployment benefits, strengthen the safety net for lower-income Saudis and provide funds for writing off debts as well as for housing, education, charity associations and professional associations.

Given the relatively mild policy response to the crisis and the fact that some developmental measures would have been introduced independently even if the crisis had not taken place, and together with the more recent social and political developments and political responses to these, it is difficult to disentangle specific measures with regard to the crisis. Moreover, it is difficult to generalize about the 22 States in the Arab region, given the paucity of data and the diversity of the countries within it. Despite these limitations, this chapter aims to provide an account of post-2008 developments in the region and to indicate some of the challenges that lie ahead.

## 4.2 LABOUR MARKET TRENDS

Although the crisis had a relatively limited impact on GDP growth and labour markets, pre-existing challenges were accentuated. The few positive trends that had begun before the crisis came to a halt; the labour market remains saddled with many structural, not cyclical, issues. Some of these are discussed below.

### *4.2.1 Low employment-to-population ratios*

Starting from very low levels before the crisis (46.2 per cent in 2008, see table 4.1), employment-to-population ratios remained practically the same in the Arab region[1] after the crisis. The low overall rate in the Arab region compared to the rest of the world is largely attributable to very low rates for women and young people.

[1] The Arab region includes Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Occupied Palestinian Territory, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, United Arab Emirates and Yemen. In this chapter, aggregate estimates for this region are presented under “22 Arab States” in the data tables based on the ILO’s *Trends econometric models* (ILO, 2010h). The “Middle East” region includes Bahrain, Iran, Iraq, Jordan, Kuwait, Lebanon, Occupied Palestinian Territory, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen. The “North Africa” region includes Algeria, Egypt, Libya, Morocco, Sudan and Tunisia. Data and facts not explicitly referenced in this chapter come from ILO (2010h) and more information is available from the authors.

### *4.2.2 High unemployment rates and low growth in quality jobs*

Unemployment in the Arab region is extremely high, standing at 10.1 per cent in 2010, compared to a world average of 6.2 per cent. The total unemployment rates in both Arab sub-regions eased in 2010, having increased marginally in 2009 (see table 4.1), but the rate for women was 15.8 per cent compared to 8.2 per cent for men. Although there was little change in the overall unemployment rates, this is partly explained by the fact that during the crisis many women simply dropped out of the labour market, thereby reducing the number of unemployed. This underlines the need to look at more than just unemployment rates in the interpretation of labour markets.

Youth unemployment trends followed a similar pattern to the total rate, estimated at 24.8 per cent (see table 4.1) in 2010 escalating to 33.3 per cent for young women (compared to 21.5 per cent for young men). Within the Arab region, North Africa seems to have done better than the Middle East after 2008: in fact, female youth unemployment in North Africa declined more than in the Middle East and the rest of the world.

One striking feature in the Arab region is the high share of well-educated youth amongst the unemployed. Related to this is the fact that, while in other world regions the unemployment rate declines among higher-income households, this is not the case for the Arab region. In some countries, such as Egypt, the unemployment rate seems to be higher among higher-income households (Montenegro and Hirn, 2008). This generates frustration across all social strata and can be linked to the recent social unrest across many countries in the region, which was dominated by young educated people.

Almost four out of ten people (37 per cent) in the region with a job in 2009 had a vulnerable job, working either as own-account workers or as unpaid contributing family workers. This share is higher in North Africa (40.4 per cent) than in the Middle East (32.7 per cent) though both sub-regions have lower shares than other regions, with the exception of Europe (European Union and non-European Union/CIS) and Latin America. Wage and salary work – the type of job with a higher likelihood of being decent – declined in North Africa and remained unchanged in the Middle East (table 4.2). Unpaid contributing family work increased in North Africa and again remained unchanged in the Middle East. Overall, the vulnerability rate for the region remained unchanged due to counterbalancing trends in the two sub-regions, with an increase in North Africa and a decrease in the Middle East. Compared to the rest of the world, where the vulnerable group comprises more than half the workforce, the rate in the region is relatively low at 37 per cent, partly the

Table 4.1 Arab States: Employment-to-population ratios, unemployment rates and youth unemployment rates, 2007–2010 (percentages)

| Region | Employment-to-population ratios | | | | Unemployment rates | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total | | | | Youth | | | |
| | 2007 | 2008 | 2009 | 2010p | 2007 | 2008 | 2009 | 2010p | 2007 | 2008 | 2009 | 2010p |
| WORLD | 61.7 | 61.6 | 61.2 | 61.1 | 5.6 | 5.7 | 6.3 | 6.2 | 11.8 | 11.9 | 12.8 | 12.6 |
| 22 Arab States | 45.8 | 46.2 | 46.1 | 46.2 | 10.4 | 10.0 | 10.2 | 10.1 | 25.3 | 23.9 | 24.7 | 24.8 |
| Middle East | 45.3 | 45.1 | 45.2 | 45.4 | 10.5 | 10.2 | 10.3 | 10.3 | 24.5 | 24.5 | 24.9 | 25.1 |
| North Africa | 46.1 | 46.5 | 46.4 | 46.6 | 10.2 | 9.6 | 9.9 | 9.8 | 24.3 | 22.6 | 23.4 | 23.6 |

Note: p = preliminary estimate.
Source: ILO (2010h).

Table 4.2 Arab States: Changes in employment status, 2007–2009 (percentages)

| Region | Percentage change in shares | | | | |
|---|---|---|---|---|---|
| | Wage and salaried workers | Employers | Own-account workers | Contributing family workers | Vulnerable employment |
| WORLD | 0.1 | 0.0 | –0.1 | 0.0 | -0.1 |
| 22 Arab States | –0.5 | 0.5 | –0.7 | 0.7 | 0.0 |
| Middle East | 0.0 | 0.2 | –0.2 | 0.0 | -0.2 |
| North Africa | –0.9 | 0.6 | –1.0 | 1.2 | 0.2 |

Source: ILO (2010h).

result of the relatively small agricultural sector where most of the family workers can be found.

### 4.2.3 High share of public-sector employment

Though there has been little discernible change in the employment share of the public sector after the financial crisis, its large size is a characteristic feature of the region. According to 2004 data, the public sector in the Arab region represented some 29 per cent of total employment, and wages absorbed some 38 per cent of current public expenditure. This is almost double the world average, excluding China. Public-sector reforms and policies to encourage privatization and to support private-sector development, introduced recently in several countries in the region, have not yet succeeded in changing this pattern significantly. However, there are some variations across countries, ranging from the low share of the public sector in Morocco (10 per cent) to more than 80 per cent among employed nationals in most of the Gulf Cooperation Council (GCC) Member States.

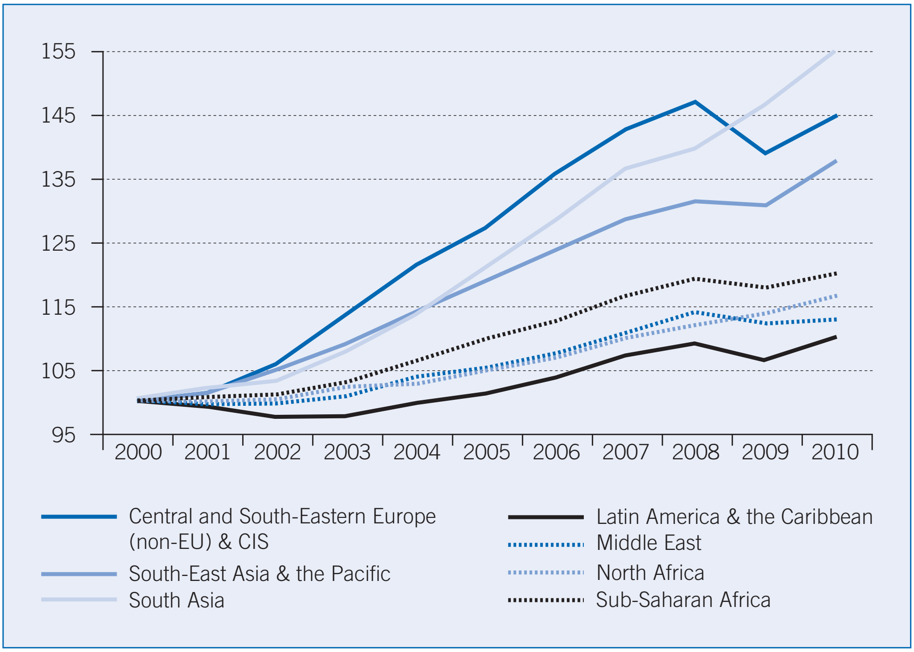
### 4.2.4 Limited growth in productivity

Increases in productivity (measured as output per worker employed) in the Arab region have consistently lagged behind other world regions for many years (figure 4.1). However, North Africa seems to have had a relatively high increase in productivity following the crisis. In the Middle East productivity stayed practically the same, while it declined in most other regions with the exception of South Asia.

## 4.3 CRISIS TRANSMISSION CHANNELS

As is evident from the above discussion, the Arab economies were less affected by the financial crisis than other parts of the world. Most managed to maintain positive, albeit lower, GDP growth rates during and after the crisis. During the first months of the global crisis, the transmission channels were financial markets although, due to the relative insulation of some economies in the region from global markets and generally low levels of market capitalization, this transmission channel had rather limited impact. Furthermore, in the oil-exporting economies a cushion of surplus liquidity had been built up as a result of high oil prices over the preceding years. Finally, due to the relatively weak links with world trade markets (Arab States accounted for less than 5 per cent of total

Figure 4.1 Changes in productivity, by region, 2000–2010 (Index 2000 = 100)




Note: Excludes East Asia where the productivity index grew to 221 by 2010.
Source: ILO (2010h).

world exports), the reduction in global trade following the crisis affected the Arab economies less than others.

Nevertheless, the financial crisis hit some real economic sectors. Tourism slowed down in some countries (for example, Egypt, Jordan and Tunisia). Rising oil and commodity prices had a mixed effect, as they benefited net energy exporters but yielded costs for net importers. Foreign direct investment (FDI) inflows in the region fell from US$35 billion in 2008 to $28 billion in 2010.[2]

Remittances are an important source of income for middle- and low-income countries in the Arab region, partly compensating for the relative absence of formal social protection mechanisms. Remittances declined by 8 per cent for the middle-income group[3] and 2 per cent for

[2] Estimates provided by the World Bank and UNCTAD.

[3] Algeria, Egypt, Jordan, Lebanon, Morocco, Occupied Palestinian Territory, Syria and Tunisia.

the lower-income group[4] between 2008 and 2009. In 2010 remittances grew on average by 5.3 per cent.[5]

## 4.4 SELECTED POLICY RESPONSES

Where there was an identifiable response to the crisis, governments put most emphasis on the financial sector, aiming to reduce the systemic effect arising from lack of credit. Fiscal and monetary measures followed to maintain economic activity at the macro level. While many projects were postponed and some abandoned, increases in public spending, if not rescue packages as such, were introduced or announced in Egypt, Jordan, Libya, Mauritania, Morocco and Tunisia as well as in some GCC economies. Egypt focused on the building and construction sector, as well as government investments in water, sewage, infrastructure, railways and airports. In Morocco the Government targeted tourism as well as the textile, leather and automobile industries. In the GCC, governments provided continued support to the construction, petrochemicals, oil/gas and water sectors. However, these and other measures, such as tax reductions and support to various industrial sectors, were not made in such a way that employment-intensive sectors were favoured over non-employment-intensive ones.

Enterprise support took various forms. In Djibouti and Egypt enterprises were to benefit from various tax reductions and exemptions. In Morocco and Tunisia they were given a tax "holiday" with respect to their social security contributions (meaning they can postpone or be excused from paying their contributions for a period of time). The Dubai Government began implementing measures to ease visa rules for foreign property owners and abolished the UAE Dirhams 150,000 (US$41,000) minimum capital requirement for starting a business.

Many governments set up mechanisms for monitoring the effects of the crisis. New committees for providing follow-up reports on the crisis were created in Jordan, Saudi Arabia and Sudan. In some cases there was an expansion of dialogue between the social partners. Jordan formed a high-level committee to study the impact of the global crisis on the economy and created a socioeconomic council composed of representatives of employers, employees, civil society institutions and the public sector.

Countries took defensive action, some due to the crisis and others as part of their development objectives. In Algeria, measures aimed at

[4] Comoros, Djibouti, Mauritania, Sudan and Yemen.

[5] IMF (2010c) and UNDP (2010a) estimates for the Arab region.

restricting foreign investors to a minority share (49 per cent) of joint ventures with local companies, and for companies importing goods for re-export to cede a 30 per cent share of their capital to local entities. In Iraq, tariffs were raised, a step which may appear defensive but was announced as an incentive to foreign companies to locate their operations within the country.

Salary increases for civil servants were given in most countries, and in a number of countries minimum wage levels were raised (Jordan, Lebanon, Morocco and Tunisia). Income protection schemes were also introduced in some countries, such as unemployment insurance including assistance for new jobseekers (Bahrain).

Some countries with large numbers of migrant workers took measures to reduce their numbers. Kuwait announced a reduction in the number of expatriate workers in the public sector by half (from 15,000 to 8,000) over the course of the new five-year plan, together with measures to deport around half a million foreign workers (about 15 per cent of the country's population) who lack skills, are unemployed or stay illegally in the country. In Saudi Arabia, the number of foreign workers is expected to decline more drastically: from nearly 9 million to only 2 million in the next eight years.

Finally, a range of labour market programmes also received attention. These include job-sharing and early retirement programmes (Tunisia), support and subsidies for SMEs (Bahrain, Egypt, Jordan, Morocco, Tunisia and United Arab Emirates), expansion of employment services (Saudi Arabia) and of training schemes for unemployed youth.

While some governments introduced measures that were expected to have an expansionary effect, others continued with their established programmes of liberalizing the economy. For example, there was the removal or reduction in the level of subsidies in Jordan, Syria and Yemen. Some governments took complementary measures to cushion the costs of these economic reforms along with the additional costs expected to arise from the crisis. For example, Egypt planned to go ahead with regulatory reforms adopted in 2008 in the areas of tax law, tariff schedules and the economic courts law, but also planned to introduce various measures in support of its employment and social assistance objectives. Jordan's reforms continued in the areas of tourism, petroleum, taxation, insurance and qualifying industrial zones (QIZs) but also introduced compensatory social safety net measures to alleviate the social costs that would arise from the removal of subsidies from the more vulnerable segments of the population.[6]

[6] Many of these measures and the general move towards the liberalization of the economy were halted or even reversed following the social crisis in the region since December 2010.

## 4.5 KEY CHALLENGES

While the apparent impact of the financial crisis was limited, the crisis highlighted the challenge of quality employment creation that is likely to become an even more pressing concern in the wake of the recent social unrest in some countries. GDP growth in 2010 was forecast to reach 3.6 per cent in the Middle East and over 5 per cent in North Africa. However, an analysis carried out before the crisis estimated that to keep unemployment from rising in selected countries in the region, the annual economic growth rates should generally be in the range of 7 to 10 per cent (LAS and UNDP, 2009). A more recent analysis has estimated that, at the current rate of economic growth, the region will be able to create only 11 million new jobs in the next decade against the 18 million required to absorb the unemployed and new entrants to the labour force (IMF, 2010c).

In addition, the recent political developments in the region imply that the future course of the Arab economies in the short to medium term is probably more uncertain than in other world regions. Nevertheless, the Arab region shares some more or less common structural features so that, if addressed properly, the countries can set in motion sustainable developmental processes and strengthen the mechanisms that could reduce and mitigate future adverse effects (Haq et al., forthcoming). Some related policy directions are highlighted below.

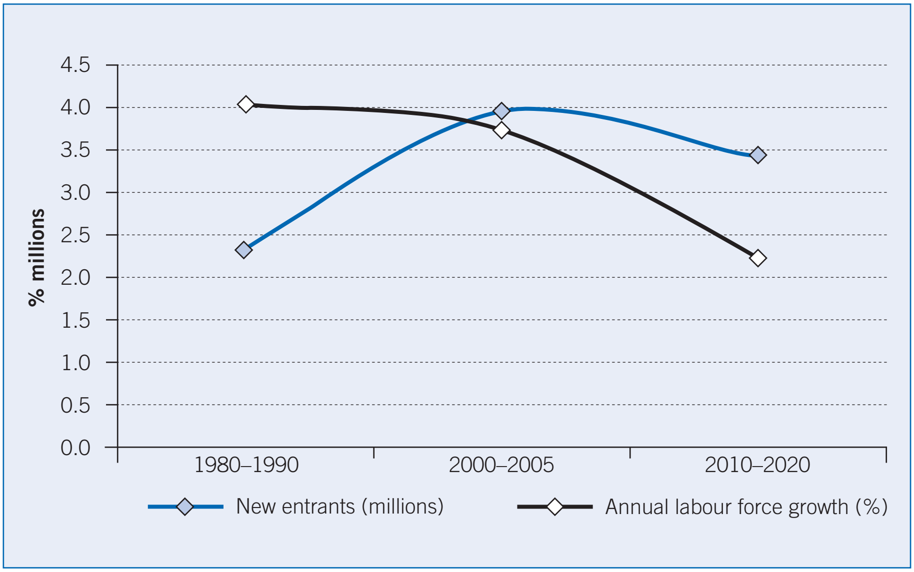
### *4.5.1 Take advantage of the already closing demographic window of opportunity*

The demographic window of opportunity is closing fast in the Arab world and the Arab region faces the risk of failing to make good use of it. Opening in the mid-1990s (figure 4.2), this window is expected to close around 2045, more or less at the same time in most Arab countries.

There are several aspects to the window of opportunity. First, because new entrants to the labour force are better educated than existing workers, they will improve the quality of the labour force and are likely to be more productive as well as more adaptable to changing jobs throughout their working lives. Second, the increasing labour force participation rates and the resulting increase in the number of potential workers versus pensioners and children (thus lowering the dependency ratio) will enable governments to adjust their social insurance schemes towards long-term sustainability and adequacy. Finally, low dependency rates should also cause individual savings and investment to increase.

Countries in Europe took advantage of the demographic window of opportunity after the Second World War, and more recently Latin

Figure 4.2 Middle East and North Africa: Labour force growth, 1980–2020




Source: Tzannatos (2008).

American and East Asian countries have done the same. In East Asia economists estimated that the demographic "dividend", the benefits of having a young and educated population, contributed to as much as one-third of its growth between 1965 and 1990 – and this was a period of fast economic growth. The "youth bulge" in the Arab region should therefore be seen as an opportunity rather than a problem.

### 4.5.2 Support the creation of jobs that are acceptable to jobseekers

Paramount for the Arab economies is the need to put more emphasis on policies that create employment and reduce unemployment. The two concepts are not synonymous. For example, the employment response to output growth in most Arab countries has been the most robust compared to other regions in the last decade, yet unemployment figures have failed to improve. Youth unemployment is particularly high in the region but policies are needed to tackle both adult and youth unemployment. Policies must address not only labour supply constraints (such as education and skills development), but also demand-side deficiencies.

In terms of labour demand, the Arab region has been creating jobs much faster than others in the decade that ended with the crisis. For example, the employment response to output growth was almost double in the Arab countries compared to the Asian economies, 55 per cent compared to 30 per cent respectively (table 4.3). However, the region has not been creating decent jobs acceptable to nationals, as wages and conditions in many cases were diluted due to unmanaged migration (not only in the GCC economies). Many skilled Arabs continue to emigrate, which reinforces the proposition that labour demand, in this case demand for skills, is low. Creating decent employment acceptable to jobseekers is thus very much related to migration, which is examined next.

Table 4.3 Annual employment and output growth rates and their ratios, selected Asian, Pacific and Arab countries, 2001–2008

| Asia and Pacific | GDP | Employment | Arab countries | GDP | Employment |
|---|---|---|---|---|---|
| China | 10.5 | 0.9 | Bahrain | 6.7 | 2.2 |
| India | 7.0 | 2.4 | Kuwait | 7.9 | 2.9 |
| Indonesia | 5.4 | 1.7 | Oman | 4.6 | 2.3 |
| Japan | 1.4 | -0.1 | Saudi Arabia | 4.2 | 3.2 |
| Republic of Korea | 4.4 | 1.4 | United Arab Emirates | 7.9 | 5.0 |
| Malaysia | 5.7 | 1.8 | *Average* | *6.3* | *3.1* |
| Mongolia | 8.2 | 3.2 | *Ratio* | *49%* | |
| Pakistan | 5.3 | 3.7 | Jordan | 7.3 | 4.4 |
| Philippines | 5.3 | 2.8 | Lebanon | 4.8 | 2.1 |
| Sri Lanka | 6.0 | 1.7 | Syrian Arab Republic | 4.2 | 4.0 |
| Thailand | 5.2 | 1.7 | *Average* | *5.4* | *3.5* |
| Viet Nam | 7.6 | 2.0 | *Ratio* | *65%* | |
| *Average* | *6.0* | *1.9* | *Average (All)* | *6.0* | *3.3* |
| *Ratio* | *30%* | | *Ratio* | *55%* | |

Source: ILO (2011b).

### *4.5.3 Manage migration to increase productivity and reduce inequality*

Migration has historically been important in the Arab world and is becoming increasingly so. This "economic" phenomenon is to be expected in an era of globalization and greater integration of the world economy. But it is also a serious human rights issue.

Traditionally, and justifiably, migration has attracted attention especially when the rights and welfare of migrant workers are violated, at times bluntly. However, one can argue that migration policies should also respect the rights of nationals. Unmanaged migration can violate the rights of citizens due to the resulting segmentation between the jobs migrants are doing under different pay and conditions from nationals, who in turn do not want to do these jobs. This leads to an additional segmentation between the public sector and the private sector through the resulting resistance of nationals to be employed in the private sector under wage and employment conditions more commonly found in the country of origin of migrants. In turn, this creates fiscal pressures due to an expanding public sector, in addition to over-employment and low productivity in that sector that can have adverse effects on the quality of public and social services.

In addition to segmentation, unmanaged migration can accentuate inequality by giving employers access to low-wage migrants and higher profits while restricting employment options for nationals and reducing their labour earnings. Productivity is also restricted, because employers choose labour-intensive techniques, which in turn imply that national jobseekers have low incentives to invest in education and acquire skills that are not going to pay much in the private sector. Hence, they opt for credentialism; that is, they invest in acquiring the minimum level or least demanding type of education that would satisfy the criteria for getting a job in the public sector. The earlier discussion in this chapter suggests that many symptoms in the Arab labour markets can be related to migration.[7] Thus, managing migration, especially for the GCC and some other countries (such as Egypt and Jordan), and more emphasis on the demand for skills are two of the most pressing policy areas for the Arab region.

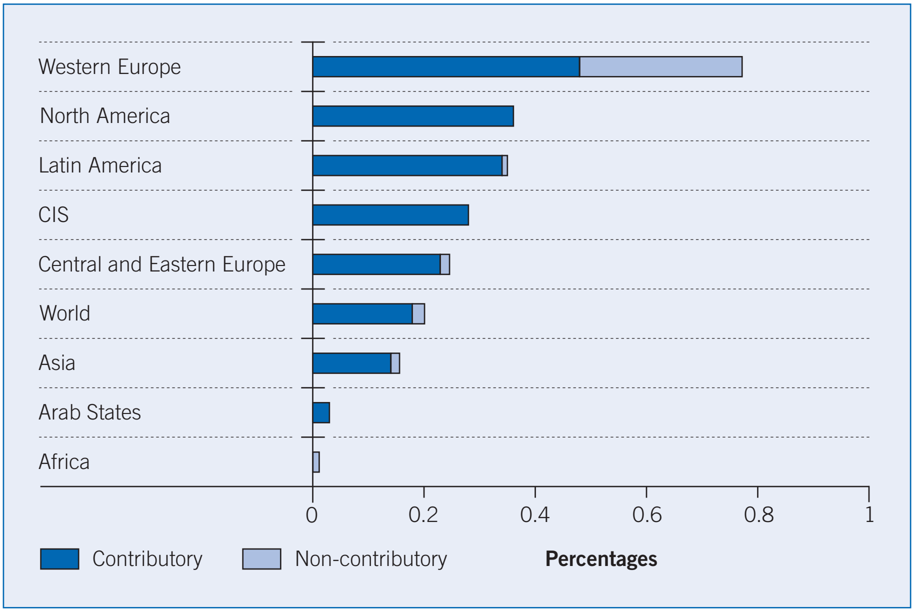
### *4.5.4 Expand social protection*

The region suffers from low social protection coverage. When present, it is in many cases fragmented between different types of programmes and institutions, provided only to those who tend to be considered establishment elites (civil servants, security, military, judges and so on) to whom it often pays generous benefits. This has already created inefficiencies, huge coverage gaps and large fiscal liabilities that will ultimately be unsustainable, thereby exacerbating the need for timely and effective reforms.

Only a few countries, such as Algeria and Tunisia, have unemployment insurance schemes. Bahrain also extends unemployment benefits

[7] Though not discussed in this chapter, emigration is an important issue in the region. For example, skilled emigration rates are among the highest in the world, as is also educated unemployment, while the wage premium for education is among the lowest in the world – all suggesting that demand for skills is far lower than the supply of skills and/or there is a massive mismatch between supply and demand.

Figure 4.3 Total number of unemployed with unemployment benefits (contributory and non-contributory), regional estimates, 2009 (percentages, weighted by labour force)




Source: ILO estimates quoted in ILO (2009c).

to first-time jobseekers. Kuwait introduced a social assistance scheme for first-time jobseekers in 2003 whereby nationals who declared they wanted to work but were unemployed received a monthly allowance for a period of up to one year. Jordan, Saudi Arabia and the Syrian Arab Republic are considering the introduction of various forms of unemployment insurance/assistance. Still, the coverage of unemployment insurance in the region remains the lowest in the world (figure 4.3).

### 4.5.5 Improve social dialogue

Social dialogue is the area where the regional deficit is probably greatest (Tzannatos, 2009). It is non-existent in a number of countries and where it exists it is in many cases under the patronage of the government.

Whether the more or less systemic lack of social dialogue in the Arab region can be directly related to recent political developments is a matter of debate. What is becoming increasingly acceptable, however, is that collective bargaining can be a potent instrument for desirable macroeconomic and labour market outcomes. Leaving aside the long-standing position of the ILO on this, research carried out by the World Bank almost ten years ago acknowledged the centrality of collective bargaining in shaping employment outcomes (Aidt and Tzannatos, 2002). In a more recent publication, the International Monetary Fund (IMF, 2010d) also argues that when there are systemic shocks such as the present financial crisis, wage setting works well when it is adjusted through centralized coordination at the national level. [8]

## 4.6 CONCLUSIONS

The general perception that the Arab countries were somewhat spared from the crisis is largely true in terms of immediate effects on economic growth and unemployment up to 2010. However, given the grim situation of labour markets before the crisis, even the slowdown of the previous mildly encouraging trends in labour market conditions fostered fear and dissatisfaction. The recent outbreak of social unrest in the region may not be a pure consequence of the economic and financial crisis, but the crisis certainly increased insecurity and added to dissatisfaction with the persistence of pre-existing labour market deficiencies, rising inequality and lack of "voice" and communication channels between the people and their (often long-serving) governments.

Among the countries that responded to the crisis, only limited elements of the proposals in the Global Jobs Pact were adopted. One focus was on infrastructure investment, but without much effort to make this employment-intensive. Some countries saw an increase in social dialogue, but more in an attempt to calm down workers than to actually find collectively agreed solutions. In terms of labour standards, the crisis intensified the discussion, but few concrete changes have materialized thus far.

Looking ahead, the global financial slowdown should be used as an opportunity for socioeconomic reform in Arab States, encouraging national authorities to strengthen national economic and social policies and to benefit from closer regional and international cooperation. Countries in the region should use this window of opportunity to establish mechanisms to promote employment *acceptable to their citizens*, share productivity gains with their workers, encourage pro-poor growth, strengthen social protection mechanisms, promote gender

[8] For a similar conclusion but in the context of ordinary development, rather than economic shocks, see Aidt and Tzannatos (2009).

equality and non-discrimination, and focus on human development and decent work. International experience has shown that such mechanisms will be most effective if developed through a process of social dialogue between governments and strong, independent organizations of workers and employers.

# PART II

# POLITICAL ECONOMY OF CRISIS RESPONSES

# POST-CRISIS MACROECONOMICS AND LEAST DEVELOPED COUNTRIES: A WAY FORWARD

# 5

*Iyanatul Islam and Sarah Anwar**

## 5.1 INTRODUCTION

The international community's support to the twin goals of job creation and poverty reduction in least developed countries (LDCs) is a core element of the global development agenda. More specifically, these goals are reflected in the Millennium Development Goal (MDG) 1b and the Social Protection Floor (SPF) Initiative. What role can macroeconomic policies play in supporting MDG 1b and the SPF Initiative? The standard macroeconomic framework that prevailed in the pre-crisis era and continues to prevail today offers a clear prescription: focus on stability and predictability in key nominal targets pertaining to inflation, debts and deficits. Such nominal targets usually include (1) low, single-digit inflation; and (2) prudential limits on debt-to-GDP ratios supported by low fiscal deficits. The rationale is that a commitment to key nominal targets over the medium to long term boosts investor confidence, promotes growth, creates jobs and reduces poverty.[1]

* The authors are chief, Country, Employment Policy Unit and Technical Officer, respectively, Employment Policy Department, ILO, Geneva. The research assistance provided by Ishraq Ahmed is highly appreciated. This chapter has also served as an input for the ILO report *Growth, development and decent work in least developed countries* prepared in connection with the 4th UN Conference on Least Developed Countries, Istanbul, May 2011.

[1] The standard macroeconomic framework in developing countries was launched through the structural adjustment programmes of the 1980s and 1990s. By 1999, the era of structural adjustment lending had come to an end and had been replaced by "poverty reduction strategies" (PRS), but the focus on the standard macroeconomic framework remained intact. See IMF (2007a) for a review of the application of this framework to 29 countries in sub-Saharan Africa that received financial assistance from the International Monetary Fund (IMF).

This chapter argues that the prescriptions of the prevailing macroeconomic framework are necessary but not sufficient for growth to be sustained. In any case, growth alone will not be sufficient to make significant progress towards the attainment of MDG 1b, nor will it fully fortify policy-makers in making significant progress towards the SPF Initiative. The post-crisis macroeconomic framework needs to move beyond a preoccupation with nominal targets and reflect much more on how sustainable resources can be harnessed to finance public investments in health, education, water supply, sanitation and infrastructure that are crucial for attaining MDG 1b (together with the other MDGs) and the SPF Initiative as well as supporting targeted interventions such as public employment programmes. This should be complemented by a more nuanced approach to inflation targeting that makes a distinction between overall inflation and the behaviour of food prices. In addition, promoting the agenda of financial inclusion, maintaining competitive and stable real exchange rates and prudent capital account management can provide much-needed policy space for LDCs to pursue a strategy of economic diversification.

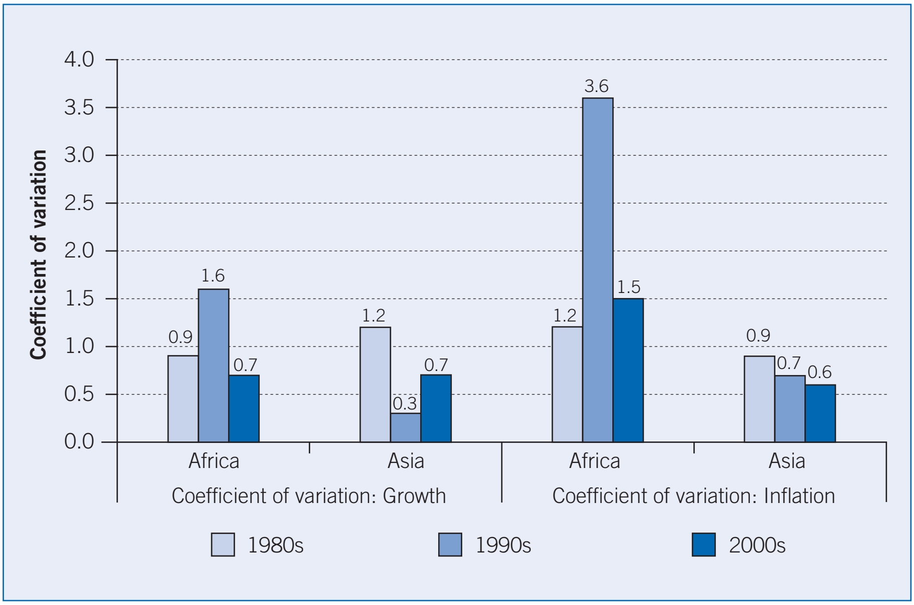
## 5.2 THE STANDARD MACROECONOMIC FRAMEWORK AND ITS CONTESTED ROLE IN THE LDC GROWTH REVIVAL OF THE 2000s

Least developed countries – covering both Asia and Africa – experienced a revival of growth in the 2000s after the "lost decades" of the 1980s and much of the 1990s, as well as a downward trend in inflation in the 2000s. This revival, together with the reduction in inflation, was also associated with a significant decline in both growth and inflation volatility (measured by the coefficient of variation), as can be seen in figure 5.1, where the strongest decline in volatility occurs in African LDCs.

What can explain such a phenomenon? To some, the diagnosis is straightforward. As one senior IMF economist puts it: "Prudent macroeconomic policies and increased reform efforts in many countries in [Africa] laid the foundation for the growth acceleration of recent years…" (IMF, 2007b).

Others are less certain. As the UNCTAD 2010 report on least developed countries notes, the robust growth of the 2000s was propelled largely by favourable external circumstances – commodity price booms, rising exports and remittances, increased capital flows, higher official development assistance and debt relief – that are unlikely to be replicated

Figure 5.1 Least developed countries: Growth and inflation volatility, by region, 1980s–2000s



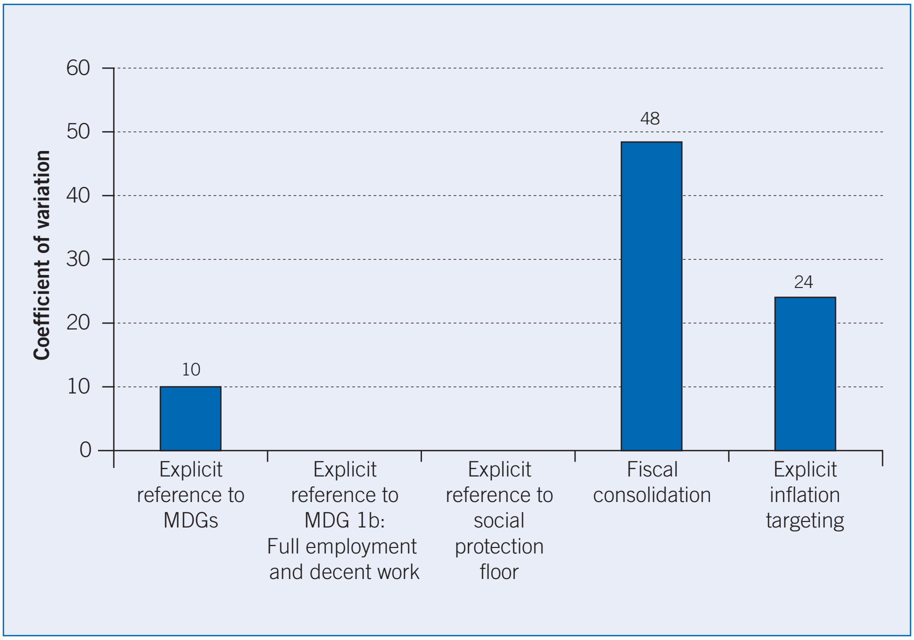

Sources: World Bank: World Development Indicators; volatility based on authors' calculations of coefficent of variation, aggregates compiled by authors based on available data from LDC countries.

in the more austere environment of today (UNCTAD, 2010a). One might also emphasize that the rapid growth of the 2000s was associated with a proliferation of low-productivity jobs, inadequate social security, declining wage shares and growing inequality, and insufficient structural transformation. In any case, the growth revival of the 2000s was unable to reverse the consequences of the lost decades of the 1980s and 1990s.

It appeared that in the wake of the "Global Crisis" one would move away from a "business-as-usual" scenario. In the case of least developed countries, the policy advice offered by the IMF during 2008–2009 was that countries with fiscal space should allow both automatic stabilizers and discretionary fiscal policy to support countercyclical measures to cope with the external demand shock engendered by the recession (Berg et al., 2009).

The emphasis on countercyclical measures proved short-lived. The IMF's latest report on the Millennium Development Goals (IMF, 2010e) emphasizes the need for "policy buffers", which essentially means low inflation and fiscal discipline. An examination of a random sample of

Figure 5.2 International Monetary Fund policy statements on 30 low-income countries and 20 middle-income countries, frequency distribution, 2011




Source: Authors' calculations based on IMF article IV latest consultations.

30 low-income and 20 middle-income countries shows that macroeconomic policy advice as manifested in the IMF's article IV consultations is dominated by concerns about fiscal consolidation and, to a lesser extent, inflation targeting. There are hardly any explicit references to the Millennium Development Goals and none to MDG 1b or to the SPF Initiative – see figure 5.2.

## 5.3 ALIGNING MACROECONOMIC POLICIES WITH THE TWIN GOALS OF JOB CREATION AND POVERTY REDUCTION IN LDCs: SOME SUGGESTIONS

Given the risk of a "business-as-usual" scenario, what are the alternatives? This section summarizes the elements of a macroeconomic framework that has the potential to lead to significant progress in job creation and poverty reduction in the least developed countries. The discussion commences with fiscal policy and proceeds to other policy areas.

### *5.3.1 Fiscal policy: Using the fiscal diamond to enhance fiscal space*

The role of fiscal policy is twofold. First, robust and regular estimates are required to assess the financing needs associated with the MDGs and the SPF Initiative. An illustration of such estimates is shown in box 5.1. The message is that there are conspicuous and unmet financing needs. More importantly, they are likely to get worse, as the global crisis has, at least according to one study, created a huge "fiscal hole" in the case of LDCs.

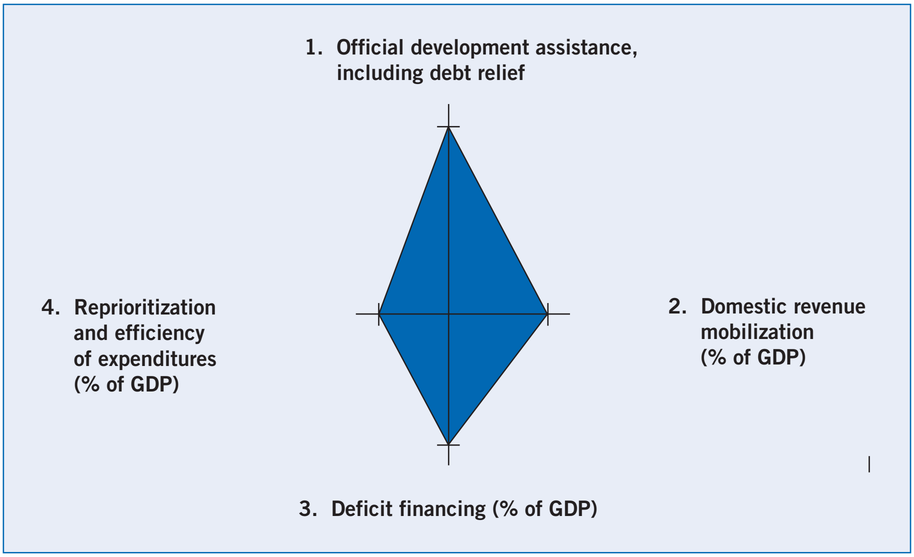
#### Box 5.1 Financing the Millennium Development Goals and the Social Protection Floor

The World Bank estimates that, if countries improve their policies and institutions, the additional foreign aid required to attain the MDGs by 2015 is between US$40 and US$60 billion a year (Devarajan et al., 2002) and the Asian Development Bank (ADB) estimates the additional per person costs for the poverty income goal to be between US$550 and US$880 (Markandya et al., 2010). To meet these per capita costs, foreign aid commitments would have to be twice their current projected size.

A forerunner to the SPF is the "basic social security package" that was proposed by the ILO in 2008. Such a package includes the following elements: (a) basic old-age and disability pensions (benefits set at the rate of 30 per cent of GDP); (b) benefits at the rate of 15 per cent of GDP for the first two children below the age of 14; (c) 100 days, guaranteed employment at a wage of 30 per cent of per capita GDP for a maximum of 10 per cent of all people of all ages; and (d) essential health care based on one health professional per 300 persons. Using these benchmarks, the study examined 12 countries, out of which seven are in Africa (Burkina Faso, Cameroon, Ethiopia, Guinea, Kenya, Senegal, United Republic of Tanzania) and the rest in Asia (Bangladesh, India, Nepal, Pakistan and Viet Nam). Using projections for the period 2010–2030, the fiscal requirements for such a "basic social security package" range from over 10 per cent of GDP (Burkina Faso) to a little over 4 per cent (Guinea).

The fiscal challenges of meeting the MDGs and the SPF in the wake of the global crisis are brought out by an OXFAM study. It shows that the global crisis has created a huge "fiscal hole" in the 56 low-income countries (LICs), by reducing their budget revenues (and their ability to spend to confront the crisis and reach the MDGs) by $65 billion over the period 2009–2010 (Kyrili and Martin, 2010). As a result of the fiscal hole and following some fiscal stimulus to combat the crisis in 2009, most LICs are cutting MDG spending, especially on education and social protection.

Figure 5.3 The "fiscal diamond" (percentage of GDP)



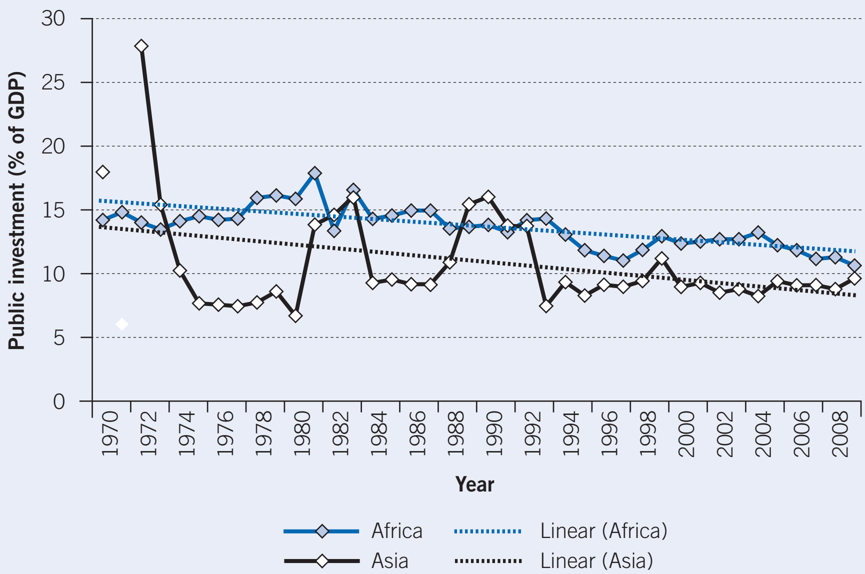

Source: Roy (2010).

Second, the aim is to identify a country's "fiscal diamond" as shown in figure 5.3. The fiscal diamond is a compact, but critical, summary of the way one can increase fiscal space to meet the core development goals. This entails mobilizing domestic and external resources within a framework of fiscal sustainability to support enhanced public investment in health, education, water supply, sanitation and infrastructure – all essential in attaining the MDGs. This needs to be combined with sustained efforts to harness resources to finance an SPF that includes such targeted interventions as public employment programmes.

It is well-known that there has been a secular decline in public investment in the LDCs, as shown in figure 5.4. What is currently the scale of the public investment challenge facing LDCs? The Commission on Growth and Development (2008) suggests that a public investment rate of around 7 per cent of GDP in infrastructure is needed as an important element of a national development strategy. Yet the data suggests that barely 2 to 3 per cent of GDP is invested in infrastructure in many developing countries and emerging economies. This is clearly a policy challenge, given that 50 per cent of enterprises in Asia and Africa cite lack of access to electricity as a major constraint on their business operations.[2]

[2] These estimates can be derived from online data available at www.enterprisesurveys.org.

Figure 5.4 Public investment in least developed countries, Africa and Asia, 1970–2008 (percentage of GDP)




Sources: World Bank: World Development Indicators; US Energy Information Association; FAO; aggregates and calculations compiled by authors.

Addressing these concerns requires determined public action to cope with the public investment deficit that has built up over decades. Hence, a resource mobilization strategy pursued through improved budgetary execution and enhanced domestic revenue-to-GDP ratios in countries with a low tax burden are core elements of a development strategy.[3] For example, estimates show that the Bangladesh Government can fully upgrade its public employment programme to an Indian standard national employment guarantee scheme by increasing its historically low tax-to-GDP ratio by 3 percentage points and by better utilization of its existing resources (Islam et al., forthcoming). This can be complemented by other initiatives, such as public–private partnerships and efforts to tap domestic savings and channel them into productive investment. In addition, where energy taxation can be used effectively and equitably, it

[3] This is an issue on which there is broad agreement in the international community (IMF, 2010e; UNDP, 2010b).

can become a new source of revenue that has the benefit of supporting initiatives to cope with climate change.

Domestic resource mobilization needs to be supported by enhanced development assistance from donors. Hence, maintaining aid commitments and exploring feasible options for identifying alternative sources of reliable and low-cost development finance to supplement traditional sources are important elements of a development-friendly macroeconomic framework.

As part of enhanced development assistance, an important issue is the role that debt relief has played in enhancing fiscal space for LDCs, as shown in box 5.2. While debt relief in aggregate has contributed to enhancing fiscal space, country-specific experiences suggest that there is significant scope for improvement.

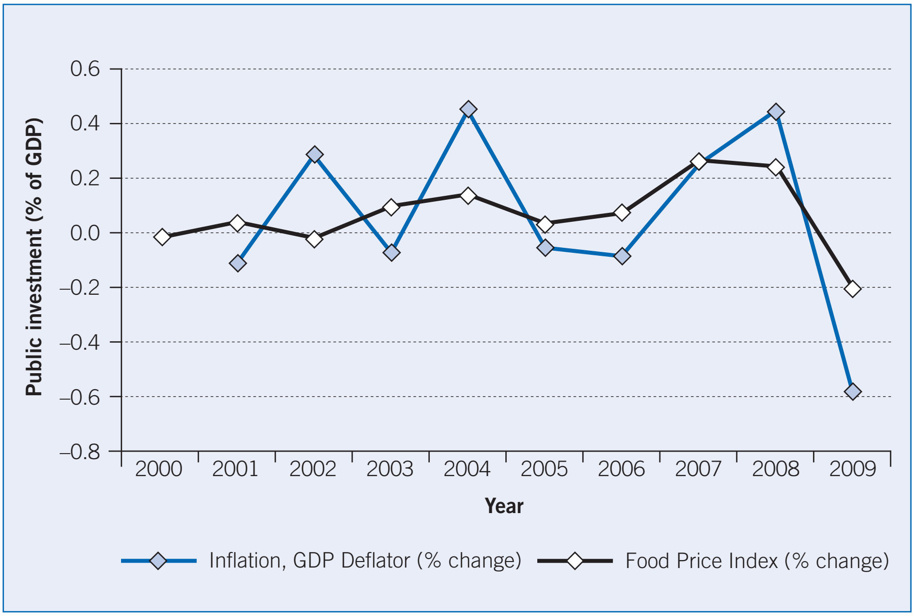
### Box 5.2 The relationship between debt relief and fiscal space in LDCs

According to the IMF's African Department Director, the fiscal space created by high levels of debt relief is supporting poverty-reducing spending in LDCs (IMF, 2007b). Initiatives such as the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) have substantially reduced the debt-to-GDP and debt-to-export ratios of a significant subset of countries in the LDC group, improving the overall sustainability of their debt and freeing considerable amounts of resources that were previously earmarked for debt servicing (UNCTAD, 2010a).

The trends indicate that the level of debt relief for LDCs spiked at a high level from 2005 to 2006, following the Gleneagles Summit, but swiftly came down in 2007. Total debt service steadily declined from above 20 per cent of total exports to less than 5 per cent in 2008. However, this progress does not mean that the debt issue is no longer relevant in LDCs. As of April 2010, 14 LDCs which still remained in debt distress or at high risk of debt distress were not identified as HIPCs or had not reached the completion point. Even in the best-case scenario of a fast recovery and a long-term growth path, LDCs and developing countries alike will face higher debt burdens as a result of the global economic crisis.

The relationship between debt relief and fiscal space differs across LDCs. The fiscal space assessments for Malawi and Mozambique noted that debt relief under the HIPC Initiative had expanded fiscal space and thereby allowed for a scaling up of public investments (UNDP, 2010b). The MDG Report for Malawi noted that, with 84 per cent of the country's external debt stock cancelled, the country's annual debt service had been reduced to US$15 million, freeing up US$110 million for expenditures in priority programmes. However, one country study, using the MDG framework to critically examine fiscal policies in Zambia, finds that the Zambian Government enjoys very little "policy space" and when all calculations are carried out and attendant conditionalities on policy-making are taken into account, HIPC debt relief actually provides marginally less fiscal space, rather than more (Weeks and McKinley, 2006).

Figure 5.5 Least developed countries: Inflation and the Food Price Index, 2000–2009 (percentage changes)



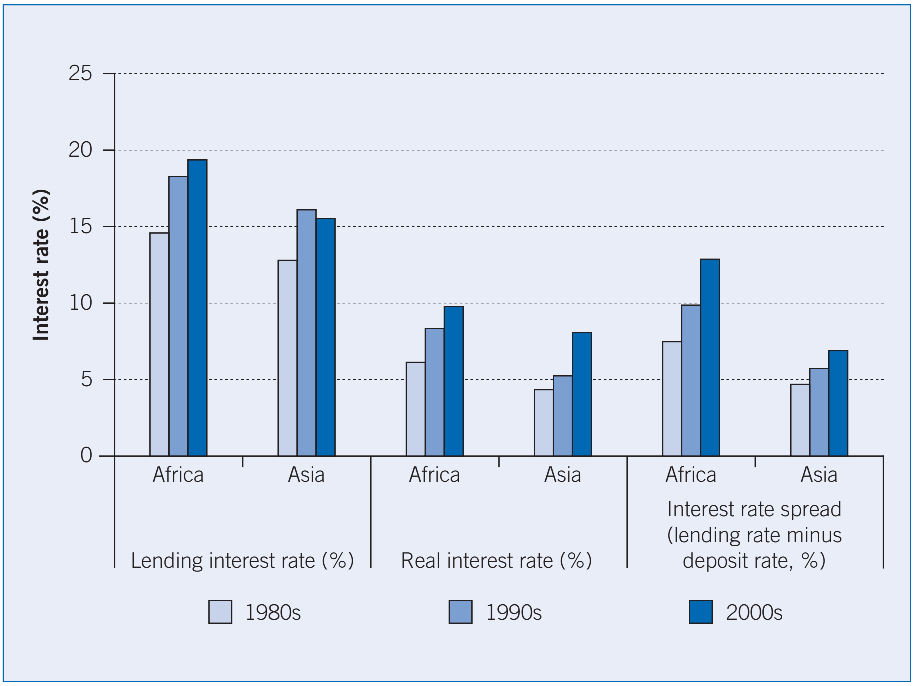

Note: correlation coefficient between percentage change in inflation and food price index is 0.8.
Sources: World Bank: World Development Indicators; US Energy Information Association; FAO; aggregates and calculations compiled by authors.

### *5.3.2 Monetary policy: Going beyond inflation targeting*

In coping with inflation in LDCs, recent economic history suggests that it is necessary to make a distinction between the overall inflation rate and the behaviour of food prices, given that there is a close correlation between the latter and the former (figure 5.5). In particular, food prices – which have risen again – have threatened to derail progress in the attainment of the MDGs, have exposed the paucity of social protection systems and have engendered social unrest. The latest estimates are that the current increase in food prices has pushed over 40 million people in the developing world into a transient episode of poverty (World Bank, 2011). The appropriate response in this case is to undertake policy actions across a wide front to improve food security. Using restrictive monetary policy to tame rising food prices is unlikely to work.

When judged from a cost-of-borrowing perspective, it is by no means clear that the low inflation environment of the 2000s has provided tangible benefits to the private sector. The median real lending rate in

Figure 5.6 Least developed countries: Interest rates, by region, 1980s–2000s (percentages)




Source: World Bank: World Development Indicators; aggregates compiled by authors.

LDCs has risen between the 1990s and 2000s (figure 5.6). Furthermore, LDCs are afflicted by rising interest rate spreads. Hence, a major challenge for monetary policy in LDCs is to find ways of reducing the cost of borrowing. This means taking account of the extent to which lack of access to finance acts as a binding constraint on growth. Private-sector firms in developing countries usually regard lack of access to finance as a major impediment to business operations and their employment-creating potential.[4] Hence, central banks and financial authorities have an obligation to enhance financial inclusion without forsaking their prudential obligations and their role in safeguarding price stability. Enhancing financial inclusion means (1) increasing access to finance for the private sector, especially small and medium-sized firms; (2) encouraging the development of well-regulated and efficient microfinance institutions (MFIs) that can respond to the financing needs of poor and vulnerable households that seek durable self-employment.

[4] These estimates can be derived from online data available at www.enterprisesurveys.org.

### 5.3.3 Exchange rate and capital account management: Aiming for competitive and stable real exchange rates and coping with capital flows

In the sphere of exchange rate regimes and capital account management, the aim should be the adoption of institutional arrangements that sustain competitive and stable real exchange rates, given the evidence that the real exchange rate exerts a powerful influence on structural transformation (Rodrik, 2008). More specifically, a study on sub-Saharan Africa using data for the period 1970–2004 shows that real exchange rate overvaluation reduces growth and impedes export diversification (Elbadawi et al., 2009). As box 5.3 shows in the case of Malawi, moving towards a competitive and stable real exchange rate regime is an essential component of a pro-employment macroeconomic framework.

In cases where unrestrained capital flows pose a policy challenge, a more prudent approach to capital account management might be justified, as this opens up policy space for initiatives that create employment (Ostry et al., 2010). Forty per cent of African LDCs have significant restrictions on the capital account (Berg et al., 2009) but for the remaining 60 per cent there is little or no evidence that capital account liberalization has necessarily provided them with the capacity to boost growth (Cerra et al., 2009).

#### Box 5.3 Malawi: The exchange rate regime and its implications for growth and employment

A study commissioned by the ILO (Durevall and Mussa, 2010) shows that "macroeconomic policy, particularly exchange rate policy, matters a great deal" in affecting economic growth and employment creation. The study maintains that Malawi has a "tradition of attempting to maintain a stable nominal exchange rate, i.e., fixing the value of the Kwacha in terms of US dollars…The official purpose of maintaining a stable exchange rate is primarily to reduce inflation", with the Government arguing that this anti-inflation dimension of exchange rate policy is worth preserving because export supply is not very responsive to the exchange rate. This might be true in the short term, but ignores the role that a competitive real exchange rate plays in supporting structural transformation in the medium term. The study shows that, given the higher inflation rate in Malawi relative to its trading partners, attempting to maintain a nominal exchange rate leads to a real appreciation and also induces volatility. There is also evidence that the real appreciation is associated with a sharp jump in import penetration from 44 per cent of GDP in 2007 to 53 per cent in 2008. The study urges policy-makers to recognize that with a competitive and predictable real exchange rate regime, "firms would most likely have created more jobs, invested more and diversified more in Malawi".

Source: Durevall and Mussa (2010), pp. 84–87.

## 5.4 CONCLUSIONS

In order to achieve progress towards the twin goals of MDG 1b and the SPF Initiative, the post-crisis macroeconomic framework needs to move beyond a preoccupation with inflation targeting and fiscal discipline. Domestic and external resources have to be mobilized to support enhanced public investment in health, education, water supply, sanitation and infrastructure, which is central to the goal of achieving the MDGs and SPF Initiative. Monetary policy needs to move beyond inflation targeting, as recent data highlight the need to make a distinction between the overall inflation rate and the behaviour of food prices. Moreover, it is clear that LDCs are afflicted by rising interest rate spreads, signalling the need to reduce the cost of borrowing by taking into account the extent to which lack of access to finance acts as a binding constraint on growth. Central banks and financial authorities should work towards enhancing financial inclusion without neglecting their role in safeguarding price stability. Moreover, it is essential to move towards a competitive and stable real exchange rate regime, as such a regime is an essential component of a pro-employment macroeconomic framework. Finally, where unrestrained capital flows pose a policy challenge, a more prudent approach to capital account management might be justified, as this would open up policy space for initiatives that create employment.

# THE POLITICS OF ECONOMIC ADJUSTMENT IN EUROPE: STATE UNILATERALISM OR SOCIAL DIALOGUE? 6

*Youcef Ghellab and Konstantinos Papadakis* *

## 6.1 INTRODUCTION

This chapter depicts the process of design and implementation of austerity policies aimed at reducing public deficits and debt in eight European countries [1] and the role of social dialogue in this context. It is argued that, as governments are shifting policy priorities from economic stimulus towards fiscal consolidation and debt reduction, social dialogue and tripartism are given a less prominent role compared to the first phase of the global economic crisis, during which they played a significant part in devising crisis responses. Austerity policies are presented as being inevitable and non-negotiable. This may not be surprising, considering that the current structural adjustment promoted by the international financial institutions (IFIs), and lately the European Union (EU), is based on Washington Consensus policies which usually exclude public deliberation. The chapter argues that social dialogue should remain part of policy design and implementation even in times of crisis, and highlights several ways of rebalancing the negotiating powers of actors in the real economy to enable them to influence policy choices.

* Senior Employment and Industrial Relations Specialist, and Research and Policy Development Specialist, respectively, Industrial and Employment Relations Department, Social Dialogue Sector, ILO, Geneva. The authors would like to thank Nancy Varela for excellent research assistance.

[1] Greece, Ireland, Italy, Latvia, Portugal, Romania, Spain and United Kingdom.

## 6.2 SOCIAL DIALOGUE: A KEY COMPONENT OF CRISIS RECOVERY STRATEGY IN 2008–2009

In 2008 and 2009 the world experienced the worst economic crisis since the Great Depression of 1929. Workers have paid a heavy price in job and income losses, while employers have experienced a dramatic drop in demand for their products and services (IILS, 2009b, 2010). Governments saw their revenues diminish while at the same time they had to face a dramatic increase in public expenditure brought about by the implementation of stimulus packages and the bailout of financial institutions.

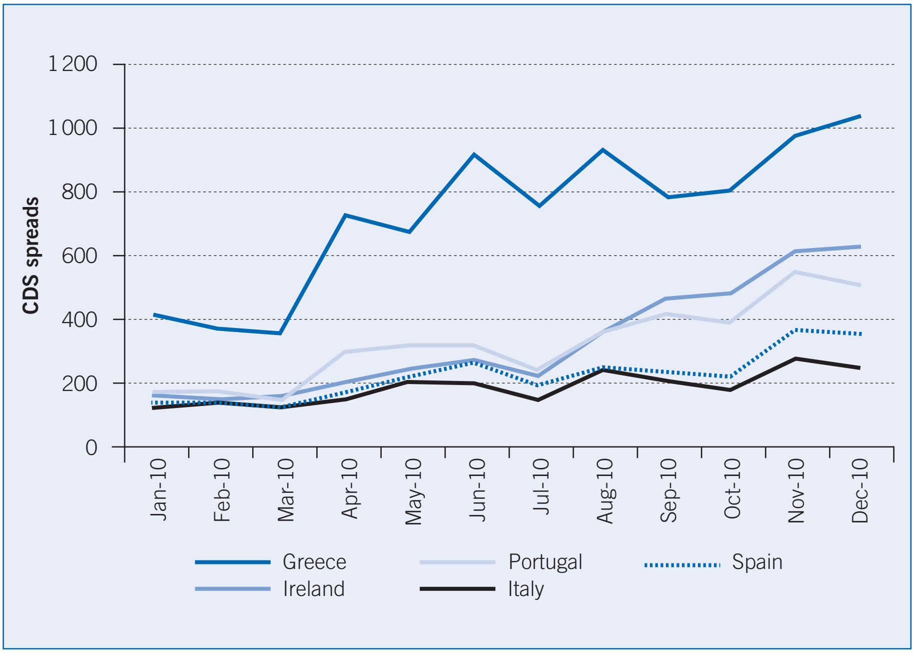
By the autumn of 2008 governments realized that the financial crisis was being transmitted to the real economy and that the challenges could not be addressed by public authorities alone engaged in unilateral decision-making. On the contrary, the crisis called for effective tripartite cooperation between governments and the social partners.

ILO assessments of crisis-related responses by member States show that the combination of social dialogue instruments and state intervention in many countries during the period 2008–2010 helped to accelerate recovery (ILO, 2010i). The positive spill-over of social dialogue in times of crisis has been explained elsewhere (Freyssinet, 2010; Glassner and Keune, 2010; Rychly, 2009; Ghellab, 2009; Baccaro and Heeb, 2010; Papadakis, 2010). These recent studies have documented various successful experiences of national social dialogue in the context of the economic downturn. It goes without saying that all did not go right in 2008–2009: social dialogue faced challenges even in countries with a long-standing tradition of social partnership, such as Ireland and Spain. However, social dialogue generated effective cooperation at national and enterprise levels and created the conditions for the smooth management of national economies until recovery returns (ILO, 2010i).

## 6.3 FISCAL CONSOLIDATION MEASURES ADOPTED SINCE 2010 AND THE DANGERS OF FINANCIAL-MARKET-DRIVEN DECISION-MAKING

In 2010, while global recovery was still fragile and unemployment remained high or was still rising, governments in several European countries became increasingly alarmed by mounting fiscal deficits and public debt ratios, and abruptly shifted the focus of public policy from the stimulation of the economy to cutting public spending in order to restore fiscal balance. Most of these governments, in particular those in southern

Figure 6.1 Pressure of financial markets: The evolution of credit default swaps (CDS), selected European countries, January–December 2010




Source: Authors' calculations, based on Bloomberg Finance LP.

Europe, have come under strong pressure from financial markets to start reducing deficits sharply and immediately.

Since the eruption of the financial crisis in 2007, two technical terms, "spreads" [2] and "CDS" [3] (two indicators used by large investment banks), suddenly became the indicators most watched when it came to assessing the health of national economies and deciding additional measures of austerity (figure 6.1). The shift of the main focus of public policy-makers, away from traditional macroeconomic indicators to indicators measuring financial risk, denotes a de facto departure from a "political economy" crisis-response approach (where dialogue institutions have a role to play), towards a "financial-market-driven" approach, a trend related to the financialization of the real economy and workers' personal income – a major systemic transformation of the capitalist economy (see for example Lapavitsas, 2009).

[2] Spreads: the extra interest rate required when investments are seen as risky.

[3] Credit default swaps (CDS): the price to insure against default on the sovereign debt.

In engaging in the implementation of severe austerity plans following pressure from the financial markets, European governments relegated social dialogue to a less prominent role compared to the period of recession in 2008–2009, during which social dialogue had gained momentum. This has not come as a surprise since austerity, privatization and liberalization in a context of little or no democratic deliberation have been the four major pillars of structural adjustment policies based on the Washington Consensus. For a more detailed discussion of the Washington Consensus see Williamson (2004); Fraile (2009); Stiglitz (2002); Krugman (2010).

Historically, the negative impact of structural adjustment measures on democratic institutions, including social dialogue, has been notorious, with further adverse consequences on citizens' welfare and countries' political stability. Moreover, as Stiglitz has demonstrated, while Washington Consensus policies have had a negative impact on real economy actors by generating recession spirals and enormous social costs, they have been rather beneficial for financial market actors. In the case of the latest crisis, just as public austerity measures were reducing wages and pensions, billions of euros were made available in staggering amounts as rescue funds for banks. In at least three countries (Greece, Italy, Spain) the amounts of savings reportedly anticipated through the austerity plans roughly correspond to the size of the rescue funds made available, in the form of guarantees, to the banks operating in these countries. In the case of Ireland, guarantees for banks are three times higher than actual savings.

## 6.4 AUSTERITY MEASURES ADOPTED SINCE 2010 AND THEIR SOCIAL IMPACT

The austerity measures implemented in the eight countries under review involved tough adjustment aimed at the reduction of fiscal deficits by lowering public expenditure, gradually eliminating various subsidies, raising prices of utilities, freezing or reducing public-sector pay, and capping pension payments and social benefits.[4] These measures have been presented as inevitable and non-negotiable by the governments concerned in order to restore fiscal balance and to reduce public debt.

Among other effects they have had a direct impact on terms and conditions of employment, notably wages (particularly of those working in the public sector)[5] and pension entitlements. Also, they have affected

[4] For further details of how governments have responded to the financial crisis, see IILS (2010).

[5] For more information on how the crisis has affected the public sector, see ILO (2010j); Glassner (2010).

societies' most vulnerable groups (ILO, 2010j). The main components of these measures are summarized in table 6.1.

Table 6.1 Austerity measures: Main components related to public-sector adjustment and pensions, selected European countries

| | Public-sector adjustments | | | Pensions | | |
|---|---|---|---|---|---|---|
| Country | Employment reduction | Pay cut | Pay freeze | Pension cut or freeze | Other changes | Increase in retirement age |
| Greece | X | X | X | X | X | X |
| Ireland | | X | X | | X | |
| Italy | | | X | | X | X |
| Latvia | | X | | X | | |
| Portugal | | X | X | X | X | |
| Romania | X | X | | | | X |
| Spain | X | X | X | X | | X |
| UK | X | | X | | | |

Source: Authors, drawing on Bloomberg; EIRO; EurActiv; *Financial Times*; ITUC; SETimes.

In some countries the austerity plans have been accompanied by measures aimed at restricting the scope of collective bargaining. In Greece, for instance, the main legislative piece of the austerity plan (Law No. 3845/2010) contains provisions that can dramatically modify the regime of collective bargaining. Among other things, it enables professional and enterprise collective agreements (signed by enterprise unions, the establishment of which is facilitated) to deviate (downwards) from sectoral collective agreements. Also, it includes provisions that allow territorial pacts to set wages below sectoral agreements (Papadakis, forthcoming).

In Romania, the Government tabled a proposal in December 2010 aimed at amending the labour code and the social dialogue laws, with a view to, inter alia, restricting the scope of collective bargaining in the public sector and modifying the rules on representativity of social partners. The Economic and Social Council (ESC) rejected the Government's proposals. In early March 2011, the Romanian opposition filed a no-confidence motion against the Cabinet, after the Government decided to initiate an emergency procedure to pass the new law amending the labour code (see chapter 7 in this volume for more details).

Developments in all eight countries examined are ongoing and it is still too early to anticipate and evaluate the changes that are being introduced.

Using the results of past research based on the Latin American experience regarding the impact of the Washington Consensus, it is possible to make some predictions about the new employment and industrial relations landscape that will emerge once the changes have been fully implemented. These trends are summed up in table 6.2.

Table 6.2 Labour market flexibilization measures, selected Latin American countries, 1980s–1990s

| Changes through… | Argentina | Bolivia | Brazil | Chile | Mexico | Uruguay |
|---|---|---|---|---|---|---|
| *Legislation or government action* | | | | | | |
| Easier or cheaper dismissals | X | X | | X | | |
| Atypical contracts | X | X | X | X | | X |
| Lower payroll taxes | X | X | | X | | |
| Lower work accident costs | X | | | | | |
| End of wage indexation | X | X | X | X | | |
| State withdrawal from private sector wage bargaining | X | X | X | X | | |
| Bargaining decentralization | X | | | X | | X |
| Wage flexibility through profit-sharing | X | | X | | | |
| Working-time flexibility | X | | X | X | | |
| New restrictions on unions, collective bargaining and strikes | X | | | X | | |
| *Collective bargaining* | | | | | | |
| Bargaining decentralization | X | X | X | X | X | X |
| Drop in bargaining coverage | X | X | | X | X | X |
| Work-time, functional, wage flexibility | X | | X | | X | X |

Source: Fraile (2009).

### 6.4.1 Austerity without social dialogue?

The process of design and implementation of austerity programmes took place in a very tense social climate in all eight countries examined. Industrial action and protests have been organized by trade unions as well as other groups in all these countries in an attempt to forge alliances against austerity policies imposed by governments.

In four countries, namely Greece, Italy, Romania and the United Kingdom, there has been very little or no consultation between the governments and the social partners on austerity plans. Some governments have used fast-track procedures to pass the measures. In Greece, Law No. 3845/2010 of 5 May 2010 provides for the possibility to modify conditions of work and terms of employment through presidential decree (the Government decided not to have recourse to presidential decrees in order to avoid complaints filed by unions with the Council of State before the law was passed). In Romania, the austerity plan announced by the President of the Republic on 6 May 2010 has not been subject to consultation with the social partners and was adopted and implemented without a vote in Parliament. In Italy, the Government adopted the Manovra Tremonti austerity package on 31 May 2010 in the form of a law decree. The day before enacting this law, the Government invited the social partners to an ad hoc meeting where it outlined the main measures due to be passed the following day.

In Portugal there has been some consultation, which was however not effective and did not deliver its expected outcomes because social dialogue was perceived by the Government merely as a means to get the austerity plan – already decided – endorsed by the social partners. Finally, in Ireland, Latvia and Spain social dialogue did play a role and delivered some outcomes (agreements, joint statements); however, it failed to bridge the differences between the tripartite partners on specific issues such as labour law reform in Spain, or further cuts in spending in Ireland and Latvia. Table 6.3 summarizes these trends.

### *6.4.2 Social partners' positions and expected impact on industrial relations*

The available evidence points to a split among social partners as to the necessity of the austerity measures. In general, trade unions have rejected austerity policies put in place by the governments in the countries examined, on the grounds that they are counterproductive and unfair. Also, they have strongly criticized government haste, the lack of social dialogue on the policy choices and the permanent nature of these measures. However, their mobilization has produced no visible results so far, for example in Greece, Portugal and Romania.

In cases where the government did reach out to the social partners, consulting them on the content of the austerity plans and making concessions (no further spending cuts, a fair distribution of sacrifices, measures in favour of vulnerable groups), trade unions have endorsed the austerity plans, albeit reluctantly. This was the case in Ireland with the conclusion

Table 6.3 Austerity package and social dialogue, selected European countries, 2010

| Country | Consultation | Agreement |
|---|---|---|
| Greece | No | No |
| Ireland | | |
| Jun-10 | Yes | Yes |
| Dec-10 | No | No |
| Italy | No | No |
| Latvia | Yes | No |
| Portugal | | |
| Mar-10 | Yes | No |
| Apr-10 | Yes | No |
| Sep-10 | No | No |
| Romania | No | No |
| Spain | | |
| May-10 | No | No |
| Jun-10: labour legislation reform | Yes | No |
| Jan-11: pension reform | Yes | Yes |
| United Kingdom | No | No |

Sources: Authors, based on various primary sources; Baltic Course; EIRO.

of the so-called Croke Park Agreement signed in June 2010. However, when additional austerity measures were introduced unilaterally by the Government in November 2010, social dialogue was at a stalemate. Similarly, in Latvia, when the Government engaged with the social partners on a plan to reduce public spending, the social partners agreed in June 2009 to a 500-million lats (LVL) emergency cut in the 2009 budget. When the Government proposed further spending cuts in the budget of 2010 and rejected the counterproposals of the social partners, the latter refused to endorse the Government's plans (Kolyako, 2009).

Broadly speaking, employers' organizations have approved government moves towards the implementation of an austerity policy, but in many cases they have expressed reservations about specific measures. One may argue that, while the austerity measures appear to benefit large export-led enterprises, small and medium-sized enterprises (SMEs) are likely to suffer as direct and indirect taxes increase, consumption goes down and the market in "hot money" dries up. In Greece, for instance, two employers' organizations, the National Confederation of Hellenic Commerce (ESEE) and the Hellenic Confederation of Professionals, Craftsmen and Merchants (GSEVEE), representing mostly SMEs – which account for more than 80 per cent of businesses in the country – adopted a critical stance vis-à-vis the austerity plan and even marched along with unions in demonstration against these measures on the day of the adoption of Law No. 3845/2010 (Patras, 2010). In Romania, employers' organizations distanced themselves from the Government's plans after initially supporting them. In Latvia, the Employers' Confederation of Latvia (LDDK), after having supported spending cuts in the 2009 budget, argued that the new budget (for 2010) would decrease the competitiveness of Latvian business in the Baltic market (Curkina, 2010).

In the absence of social dialogue, in some cases trade unions had recourse to legal action and appealed to the courts in order to get their voice heard. In Romania, for instance, five trade union confederations set up a Crisis Committee and allied themselves with the main opposition party – the Social Democratic Party (PSD) – to challenge in court the Government's plan to cut public wages and pension payments. On 25 June 2010, the Romanian Constitutional Court ruled that the 15 per cent reduction of pensions was unconstitutional. In the United Kingdom, the Public and Commercial Services Union (PCS) challenged in the High Court the agreement between the Government and five trade unions on reducing the maximum redundancy compensation for civil servants, and won the case (Hall, 2010). In Latvia, the Constitutional Court found that pension reform was unconstitutional and contrary to the principle of legitimate expectations (Constitutional Court of the Republic of Latvia, 2009). In Greece, legal action by the General Confederation of Greek Workers (GSEE) is pending before the Council of State. Furthermore, GSEE filed in July 2010 urgent observations with the ILO Committee of Experts on the Application of Conventions and Recommendations for non-observance by the Greek Government of 11 Conventions ratified by Greece (ILO, 2011c).[6]

There are indications that some governments have already become concerned about the disruption of dialogue with the social partners and the long-term impact of this on industrial relations. In order to reverse this trend, they have been trying to reach out to the social partners once again. In Portugal, the Government has announced an ambitious agenda for 2011 which focuses on growth and employment. In Spain, the Zapatero Government reached an agreement in January 2011 with the social partners which focuses on growth, jobs and the sustainability of public finances. In engaging with the social partners, it secured the support of the main trade unions in raising the retirement age from 65 to

[6] The Committee of Experts on the Application of Conventions and Recommendations constitutes the cornerstone of the ILO's supervisory system on international labour standards

67. These initiatives show that social dialogue can constitute a credible alternative to state unilateralism.

Many countries have implemented fiscal consolidation plans in the past, and those experiences can be instructive. For example, the successful experience of Canada in eliminating its public deficits of 1994–1999 shows that an open and inclusive approach is an important condition for the success of such a project. Both spending and revenues must be on the table to have any hope of a grand bargain in which all sides have an incentive to negotiate a comprehensive reform package. Similarly, the Irish experience of the late 1980s showed that there is no credible alternative to social dialogue and tripartism to deal with socioeconomic challenges such as the elimination of huge fiscal deficits and the promotion of a sustainable recovery.

## 6.5 CONCLUSIONS

Promoting a sustainable recovery and eliminating fiscal deficits is no ordinary public policy exercise; it is a societal project that requires broad consultation and careful preparation (Bourgon, 2010). Three reasons make social dialogue essential, even in times of austerity: (a) it provides policy-makers with all the necessary information for effective policy design; (b) it improves the chances of buy-in (ownership) and therefore effective implementation of such policies; (c) it improves the chances of maintaining balance in such policies by mitigating their adverse effects on the most vulnerable groups. Most important, reinforcing institutions of social dialogue and collective bargaining is fundamental if the solution for a sustainable recovery lies in "income-led growth" models – that is, the growth of real wages in a way that reflects productivity gains and reduces the need for sustaining consumption through recourse to private debt or government subsidies (Torres, 2010a; IILS, 2010).

If social dialogue plays its role, not only is adjustment likely to follow "the right sequence and pace", it could also help to promote alternative policy choices which are fairer for all and more sustainable, thus effectively reversing one-size-fits-all policy decisions, which are often presented as "inevitable" by the financial markets. For this to happen, there is a need to strengthen the voice and rebalance the negotiating capacities of the social partners in times of structural adjustment. One possible way of doing so is to build alliances between the social partners and also between them and social movements. Examples of such alliances include the historical precedent of South Africa, where trade unions have, at times, sided with social movements representing the interests of the unemployed, youth, women and the poor. A recent example is provided by the events currently unfolding in the Arab States where unions have sided with social movements which did not have a traditional leadership structure and were not headed by a specific leader, making it difficult for the public authorities to strike social pacts to end their mobilization. Finally, the unprecedented case of Greece, where employers and workers marched together in protest against austerity measures, is another example. As a complement to such alliances, the capacity of trade unions to mobilize at cross-border level may emerge as an important way of rebalancing bargaining power, not only at EU level, where this issue has been the subject of extensive discussion, but also at the global level (Bercusson, 2008).

Another important way of strengthening social dialogue is to build the capacity of the social partners and especially Labour Ministry officials to enable them to fully participate in the design and implementation of austerity measures on an equal footing with representatives of the Central Bank, the Ministry of Finance, the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD) and the EU. Such participation can help to re-politicize the question of austerity measures, which are usually presented as a technical response to which there is no alternative and in which there is no room for political deliberation (Stiglitz, 2002; Supiot, 2010).

In this context, the role of international institutions such as the ILO, which draws its legitimacy from its tripartite structure and its constant connection with the real economy, may be key, not least in assisting in the promotion of policy coherence at the national and international levels. It is important that the ILO initiate a dialogue with the IFIs and the EU institutions with regard to desirable models of social dialogue and industrial relations, including in light of the 2007–2008 European Court of Justice rulings (*Laval, Viking, Rüffert and Commission v. Luxembourg*) which brought about significant changes in the European social model(s) (see for example Höpner, 2008). Such a dialogue should also be maintained with the IMF and the OECD, which do not seem to have interpreted the recent collapse of financial markets as calling into question the long-standing conventional policies.

# 7 LABOUR REFORMS IN ROMANIA

*Robert Kyloh* *

## 7.1 INTRODUCTION

In the aftermath of the global financial and economic crisis, Romania is in the vanguard of renewed focus on labour flexibility. In March 2011 the Government introduced a new Labour Code which provided much greater flexibility in respect of dismissal procedures, working time, the scope for temporary, casual and agency work, probation periods and a range of other provisions.[1] Shortly thereafter, in mid-April 2011 the Government introduced a new Social Dialogue Law which significantly alters the arrangements for collective bargaining, the rules governing the organization of trade unions and employers' associations and the arrangements for dialogue on economic and social issues with the social partners.

Both laws have proven to be highly controversial. According to Mircea Dusa (2011), leader of the Opposition Social Democrat Party in the Lower Chamber of the Parliament:

> When it comes to the contents of the law on social dialogue we criticize the violation of freedom of association, the limitation of trade union rights, of negotiation rights, the reduction in the role played by the Economic and Social Council ... as well as the containment of the right to strike.

Both laws were adopted according to Article 114(1) of the Romanian Constitution which in exceptional circumstances allows the Government to "take responsibility" for a law before the Parliament and thereby avoid

---

* Senior Economic Adviser, Policy Integration Department, ILO, Geneva. The author wishes to thank Stephen Pursey, Corrine Vargha and Dori Sari for comments on earlier drafts of this chapter.

[1] Law to Modify and Complete the Law No. 53/2003, the Labour Code.

lengthy debate and line-by-line amendments to the draft law. Opposition political parties have condemned the repeated use of this procedure as undemocratic and unsuccessfully challenged the new legislation in the Constitutional Court (Nine O'Clock RO, 2011a). The Opposition parties also boycotted the parliamentary session when the Social Dialogue Law was introduced (Nine O'Clock RO, 2011b).

These events have heightened social tensions leading to numerous street actions and protest rallies (EIRO, 2011). The Economist Intelligence Unit recently noted (2011, p. 13):

> Despite strong catch-up growth over the past decade, Romania remains a poor country by EU standards, characterised by extreme income inequalities. The difficult economic situation and rising unemployment have increased the risk of social unrest.

In its justification for the recent reforms, the Government claimed that the existing Labour Code (2003) "has not been an incentive for the development of the national economy" and that the revised law will boost productivity, competitiveness and employment (Government of Romania, 2011). However, the precise mechanisms whereby these changes in labour legislation are expected to deliver both higher productivity and employment have not been spelled out by either the Government or those supporting the reforms. Some of the strongest advocates of labour reforms are foreign investors and multinational companies who produce mainly for export markets and compete against low labour cost countries in Asia and elsewhere (American Chamber of Commerce in Romania, 2011). The Foreign Investors Council, which had lobbied for these labour reforms for many years, recently claimed that the new labour legislation would generate 90,000 additional jobs (Spanu, 2010).

This chapter reviews both recent and longer-term events that have led to these labour reforms and examines whether the previous labour legislation did indeed constrain economic growth and higher employment. It concludes that the focus on altering collective bargaining and the rules concerning representivity of the social partners has not been justified on economic grounds but that other, more constructive, labour reforms are urgently required.

## 7.2 LABOUR REFORMS AS A RESPONSE TO THE 2008 CRISIS

On 10 May 2010 the International Monetary Fund (IMF), in concluding its regular Article IV consultations with Romania, stated that "Romania's labor market is rigid compared to others in the region" (IMF, 2010f,

p. 26). The evidence cited in support of this statement was data from the World Bank “employing workers index” of the Doing Business Report and the relatively low employment and participation rates in Romania (ibid., pp. 26–27).

Shortly thereafter, the Government of Romania (2010a, para. 19) informed the IMF that:

> We will introduce by end-2010 a revised labor code and collective contract legislation, to increase flexibility of working time, and to reduce hiring and firing costs through more flexible contracts. We also aim at allowing greater wage flexibility.

But by the second half of 2010 the focus of reforms had broadened to include rules concerning the “representivity” of trade unions and employers’ associations which can have significant implications for collective bargaining and freedom of association. The Government informed the IMF in late 2010 that:

> We are continuing work on labor market reforms to increase flexibility, increase representivity in the negotiations between social partners, and encourage greater labour force participation, particularly for young people ... (Government of Romania, 2010b, para. 18)

In late November 2010 the Government of Romania released drafts of the two new laws: the revised Labour Code and the new Law on Social Dialogue which amalgamated and modified various existing labour laws. At the request of recognized trade unions in Romania, the ILO provided written comments on these draft laws to the Government and the social partners pointing out instances where the draft laws were inconsistent with International Labour Convention ratified by Romania as well as proposing other changes to make the laws consistent with international labour standards (ILO, 2011d). The ILO also participated in meetings with the IMF, the World Bank and the European Commission where the draft legislation and other possible labour reforms were discussed (see ILO, 2011e).

It is the Social Dialogue Law that contains the provisions related to collective bargaining and “representivity” issues. Over the last two decades a relatively strong and well-organized trade union movement has emerged alongside a comprehensive system of collective bargaining, with provisions for bargaining at enterprise, industry and national levels. On the employer side there is less cohesion with significant political and ideological differences between the 13 employers’ organizations that have been granted recognition at national level. This divergence has been clearly evident in recent months with several employers’ organizations strongly opposing aspects of the reforms, which they claim are politically motivated and designed to promote the interests of employers aligned with the Government.[2] Several other nationally recognized employers' associations,[3] along with the foreign investors, have generally supported the government position on the reforms. Among the employers' organizations, the most controversial aspects of the Social Dialogue Law are changes to the rules that will be applied to determine whether or not an organization is "representative" and therefore has the right to negotiate collective agreements or participate in forums such as the Economic and Social Council. Regardless of whether or not these changes are politically motivated or desirable from an industrial relations perspective, no firm evidence has been produced to show how the changes being implemented will boost employment and productivity in the manner asserted by the protagonists of the reforms.

Romanian unions and the international trade union movement have also strongly opposed many aspects of the reforms. Shortly before the Social Dialogue Law was adopted the General Secretary of the International Trade Union Confederation (ITUC)[4] wrote to both the Prime Minister and the Presidents of the Parliamentary Parties claiming that the Social Dialogue Law will:

> ... undermine representivity of trade unions on different levels and trade union pluralism, eliminate the national collective bargaining and leave trade union leaders without legal protection. The changes proposed by the Romanian Government will further dilute the protection of workers' rights on the individual level by opening them to abuse from the part of employers.

Issues of concern to the trade unions include a provision in the new law that states: "the establishment of a trade union requires a minimum of 15 employees from within an employing entity".[5] But it is estimated that around 85 per cent of all enterprises in Romania have fewer than ten workers (Ciutacu and Chivu, 2010, table 4, p. 17). Unions are concerned that this reform may inhibit their ability to organize workers in the vast majority of small enterprises as well as workers in the same occupation but working in different enterprises.

Trade unions are also concerned that the new law makes it more difficult for the social partners to negotiate a collective agreement at enterprise level. For this to occur, the union must represent over half of all employees in the enterprise; previously, the formal quantitative

[2] The General Union of Industrials of Romania – 1903 (UGIR–1903) and the National Confederation of Employers (Conpirom) are among the employers' associations strongly opposing the reforms.

[3] This includes employers affiliated to the Alliance of Romanian Employers' Confederations (ACPR).

[4] Letter from Sharan Burrow, General Secretary, ITUC, to the Prime Minister of Romania and the Presidents of the Parliamentary Parties, Brussels, 13 April 2011.

[5] Law on the Social Dialogue Code, April 2011, Title 2 Chapter 1, Article III (2).

threshold was 33 per cent but in reality unions with far fewer members were allowed to negotiate collective agreements at the enterprise level. Significant changes have been made to the arrangements for collective bargaining at industry level. The previous legislation allowed the social partners discretion in determining the number and definition of industries for the purpose of collective bargaining at this level. The new law removes this discretion; it defines industries where it will be possible to negotiate a collective agreement. But the industries thus defined do not coincide with existing trade union and employer association structures. Consequently both unions and employers will have to significantly alter their institutions through mergers, recruiting members in sectors not currently organized and carrying out other structural reforms before they can effectively participate in branch-level collective bargaining. The experience of unions and employer associations in other countries of structural reforms of this nature suggests that this will be a complicated and time-consuming exercise. Disruptions to industry-level collective bargaining may therefore occur for a prolonged period.

The new law also dramatically alters the arrangements for "extending" an industry-level collective agreement beyond the workers and employers that are signatories to the agreement. In the past, industry-level collective agreements were automatically extended to all employees in the industry (the so-called *erga omnes* provision). Under the new law this provision is abolished and is replaced by a provision which allows the Ministry of Labour, Family and Social Protection to extend an industry-level collective agreement to all entities in the industry "based on a well grounded request of all the signatory parties of the respective collective contract".[6] However, the law does not define "a well grounded request", thus leaving considerable discretion with the responsible Minister. In discussions with the author of the present chapter, representatives of both trade unions and some registered employers' associations were critical of this proposed reform.[7] Several employer representatives argued strongly in favour of automatic extension of collective agreements, because in their opinion this prevented worker abuses and the undercutting of appropriate minimum labour standards and wage levels.[8]

The new law provides scope for collective bargaining at an intermediary level between the enterprise and industry. It refers to collective

[6] ibid., Article 143 (5).

[7] Discussions were held with representatives of several recognized employer associations and trade unions between November 2010 and February 2011.

[8] Employers' organizations taking this view include the General Union of Industrials of Romania–1903 and the National Confederation of Employers (Conpirom).

bargaining at the "group of entities level"[9] and sets out representivity criteria and procedural rules for bargaining at this level which unions have criticized as being highly ambigious.

Finally, and most importantly, the reforms also alter the arrangements for national-level collective bargaining. Previously, all employees in both the public and private sectors were covered by a single national collective agreement that set basic conditions, including a minimum wage, that could be improved upon at industry and enterprise levels. But both trade unions and several employers' associations have been highly critical of the fact that the new law provides no scope for collective bargaining at national level. The social partners opposing this aspect of the reform point out that under Article 4 of the ILO Right to Organise and Collective Bargaining Convention, 1949 (No. 98) the determination of the bargaining level is a matter to be left to the discretion of the parties.

Other provisions of the new law stipulate that wage negotiations in the public sector can take place only within precise limits that are not subject to negotiation. During discussions, trade unions have strongly criticized this provision also, claiming that it is not in conformity with ILO Convention No. 98.

## 7.3 PAST ECONOMIC PERFORMANCE PROVIDES NO GROUNDS FOR REFORM

While there are important labour market problems that warrant reform in Romania, the case for abolishing the national collective agreement or altering the rules that determine which trade unions and employers' organizations can negotiate collective agreements or participate in dialogue with the Government is highly problematic in the context of economic developments over the past two decades.

### *7.3.1 The lost decade of the 1990s*

Romania experienced a severe double-dip recession in the 1990s during which hyperinflation ensured that real incomes plummeted. At the dawn of the new century, the real level of GDP was still roughly 20 per cent below its 1989 level. It has been estimated that some 2.4 million jobs were lost during the course of the decade, with the bulk of the job destruction taking place in the manufacturing sector (Ciutacu and Chivu, 2007,

[9] Law on the Social Dialogue Code, Article 51 (2).

figure 8, p. 28). In 1990 the agriculture sector accounted for 29 per cent of total employment – already high compared to other developed and transitional economies – but by 2000 this figure had risen to 46 per cent. Real wage and income levels also declined dramatically during the 1990s. Between 1989 and 1999 the real minimum wage fell by a massive 75 per cent, while the real average monthly wage declined by almost 40 per cent over the same period (Ciutacu and Chivu, 2007, figures 15 and 17).

### *7.3.2 The start of economic recovery, 2000–2003*

Economic recovery commenced shortly after the turn of the millennium, partly due to strong export growth. This export-led recovery was kick-started by currency depreciation in 1999 and a massive decline of 60 per cent in real unit labour costs between 1999 and 2003 (IMF, 2003, figure 7, p. 8). The IMF (ibid., p. 8) concluded that these developments boosted profitability and helped Romania gain market share in its main export markets.

Towards the end of 2001 Romania sought assistance from the IMF, negotiating a Stand-By Arrangement. By this stage the main political parties in Romania had decided to seriously pursue membership of the European Union (EU). This helped mobilize political will for a more disciplined application of macroeconomic stabilization policies and structural reforms. Though annual inflation rates were still high in 2001–02 a clear trend towards greater price stability had been established. This deflationary trend was maintained for several years thereafter as fiscal and monetary policies became more restrictive. In fact, the fiscal deficit declined progressively over the first half of the decade, falling from 4 per cent of GDP in 2000 to 0.7 per cent by 2005. Over this same period the public debt-to-GDP ratio declined from a fairly moderate 27.8 per cent to a low 19.9 per cent.

In this period the Government relied heavily on exchange rate policy to achieve stabilization, slowing the pace of nominal depreciation and allowing the real exchange rate to appreciate. To contain the balance of payments deficit within manageable levels in this policy environment required careful attention to international competitiveness and declining real unit labour costs. The wage deflationary policy combined with stabilization measures did result in robust economic growth, declining inflation and increased investor confidence for several years.

During this period reforms were also made to the tax structure, which helped reduce unit labour costs. In 2002 and 2003 payroll taxes were reduced in stages by some 8 percentage points, with further reductions in 2004 and 2006. In 2003 the VAT system was adjusted to cover a much broader range of goods and services at the prevailing 19 per cent rate.

Further, in January 2005 the Government finally announced plans to abolish the existing progressive system of income taxes and introduce a flat rate income tax of 16 per cent which applied to all incomes, company profits and incomes derived from other independent activities. This reform involved a cut in the company profit tax rate by a massive 9 percentage points. As part of these reforms the Government also introduced a 3 per cent tax on the turnover of microenterprises, again with a view to mitigating tax evasion.

While the aim of the reforms may have been to reduce tax evasion and curb the size of the informal economy, their regressive nature helped to fuel demands for compensating income increases at the bottom end of the income distribution. Moreover, it is certainly not clear that these reforms helped to broaden the tax base. In 2008 the total tax-to-GDP ratio remained a very modest 28 per cent, while the ratio of taxes on profits to GDP stood at 2.8 per cent and VAT to GDP at 7.9 per cent.[10]

Although these structural reforms helped to bring about the decline in real unit labour costs, they also exacerbated industrial relations pressures and political demands for higher minimum wages and a strengthening of collective bargaining. Productivity growth significantly exceeded the growth in real average wages from the late 1990s to 2003, thereby substantially reducing real unit labour costs and the labour share in national output. However, the fact that workers felt they had not received their fair share of the growth dividend for such a long period, together with the fact that this came on top of significant real wage cuts in the early 1990s, engendered resentment and pressures for wage catch-up which could not be permanently contained. These stabilization and structural adjustment policies almost certainly had some impact on the negotiations over labour legislation and labour market institutions.

### *7.3.3 Accelerating economic recovery, 2004–2008*

Although the Labour Code introduced in 2003 following extensive social dialogue was criticized by the IMF, the World Bank and part of the business community, the new legislation was followed by accelerated economic growth.[11] During 2004 GDP growth reached 8.5 per cent

[10] Another important focus of the IMF Stand-By Arrangement negotiated at the end of 2001 was on reducing deficits in the large state enterprises and eliminating their reliance on lax credit provided by the state banks. Consistent with this policy, in 2001–2002 the Government implemented significant increases in prices for gas, heating and electricity in order to reduce the large deficits which the public utilities had accumulated, thereby further eroding workers' purchasing power.

[11] Detailed negotiations over a revised Labour Code had commenced in 2000 and lasted some three years, with the revised Code coming into effect in March 2003. Despite the lengthy process

(up some 3.2 percentage points on the growth recorded in 2003), while CPI-measured inflation fell to single digits (down some 4.8 percentage points on the previous year), the fiscal deficit was halved to just 1 per cent and the public debt-to-GDP ratio fell by some 3.3 percentage points. On the basis of these macroeconomic indicators it would be difficult to suggest that the introduction of the 2003 Labour Code caused any immediate problems.

Over the longer term it is also difficult to detect any clear negative link between the introduction of the revised labour legislation and the macro economy. During the five years following its adoption, Romania started a process of economic catch-up on the nations of western Europe. Between 2003 and 2008 the country experienced an economic boom, with annual GDP growth averaging 6.5 per cent. As a result, Romania's per capita income (on purchasing-power-parity terms), which had been only about 20 per cent of the euro area average in 2000, had jumped to nearly 40 per cent by 2007.

This period of buoyant economic results between 2003 and 2008 was underpinned by rapid capital inflows and significant foreign direct investment. Net capital inflows increased from 6.7 per cent of GDP in 2003 to 17.7 per cent in 2008. Capital inflows of this magnitude funded a dramatic increase in investment, which jumped from 22 per cent of GDP in 2003 to 30 per cent in 2007. At the same time, credit to the private sector

---

Note 11 continued

of social dialogue, the IMF was concerned, arguing even before it was adopted that:

> The new Labor Code, the main features of which remain under discussion, should avoid imposing restrictive regulations on employers and should not complicate the downsizing of state-owned companies ... the authorities must spare no effort in maintaining flexible labour market conditions and creating an environment conducive to private sector growth. (IMF, 2003, p. 24, para. 53)

The IMF's concern about the impact of the new Code led to its statement in the Article IV discussions with the Government in April 2004 that:

> The new labor code ... is seen by the business community as overly restrictive in many areas. Particularly at issue are provisions on hiring and firing, the collective contracts, and a new wage-guarantee fund for bankrupt companies ... They [the Romanian authorities] agreed, however, to address the issues that have raised concerns by amending the law in early 2005, in line with recommendations of the World Bank. (IMF, 2004, para. 28)

In light of the above and in an effort to re-establish social dialogue and collaboration the Prime Minister convened consultations with various trade unions and employer associations in April 2005. Tripartite and bipartite discussions about the proposed labour reforms continued over the next few months. By July 2005 the Government was able to table an Emergency Ordinance in the Parliament that introduced broad-ranging reforms into the labour legislation. Soon after the introduction of the Emergency Ordinance the trade unions and the recognised employer organizations expressed their general support for the compromise solution although neither side was completely satisfied. However, the Foreign Investors Council was highly critical of the outcome. In July 2006 the Government introduced some further amendments to the Labour Code.

began to expand rapidly, initially from a low base but reaching annual growth rates of around 50 per cent in 2006 and 2007. However, a significant and rapidly increasing proportion of this borrowing from the local subsidiaries of foreign banks was in euros rather than domestic currency. Romanian companies producing for the domestic market and households were increasingly exposed to exchange rate risks. While the growth in foreign investment and the credit expansion helped fuel asset bubbles, with equity and housing prices rising at unsustainable rates, investment rates in the real economy, particularly in the manufacturing export sector, remained exceptionally strong, indicating that international competitiveness remained strong. Between 2006 and 2008 gross fixed investment maintained average annual growth rates well in excess of 20 per cent.

It is important to note that the deflationary trend was also maintained after the introduction of the 2003 Labour Code. Real wage moderation was also maintained for several more years after its adoption, and this was possible despite a significant tightening in the labour market. Between 2002 and 2008 the downward trend in the employment rate was halted and the unemployment rate declined from 8.6 per cent to 5.8 per cent, well below the EU average. There was also an impressive decline in long-term unemployment over this period, though the duration of unemployment remained a concern.

Between 2003 and 2006 public-sector wage growth started to pick up, but the previous trend of productivity growth exceeding average real wage growth was sustained for much of this period, thereby contributing to a further decline in real unit labour costs (IMF, 2007c, figure 4, p. 10; see also the discussion on competitiveness, ibid., box 2, p. 12). Rapid wage increases in the public sector spilled over into the private sector, with the result that in 2007 and 2008 average real wage growth exceeded productivity improvements and real unit labour costs increased significantly. By 2007 the prolonged period of robust economic growth and economic catch-up was starting to hit a hard balance-of-payments constraint despite strong and sustained export growth. The current account deficit peaked at 13.4 per cent of GDP in 2007. This generated legitimate concerns about the implications of a change in foreign investor sentiment and the possibility that capital inflows could rapidly reverse in the absence of any capital controls, and could lead to a severe balance-of-payments crisis. These developments rightly led to concerns about the possibility of domestic demand overheating and the need for a countercyclical fiscal policy to moderate these pressures and help keep the current account deficit within manageable proportions. Fiscal policy was gradually loosened after 2006, with the fiscal deficit increasing from 1.4 per cent of GDP in 2006 to 4.9 per cent in 2008. In the lead-up to EU membership and the initial period after joining, public employment levels expanded and the growth in public-sector wages accelerated. Also, in the lead-up to elections in 2008 public expenditure in other areas, including pensions and transfer payments, increased significantly. These developments were reflected in an increase in the ratio of general government expenditure to GDP from 32.7 per cent in 2006 to 36.7 per cent in 2008. Despite this, public debt levels remained moderate, reaching only 20 per cent of GDP in 2008.

The attention of those trying to contain the size of the twin deficits and preserve a sustainable growth strategy was also increasingly drawn to labour cost developments. Nevertheless, despite increasing concerns about overheating and rising labour costs pressures, immediately prior to the onset of the global economic crisis in 2008 IMF staff noted the following in their Article IV Report (IMF, 2008b, p. 4):

> Propelled by EU accession and massive capital inflows, Romania has enjoyed a stretch of strong economic performance, combining brisk catch-up growth with, until mid-2007, disinflation.

The same IMF publication noted that:

> Romania's export market shares have steadily increased for all major export destinations. While nominal unit labor costs (ULC) in manufacturing have risen particularly sharply, profitability remains intact, and Romania's euro-dominated wages are still among the lowest in the EU; foreign-investor interest in re-locating production to Romania remains also strong. (ibid., p. 11)

## 7.4 ROMANIA IN THE GLOBAL ECONOMIC CRISIS

Like the vast majority of economies in emerging Europe, Romania was hit hard by the global crisis. As global investor sentiments turned, the previously strong capital inflows were abruptly reversed, as many had feared. As a result, by October 2008 commercial banks in Romania were experiencing liquidity problems and interest rates spiked. These events unfolded as the country neared parliamentary elections. The resulting uncertainties about future fiscal policy and concerns about the magnitude of the current account deficit led the international rating agencies to cut Romanian credit ratings drastically.

These financial market pressures were rapidly reflected in the real economy. Real GDP growth had been charging along at an average annual rate of 9 per cent in the first three quarters of 2008 but output collapsed in the final quarter, declining at a 13 per cent annual rate. This was one of the most dramatic turnarounds in emerging Europe.

As global economic uncertainty intensified, all currencies in emerging Europe came under pressure. The Romanian currency (leu) was no exception, depreciating by around 20 per cent against the euro between October 2008 and January 2009. However, the currencies of several other emerging economies in Eastern Europe fell more dramatically in this period. A key concern of the Romanian authorities and their advisers was the health of the banking system. Given the rapid growth of foreign currency loans in the years prior to the crisis, there were serious concerns about how the banking system would cope as the domestic currency depreciated, pushing up loan repayments and generating a possible explosion of non-performing loans.

In early 2009 the Romanian authorities began to negotiate another Stand-By Arrangement with the IMF. The agreement was concluded by April and involved additional financial support from the World Bank and European Commission (IMF, 2009b, para. 47). Access to over US$17 billion in budget and balance-of-payments support came with public-sector belt tightening, although there was some streamlining of formal conditionality compared with decades gone by.

The Government had already commenced the process of fiscal retrenchment in late 2008. This included a 3 percentage point reduction in the fiscal deficit brought about by increases in social contributions, indirect taxes hikes and public wage bill cuts introduced in the 2009 budget (IMF, 2009b). The Stand-By Arrangement required further cuts in public expenditure, yielding 1.1 per cent of GDP in 2009 and additional cuts in 2010.

After the re-election of President Basescu in the autumn of 2009 and the reappointment of Prime Minister Emil Boc, the fiscal adjustment plans for 2010 were significantly revised and replaced by a package of reforms that produced a much larger fiscal contraction (equal to 4.6 per cent of GDP) than had been previously announced. The package included a 25 per cent cut in public wages, the elimination of holiday bonuses and the 13th month salary in the public sector, a 15 per cent reduction in most social transfers and a 5 percentage point jump in VAT. Important reforms have also been implemented to the pension system, increasing retirement ages and altering pension indexation arrangements, as well as far-reaching reforms to the public wage system that significantly reduce bonuses. Although the trade union movement in Romania accepted that some fiscal adjustment was required to stabilize the economy, it strongly contested the magnitude of the contraction and the unequal distribution of the burden. Romanian workers and pensioners had done little to cause the financial crisis, but were now expected to absorb the bulk of the painful adjustment effort. The trade unions organized a series of large protest actions during the summer of 2010 (EIRO, 2010).

The subsequent recession in Romania proved to be one of the deepest and longest in Europe, with GDP declining by 7.1 per cent in 2009 and a further 1.3 per cent in 2010 due to declining domestic demand. Gross fixed investment plummeted by 25 per cent in 2009 and a further 13 per cent in 2010, while private consumption fell by 8.7 per cent and 1.6 per cent in the same period. The rapid evaporation of foreign credit and economic confidence explain the initial drop in domestic demand. But the shock was clearly exacerbated by the austerity measures implemented in 2009 and 2010. Some indicators suggest that a mild economic recovery commenced in early 2011, but retail sales and other indicators of domestic demand remain depressed.

One bright spot in recent economic data is the export sector. Even at the height of the global crisis the impact on Romanian exports was less dramatic than in other emerging economies in Europe. Since early 2010 export growth, and in particular manufacturing exports including machinery and equipment, have been booming and constitute the main factor contributing to aggregate demand. This is a testament to the international competitiveness of the manufacturing sector where workers are organized and collective bargaining takes place. Despite this, real wages in the manufacturing sector declined significantly in 2010. Romania has again demonstrated that its labour legislation and labour market institutions are compatible with a high degree of real wage flexibility. Moreover, despite significant real wage growth in 2007 and 2008 Romania continues to be a low-wage country. With a minimum wage of around 160 euros per month (this compares with a minimum wage of 1400€ in Ireland), and nearly 30 per cent of employees surviving on incomes around this level, Romania has a major comparative advantage in labour costs over other countries in the European Union. This explains why export growth from Romania is again surging and providing hope for economic recovery in the face of depressed domestic demand.

## 7.5 CONCLUSIONS

The recent labour reforms in Romania are highly contested. Although the advocates of greater flexibility have claimed that these reforms will produce a massive increase in employment and improvements in productivity, no convincing evidence has been produced to demonstrate that weakening collective bargaining or changing the representivity rules for trade unions and employers' organizations can deliver these objectives. Given the absence of a clear economic rationale for the recent labour reforms it remains unclear why they were announced in Letters of Intent between the Government and the IMF and implemented in the context of a Stand-By Arrangement. Meanwhile attention has been diverted away from the real reasons why Romania suffered severely from the global crisis. These reasons include the unsustainable growth in private-sector debt denominated in foreign currencies prior to the recession.

Instead of tackling the root cause of the problem, labour reforms have been pushed up the political agenda. No country has perfect labour legislation or labour market institutions. But at least the previously-existing labour legislation in Romania resulted from lengthy negotiations between the Government and the social partners, with technical assistance from the ILO. It involved compromises from all sides. Moreover, for a prolonged period following the introduction of the previous labour legislation Romania experienced rapid economic growth, strong foreign direct investment, declining inflation and improved labour market performance.

Aspects of the previous legislation were partly the result of implicit or explicit trade-offs for policy reforms in areas such as tax policy, energy-pricing policies, privatization and employment reductions in public enterprises, as well as trade liberalization and financial market deregulation. The legislation has facilitated the development of a comprehensive collective bargaining system and relatively strong trade unions, and this helped to preserve a balance between the interests of workers and employers in an open economy, preventing even wider income inequalities from emerging. If this equilibrium is now destroyed by weakening collective bargaining and the social partners, popular support for liberal economic policies may be undermined.

The current labour reforms do not result from compromise and consensus. Consequently, they will heighten existing political and industrial relations tensions. As one commentator recently noted:

> the authorities enforced a new Labour Code aimed at increasing the flexibility of the labour market, but with the potential of seriously unsettling it. In a time of crisis, the new Code gives employers even more power over their employees. (Nine O'Clock RO, 2011c)

Further strikes and protests will weaken investor and consumer confidence. Given the dramatic decline in domestic demand in the last two years and the further public employment cuts and fiscal retrenchment expected in 2011 and 2012, Romania requires an industrial relations environment that will restore stability and engender confidence. There are a number of critical labour market problems that require urgent attention in Romania. Foremost among them is the excessive size of the informal economy and the prevalence of undeclared work. Estimates of the size of the informal economy vary from around 20 per cent to nearly 40 per cent of GDP (Schneider, 2007; Stanculescu, 2006). Policies that focused on reducing the so-called tax wedge by cutting payroll taxes and moderating real labour costs in the period before 2007 comprehensively failed to reduce the incidence of undeclared work. The Government has announced that it is considering further cuts in payroll taxes, but what is really required to tackle undeclared work is the development of a truly independent and well-resourced labour inspection system (Vega Ruiz, 2010).

Second, the labour force participation rate and the employment rate in Romania are well below the EU average. Of particular concern is the extremely low employment rate for young people, especially as there is a high level of migrants among them. This trend began in the 1990s with the disappearance of jobs and low domestic wages. It is estimated that there are up to three million migrants, which represents about 13 per cent of the population (Nesporova and Popova, 2010). The abolition of the national collective agreement that established minimum wages and labour standards may accelerate the migration of young workers and discourage domestic job search.

Another factor depressing the employment rate is the high level of average hours worked. Actual weekly working hours for full-time employees in Romania exceed 41 on average, by far the largest in the EU-27 countries (European Foundation for the Improvement of Living and Working Conditions, 2009, figure 5, pp. 16–17). This is often overlooked by observers who call for labour reforms to boost the employment rate. In fact, overall labour utilization in Romania, taking into account both the employment rate and average hours worked, is only slightly below that of the United States and above that of many EU countries (Landesmann, 2008).

Third, in the lead-up to the recession of 2008 Romania faced a critical skill shortage problem. The skill mismatches and other structural problems in the labour market have been further exacerbated by a dramatic decline in public resources for employment policies, from 0.7 per cent of GDP in 2003 to just 0.3 per cent in 2008 due to declining payroll taxes. As part of this process, the budget for active labour market policies (ALMP) was slashed from a low 0.1 per cent of GDP in 2003 to a mere 0.03 per cent in 2010. The expenditure on ALMP in Romania is roughly one-tenth of average EU spending (Nesporova and Popova, 2010, pp. 10–11). Further cuts in payroll taxes may well exacerbate this problem.

Finally, the main reason why Romania continues to lag well behind the per capita income levels achieved in most other EU countries and other advanced economies is the low level of productivity in the economy (output per hour worked). This remains a critical problem despite impressive productivity growth from a low base over the last decade. It would suggest that Romania should avoid reforms that are designed to artificially boost the participation and employment rates of marginal workers unless the increase in labour utilization is matched by investments in capital equipment and technology. A low-wage strategy that encourages labour/capital substitution would be counterproductive. On the contrary, boosting support for research and development and enhancing physical infrastructure should be high priorities.

This package of reforms could assist Romania to improve both efficiency and equity in the labour market and eventually provide the country with coherent labour legislation, as well as labour market institutions and labour policies that are conducive to strong, sustained and balanced economic growth as well as decent work.

PART III

# EMPLOYMENT RECOVERY WITH QUALITY JOBS

# 8 EMPLOYMENT-LED GROWTH AND GROWTH-LED EMPLOYMENT IN THE RECOVERY

*Duncan Campbell**

Beyond the understandable focus on sustainable growth, the central problem facing labour markets in an interdependent global economy is distribution of productive employment opportunities. It is a commonplace that growth alone is inadequate for the creation of productive jobs; rather, it is the pattern of growth that matters. More recently, this sentiment has been reinforced by the view that the devastation wrought by the worst global economic downturn since the Great Depression offers the policy world an opportunity to rethink just that pattern of global growth resulting from an untempered reliance on the market. Opinion now, including that of the International Monetary Fund (IMF), [1] discounts any of the now abundant signs of recovery that do not also include a recovery of jobs. An employment-led recovery is the aim. Just what, however, does this mean?

This chapter explores a theme relating to the distribution of productive employment in developing countries, and argues that a meaningful distinction can be made between labour markets that are "employment-led" and those that are "growth-led". And further, that an employment-led approach to growth does not take us very far, if left on its own.

* Director of Policy Planning in Employment , ILO, and Fellow, Institute for the Study of Labour (IZA).

[1] Dominique Strauss-Kahn, IMF Director-General, speaking at the ILO/IMF Conference in Oslo, September 2011 (see ILO and IMF, 2010).

## 8.1 AN ADMITTEDLY IMPERFECT TAXONOMY: IS THE DEMAND FOR LABOUR DERIVED OR SELF-CREATED?

The thrust of much recent literature finds the well-known concept of a "dual economy" an exaggeration. "Traditional" and "modern" sectors are in fact not worlds apart; they are not separate, but more closely intertwined than hitherto believed. The observations are empirically compelling, but in implied policy terms, often misguided. At a time when a strong employment component of growth is, because of its absence, of widespread policy concern, it is useful to recall that there is an extant pattern of growth in which employment has been the lead, rather than the lag, variable in the growth equation.[2] The problem is that where employment drives growth or at least seeks to, the result has most often been widespread underemployment and working poverty. To help understand whether it is growth that drives employment or the reverse, it is useful to propose an imperfect taxonomy (table 8.1).

Table 8.1 A loose taxonomy of employment- vs. growth-led labour markets

| Employment-led labour markets are … | Growth-led labour markets are … |
|---|---|
| relatively more … | |
| "traditional" | "modern" |
| vulnerable in employment status | likely to have a higher share of wage-earners |
| part of the informal economy | part of the formal economy |
| rural | urban |
| likely to be less productive | likely to be more productive |
| credit-insufficient | access to credit |
| likely to have a lower capital/labour ratio | likely to have a higher capital/labour ratio |
| oriented to domestic, even local markets | oriented to domestic and international markets |
| sheltered from the impact of macroeconomic policies | exposed to macroeconomic policies |
| deficient in the quality of jobs | deficient in the quantity of jobs |
| likely to be less or unprotected | likely to have at least de jure protection |
| prone to greater earnings instability | stable and predictable in earnings and income |

Source: Author.

[2] Following Ghose et al. (2008), this chapter's premise finds continued relevance in the idea of a dual economy as characterizing developing country labour markets.

### 8.1.1 The "demands" for labour

The nature of demand itself – its origin, its strength, its sustainability – lies behind the employment-led versus growth-led continuum. The demand for anyone's labour is never a "given" – nor, even where there is such demand, is there any guarantee that it is permanent. The strength and continuity of demand constitute a continuum – from strong to tenuous, from stable to erratic.

Imagine three types of labour demand. The first of these is the textbook case of labour as "derived demand"; that is, labour, not employed as an end in itself, but because it is needed to fulfil demand arising from the product market. An autoworker is an autoworker because there is a demand for the worker's input in satisfying demand in the product market. While obvious, but nonetheless overlooked, this framework is entirely causal or sequential: growth leads to jobs.

A second source of labouring could be thought of as emanating from demand that is in fact auto- or self-derived. A subsistence farmer's labour is derived from the farmer's demand to eat. Here, moreover, is an instance where demand is indeed permanent. Here, too, is an instance where demand and need are synonymous in a way that does not apply to, say, the demand for an automobile.

The third type is the instance in which labour is in fact "chasing" or endeavouring to "stir up" demand, all too often in instances where such demand is rather feeble. This category would include the survivalist or distress strategies of street vendors to "create" often elusive demand.[3]

These different motivations to labour do not fully correspond to different statuses of employment. For example, labour that is more clearly derived from product-market demand does not solely apply to paid employees. Many self-employed are represented in this category. Similarly, paid employment is not necessarily a healthy and stable derivation of demand. Casual day labourers, for example, face uncertain demand, uncertain wages, and uncertain locations of work – a strong "demand search" component to their labour market involvement is clear.

While the first of these three demand types can be considered growth-led, deriving as it does from demand in the product market for a labour input, the latter two are employment-led – less derived from "growth" than contributions to it. But of what use is such an admittedly loose taxonomy when all categories, in the end, are responses to some form of demand, whether steady and strong, or uncertain and sought-after?

[3] At the troubling extreme, it would also include those children and adults who trade their bodies for income.

Two answers are of possible relevance. First, these different "demand regimes" coexist. Simply ascribing underemployment and working poverty to inadequate demand masks the point that demand-deficient underemployment coexists with respectably demand-sufficient employment in many developing countries. One's attention is therefore drawn to the need to look not only at the level of growth, but its repartition. It is the sheer magnitude of survivalism in otherwise healthily growing developing countries which argues against reliance on growth alone to solve labour market problems. While it is no doubt the case that there is too much supply chasing too little demand, a pertinent question might be to ask how that demand is accessed.

Second, in policy terms, one should be thinking just as much about how to improve employment's contribution to growth as one should about how to improve growth's contribution to employment. It is the latter, however, that occupies most policy attention.

### 8.1.2 Improving employment's contribution to growth

When policy-makers focus on the notion that growth needs some help in creating jobs, one of the remedies that often comes to mind is to focus on the supply side of the labour market. A better educated, better trained, healthier supply of labour contributes to growth through the higher productivity that would accompany such an improved supply of labour, through the greater ease with which transitions to higher value addition and more rapid structural transformation could be made. There is no argument here. These are sound empirical conclusions to draw.

However, the question is how to improve employment's contribution to growth. How to enable the transition from an employment-led growth model to one of growth-led employment? Employment-led growth exists as a survival strategy, as there is no alternative. There is no growth that is creating jobs for hundreds of millions of poor people – today or at any time in the past! Growth assumes consumption and the disposable income needed for this. These are wanting. It assumes investment by "capitalists" with a view to gaining an adequate return in the real economy. But the role of investment is uncertain in the absence of demand.

Yet there could be useful interventions for unleashing demand. For example, infrastructure has an important role to play in converting a subsistence farmer to a commercial farmer. For the street vendor, the chase after demand can be facilitated by measures to attract demand. Commercial zoning laws, product diversification and access to credit could all increase the throughput of the street vendor toward the end of greater income generation.

## 8.2 "EMPLOYMENT-LED GROWTH" IN ITS CONTEXT

Common features of the poorest countries are incomplete or unintegrated markets, whether for products, services, labour or capital, and inadequate demand in the economy to absorb new entrants into the labour market into relatively productive and stable employment. In the absence of alternatives for income generation, a substantial share of working men and women (and children) "create their own demand", whether through subsistence farming, rudimentary trade such as rag-pickers or street vendors, or, more rarely, in paid employment. While such work is overwhelmingly in the informal economy, it is less the formal versus informal taxonomy that matters here than the barriers to demand.

The ILO defines as "vulnerable" workers those who are own-account workers and contributing family members in the labour market.[4] Their participation in the economy is often but not always "employment-led", as it is often but not always their supply that creates demand, or seeks to do so, rather than the reverse. Employment-led growth predates the modern economy. The place of the employment-led labour market in historical sequence is aptly evoked in Paul Collier's description (2008) of the "bottom billion" as living and working in the 14th century. While Collier's argument is quite convincingly concerned with the geo-political distribution of economic welfare, a different picture – or, rather, the same picture but of a different magnitude – emerges when political borders are removed and just the working population is concerned. When this is done, the population of the "bottom", or the "have-nots", is closer to 50 per cent of the global labour market, or, in population terms, closer to 3 rather than 1 billion. Vulnerable employment shares by subregion are shown in figure 8.1.

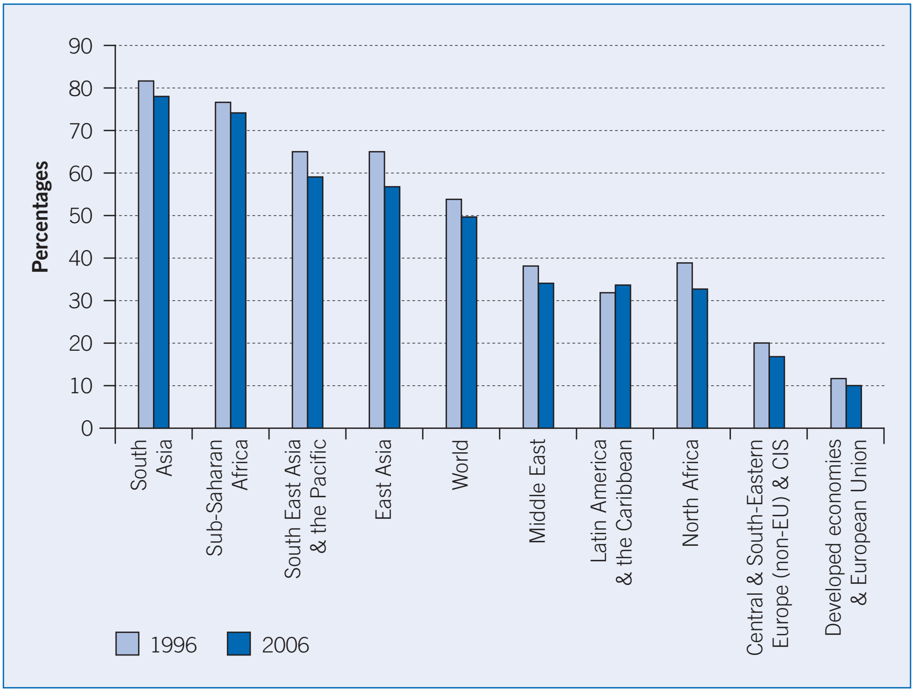
Thus, while, in population terms, the vast majority of the developing world's people are living in countries that have enjoyed a sustained period of healthy GDP growth, and can be said to be converging with industrial countries (with variable lags), this says little of how growth is distributed within these countries.[5] Averages conceal as much as they reveal.

Employment-led labour markets in developing countries coexist but are far from being fully integrated within the successful growth patterns of these countries. In fact, much of this labour-market group is beyond

[4] By definition, therefore, paid employment is not considered as vulnerable work, although a more conventional understanding of the word vulnerable would include those casual day labourers whose wage work is neither predictable, regular, well remunerated, nor contractually protected.

[5] It is also the case that most developing countries have substantially higher rates of population growth than industrialized countries. The apparent rate of convergence thus looks quite different when one compares the rate of GDP growth to that of GDP per capita growth.

Figure 8.1 Vulnerable employment shares, by region, 1996 and 2006




Source: ILO (2010k).

the influence of macroeconomic policies. For example: fiscal policies relative to health and education often do not reach this group or reach it inadequately; monetary policies are less effective for those who face a widespread lack of access to credit; and exchange-rate fluctuations are less important to those who neither import nor export.[6]

From this perspective, there is no obvious spillover of the fortunes of the modern, "growth-led" labour market on those of the employment-led labour force. Nor does one possible exception to this bode particularly well: the impact of the crisis has been to increase the size of the employment-led labour market in both relative and absolute terms (see ILO, 2011f). As the opportunities for paid employment in the growth-led segment of the labour market diminished, those either holding or

[6] An argument can of course be convincingly made that domestic inflation – for instance, food prices – has a strongly adverse effect on the poor who comprise this group. In view of the poor's greater share of expenditures on food, this will clearly be the case. Yet this negative would most adversely impact the urban poor, whereas the majority of the employment-led labour market is rural, and a substantial proportion of them are engaged in subsistence farming. They gain nothing from the surge in food prices nor are they much affected by it.

aspiring to paid employment had little option but to seek income-generating possibilities in the employment-led workforce. The extent to which this may have reduced earnings in that already overcrowded workforce is unknown, but that it has done so is a plausible outcome.

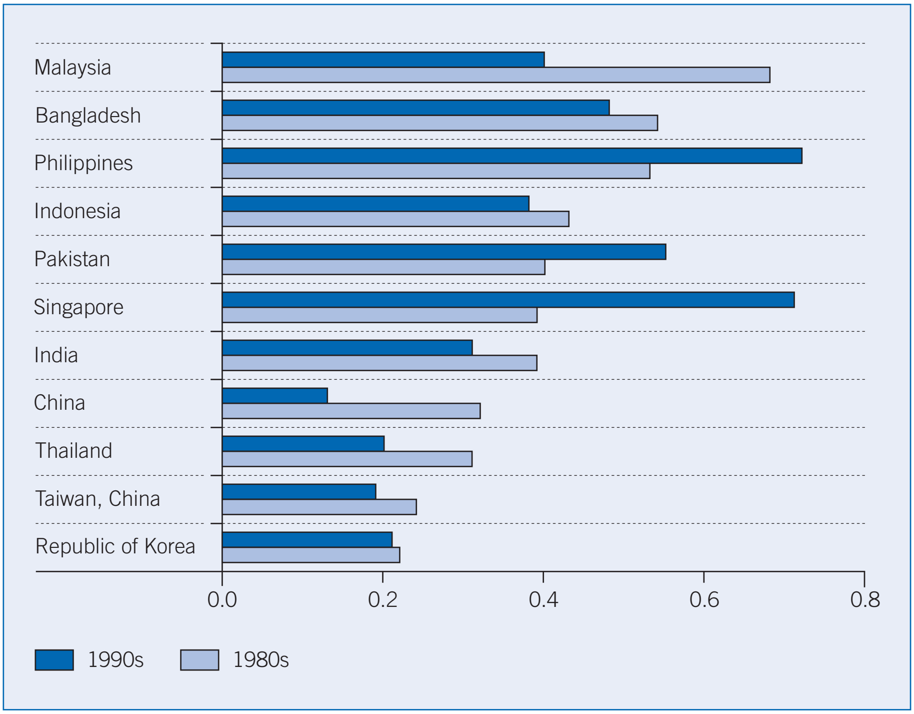
## 8.3 EMPLOYMENT DERIVING FROM DEMAND WHEN THE DEMAND IS TOO LITTLE OR IS SATISFIED WITH FEWER JOBS

Long-standing though it may be, the model of employment-led growth described in the foregoing paragraphs has been largely inadequate to lift workers and their families out of poverty, or to contribute in a robust way to economic growth. As a model of demand self-creation or survivalist activity, it has fallen short of sustaining hundreds of millions of people in their aspirations for a better life. This remains true even if some activities described as employment-led can hardly be defined as survivalist – many such activities are both dynamic and remunerative (OECD, 2009a).

However, the growth-led alternative has been equally inadequate. Indeed, growth-led employment has been beset by three empirical trends:

1. The majority of new job creation in the developing world is in the informal economy. While data limitations and methodological/definitional problems abound, one study published by the World Bank (Becker, 2004) found that, while 78 per cent of all non-agricultural employment in Africa was in the informal economy, 93 per cent of all new jobs were informal. For Latin America, the percentages were 57 and 83 per cent respectively.
2. The other side of the same coin is that formal-economy employment growth has stagnated. Common explanations include the impact of structural adjustment and associated decline of public-sector employment and intensified global competition and associated pressures to search for more flexible (and less formal) forms of employment.
3. A third tendency not unrelated to the rise in global competition: there has been an observed decline in the (formal-economy) employment intensity of growth, which may be related to the adoption of labour-saving technologies in the face of increased competition. This is consistent with the surprising observation that skill-biased technological change applies not only to the industrialized countries. Figure 8.2 compares the decades of the 1980s and the

Figure 8.2 Increase in employment associated with a 1 per cent increase in GDP, selected Asian countries, 1980s and 1990s (percentages)




Source: Kapsos (2005).

1990s for a sample of Asian countries, the majority of which have shown a declining employment intensity of growth in their formal economies.

To generalize, then, employment-led labour markets have disappointed in terms of the quality of livelihoods that they offer,[7] while growth-led labour markets have been inadequate in terms of the quantity of jobs they produce. What, then, can be the relevant policy choices facing governments?

Chapters 12 and 13 in this volume look at various types of income-led growth strategies. Clearly, for the population of working men and women described in this chapter, a "wage-led" growth strategy is meaningless. They do not earn wages. Redistribution through income

[7] "Quality" here refers only to the income dimension, not the several other criteria upon which the quality of a livelihood is based. And, of course, being in paid employment in the formal sector is no guarantee of the quality of that employment.

transfers is indeed promising – and is well described in Chapter 13 of this volume. But how about taking the distribution of productive employment more seriously as a macroeconomic priority?

## 8.4 AN APPLICATION OF THE FOREGOING DISCUSSION: TAKING EMPLOYMENT SERIOUSLY THROUGH SETTING EMPLOYMENT TARGETS

An obvious conclusion to draw is that a productive job for all those who want one in the context of healthy and sustained growth neither is, nor ever has been, a reality. Taking the world as it is, then, how can employment become at least a more central macroeconomic objective? The answer implies that policy be directed to *both* employment-led and growth-led labour markets, rather than assuming that the latter will ultimately absorb the former.[8] Target both is the message.

A growing number of governments are seeking to embed employment targets in their growth and development strategies. The idea is to make an employment target an explicit political commitment to achieve an employment outcome within a specified time period. Examples are manifold, and would include time-bound efforts: to increase the employment-to-population ratio in the European Union, in view of the declining population trend; South Africa's ambition to create five million jobs by 2020; or Viet Nam's effort to create eight million jobs over a five-year period.

### *8.4.1 The ILO and employment targets*

The ILO's interest in efforts to increase the employment content of growth has taken several forms, among which are:

- "employment-targeted" programmes related to increasing the employment intensity of public expenditure on infrastructure;
- the use of the Dynamic Social Accounting Matrix methodology (DySAM) to evaluate the employment consequences at the sector level of different policy scenarios (for details see Chapter 10); and
- examination of the role that incomes policies play in balancing macroeconomic pricing targets with the highest level of employment.

Another initiative is to assist governments in establishing their own employment targets through the evaluation of labour market trends and

[8] The argument here is quite consistent with OECD (2009a).

needs. Work of this nature is ongoing in several countries. The following brief example refers to Nepal.

### 8.4.2 An implicit employment target that is universally shared: MDG 1

Countries that do not have an explicit employment target have the means of constructing one through the universal adherence to the Millennium Development Goals (MDGs), the first one of which commits governments and the international community to halving the numbers of those living in extreme poverty from their share in 1990 to 2015. In Nepal, the ILO is assisting the National Planning Commission in converting the population poverty-reduction objective to one focusing on the halving of the share of the extreme working poor over the same time period. For argument, we imagine that poverty is homogeneously distributed in the labour market and in the population at large. This hunch proves to be accurate in Nepal.[9]

Three conclusions can be drawn from this sort of approach: an inclusive approach to employment policy must deal with both employment-led and growth-led labour markets; governments therefore need to think beyond the number of new entrants to the labour market and include in this number existing unproductive work that needs to be upgraded; and the GDP growth rate needed to do this will always be higher than the growth rate needed to absorb new entrants alone – and may indeed be a GDP growth rate unlikely to be achieved.

In the case of Nepal, work on attaining the working-poverty reduction goal by 2015 yielded two conclusions: first, the annual creation/conversion of jobs needed by 2015 is almost twice that of the new entrants alone – closer to 750,000 rather than 380,000; second, to attain this objective would require a GDP growth rate of approximately 6.3 per cent. Again, these higher-than-anticipated numbers are by no means unique to Nepal – nor is their significance in policy terms. The numbers teach two rather basic lessons. First, policy-makers need to think beyond "employment" and "unemployment" as meaningful indicators of labour market needs. The challenge is greater in magnitude than the usual "headline" numbers surrounding employment and unemployment. Indeed, Nepal's current unemployment rate of just over 2 per cent becomes rather irrelevant in this analytical approach when 55 per cent of those working are in extreme poverty.

Second, if one is willing to assume that the relationship between the rate of change of output growth and that of employment creation is

[9] The methodology – the basic arithmetic – is elaborated in a separate paper (Campbell et al., forthcoming). Intellectual antecedents of the paper are Ronnas and Kwong (2009); Kapsos (2004).

relatively constant, then this analytical approach will yield a "needed" GDP growth rate[10] that is quite often higher than any that has been achieved in the country, or is likely to be achieved. This is true for the Nepal example. A similar targeting approach applied to a sample of sub-Saharan African countries found that GDP growth needed to attain the working poverty target by 2015 was precisely twice that actually attained, but not distributed, in the first decade of the millennium – when growth was actually quite reasonable.

## 8.5 CONCLUSIONS

The underlying concern that this chapter has sought to address is the problem of the distribution of productive employment opportunities, a problem inherent in both "employment-led" and "growth-led" labour markets – the former deficient in the quality of employment; the latter, in its quantity. Can policies address both these deficiencies and can a better balance be struck?

### *8.5.1 Addressing the geographical distribution of unproductive employment*

Poverty is not homogeneously distributed in the world. Nor is it homogeneously distributed between the sexes – an issue not addressed in this chapter. Much of the effort to convert unproductive to productive work needs to focus on where the poor live and work. This is overwhelmingly in rural areas, principally in agriculture, and, more specifically still, in sub-Saharan Africa and South Asia. Part of the distributional challenge needs to address the agricultural sector, which has suffered a period of policy neglect. In the absence of alternative employment opportunities, moreover, much of the effort needs to be focused on measures to improve productivity that are not necessarily labour-displacing. The spectre of a looming second round of the food crisis adds urgency to this effort. Infrastructure is one among other issues to address in a world in which 30 per cent of commercial, agricultural output never makes it to market.

[10] That is, the rate needed to attain the target.

### 8.5.2 Addressing the structural distribution of opportunities for paid employment

Growth that is inadequate to attain poverty objectives compels a rethinking of the pattern of growth, and more particularly how to promote structural transformation – the very source of rising living standards, and not occurring rapidly enough, particularly in least developed countries.[11] While sustained, strong growth is a prerequisite for productive employment creation, a relevant policy question to ask is whether the productive-employment content of growth can be increased irrespective of the rate of growth. Here, industrial and sectoral policies need to be elaborated that are consistent both with harnessing a country's comparative advantages in products for which there is market demand, and with a view to increasing the opportunities for paid employment. This also entails a need to address constraints to the development of potentially profitable sectors, notably in terms of inadequately qualified labour supply, barriers in access to credit, or inappropriate, costly, time-consuming regulations.

### 8.5.3 Addressing the productive distribution of the existing status in employment

Much of what this chapter understands as employment-led labour markets involves people who face barriers to increasing the demand they wish to create. For example, although subsistence farmers are part of the labour "market" by definition, they are in fact not really actual market participants to the extent that markets imply exchange. Infrastructure, skills training, access to credit and product diversification would be ingredients to increase the productivity, and thus earnings, of own-account workers. The policy message here is that a preoccupation with "formalizing the informal", however worthy an objective, is secondary to the objective of improving the productivity and thus incomes of people irrespective of the "regulatory regime"[12] of which they are a part. Improving rather than ignoring employment-led labour markets is part of addressing the distributional challenge.

[11] Collier (2008) voices the concern of whether it is "too late" for many least-developed countries (LDCs) to transform their economies.

[12] The informal/formal distinction, while variously defined by governments, is nonetheless analytically appealing as both are part of the "economy" and both obey different rules, whether these are formal or informal rules. This is why the use of "organized" versus "unorganized" to describe this distinction is inappropriate: at base, there is no such thing as "unorganized" economic activity.

### 8.5.4 Addressing the distribution of capital and labour in public spending

Markets alone are seldom mechanisms that ensure equitable distribution. The latter is one of the primary roles of the State. Through public expenditure on infrastructure investment, governments can make technology choices that are more labour-intensive, and do so in an environment that is relatively sheltered from labour-saving competition. The result can be a relative increase in incomes to labour over those to capital, with both direct and indirect effects on local economic dynamism and (job-generating) growth. And surely the State, in its role as "employer of last resort", has proved its worth in the last few years in its efforts to mitigate what one could call without exaggeration, a crisis of distribution. Not all of the distributional outcomes of human effort can be completely shared, nor should they be if effort itself is not to be diminished. It is clear, however, both ethically and economically, that the distribution of opportunity should be as egalitarian as possible. The four broad avenues with which this chapter concludes promote opportunity, while at one and the same time improving outcomes.

# WHAT HAS HAPPENED TO OKUN'S LAW IN THE UNITED STATES AND EUROPE? INSIGHTS FROM THE GLOBAL FINANCIAL AND ECONOMIC CRISIS AND LONG-TERM TRENDS

9

*Sandrine Cazes and Sher Verick* *

## 9.1 INTRODUCTION

Over the decades following the oil shocks of the 1970s and 1980s, the flexibility of the United States labour market had been widely heralded as a major factor behind lower unemployment rates than those found in most continental European countries. It was argued that strict employment protection, minimum wages and strong unionization kept unemployment high in Europe because it discouraged job creation and resulted in labour market "hysteresis" as reflected by both higher rates and duration of unemployment (see, for example, Blanchard and Summers, 1986; Nickell, 1997; Blanchard and Wolfers, 2000; Layard et al., 2005). Indeed, the unemployment rate averaged only 5.5 per cent in the United States between 1987 and 2007, compared to 8.6 per cent in Germany, 9.3 per cent in Italy and 9.7 per cent in France, according to the Eurostat Labour Force Survey. During this period the United States had become accustomed to low unemployment rates and, in particular, low levels of long-term unemployment.

At the end of 2010, the labour market of the United States couldn't look more different. Having originated in that country, the global financial crisis deeply affected the world's largest economy at the end of 2007, deteriorated in 2008, and ultimately contracted by 2.6 per cent in 2009

* The authors are Chief and Senior Research Economist, respectively, of the Employment Research and Analysis Unit, ILO, Geneva. The authors are grateful to the OECD, particularly Paul Swain, for assisting us with the data on turning points for OECD countries. This chapter draws heavily from a more detailed study; see Cazes et al. (forthcoming).

(IMF, 2010a). During this period, a million workers have been laid off, particularly in the construction and manufacturing sectors and, as a result, employment in the United States fell by 4.3 per cent from 2007 to 2009. At the same time, the unemployment rate soared from 4.8 per cent in the fourth quarter of 2007 to 10.0 per cent two years later, the highest level since the recession of the early 1980s.[1] Despite some sort of recovery in economic output in 2010, unemployment remains stubbornly high (9.6 per cent in the third quarter of 2010). Long-term unemployment has become a reality for a country unaccustomed to such problems: the percentage of the unemployed out of work for six months or more reached 44.9 per cent in August 2010 (41.9 per cent in November 2010) (BLS, 2010).

This dramatic turnaround in the situation in the United States has led many commentators to question some of the fundamental relationships in the labour market. One such relationship that has received considerable attention is known as Okun's law. Using quarterly data for the post-Second World War period (Q2 1947–Q4 1960), Okun (1962) found that a 3 per cent change in output is associated with a change in the unemployment rate of around 1 percentage point. On this basis, unemployment should have risen by only 0.78 percentage points between 2008 and 2009 (since the economy contracted by 2.6 per cent) rather than 4.5 points as witnessed over this period.[2] A number of economists have subsequently debated the validity of Okun's law, suggesting that the coefficient has apparently departed from a long-term stable parameter value of 0.3.[3] However, this debate obscures the fact that Okun's "law" is nothing but a statistical relationship and, as recognized by a number of studies (see for example Knotek (2007)), the coefficient has varied over time in the context of both long-term trends and asymmetry over the business cycle.[4] That said, the increase in the sensitivity of unemployment to changes in output in the United States has risen dramatically during the global crisis. These patterns are not only important from an ex-post analytical perspective, but also in terms of how this rule of thumb is used in macroeconomic models and for forecasting purposes.

This chapter tries to shed some light on the diverging unemployment dynamics in Europe and the United States, using Okun's law as a framework. By considering asymmetry in adjustment, it is possible to identify

[1] See US Bureau of Labor Statistics (BLS); quarterly unemployment rate is seasonally adjusted.

[2] The average annual unemployment rate was 5.8 per cent in 2008, rising to 9.3 per cent in 2009 (BLS).

[3] See, for example, http://economix.blogs.nytimes.com/2010/02/22/a-broken-economic-law/.

[4] Asymmetry occurs when the correlation between time-series (output and the unemployment rate in this case) differs over various phases of the business cycle (see for example Neftci, 1984).

potential effects of institutional factors on changes to unemployment during periods of growth versus downturns. In this respect, employment protection legislation (EPL) is likely to dampen labour adjustment during a contraction because legislation prevents or slows down the firing of workers. The impact of EPL in boom times is more indirect, since more rigid legislation is likely to (theoretically at least) reduce hiring because of the anticipated cost of having to fire the worker in the future. This chapter investigates the extent to which the labour market institutional environment could explain movements in Okun's coefficient following an aggregate shock. Section 9.2 focuses on how Okun's law varies across countries and over time, especially in the context of asymmetry over the business cycle. Section 9.3 investigates the role of labour market institutions in driving unemployment dynamics.

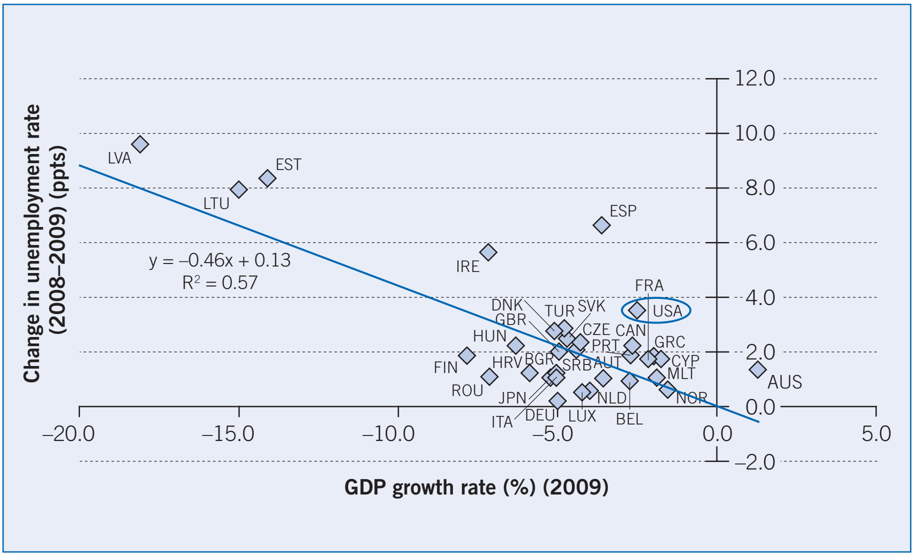
## 9.2 UNEMPLOYMENT DYNAMICS IN OECD COUNTRIES: INSIGHTS FROM OKUN'S LAW

### *9.2.1 What happened to Okun's law during the global crisis?*

Though this chapter focuses mostly on unemployment, it is important to reflect on how an economic shock such as the global crisis affects labour demand. At the enterprise level there are two main channels for adjustment to external shocks in labour demand: working time and/or employment (quantitative adjustment) or wages (price adjustment) (Cazes et al., 2009). Firms adjust hours of work more rapidly than the number of workers due to cost considerations and the need to retain workers. Even employers in countries with flexible labour markets such as the United States are reluctant to cut nominal wages because of the impact on the morale of staff and on productivity levels (see for example Bewley, 1999). The balance between external versus internal adjustment is one of the key issues of debate on the global crisis, reflecting the considerable variation in the adjustment of working hours, wages and employment across countries. For example, employment in Germany has adjusted by a small margin, while hours have decreased more than in most European countries. In contrast, evidence for the United States reveals that employers resorted more to external adjustment rather than internal mechanisms, namely hours worked and wages.

Turning to the unemployment response to output dynamics, figure 9.1 maps the relationship between the changes in the unemployment rate from 2008 to 2009 and GDP growth in 2009. As mentioned in the introduction, this graph illustrates that there has been great

Figure 9.1 Relationship between output and unemployment rates, United States and other OECD countries, changes 2008–2009




Note: The countries covered are Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Portugal, Romania, Slovak Republic, Slovenia, Spain, Turkey, United Kingdom, United States.

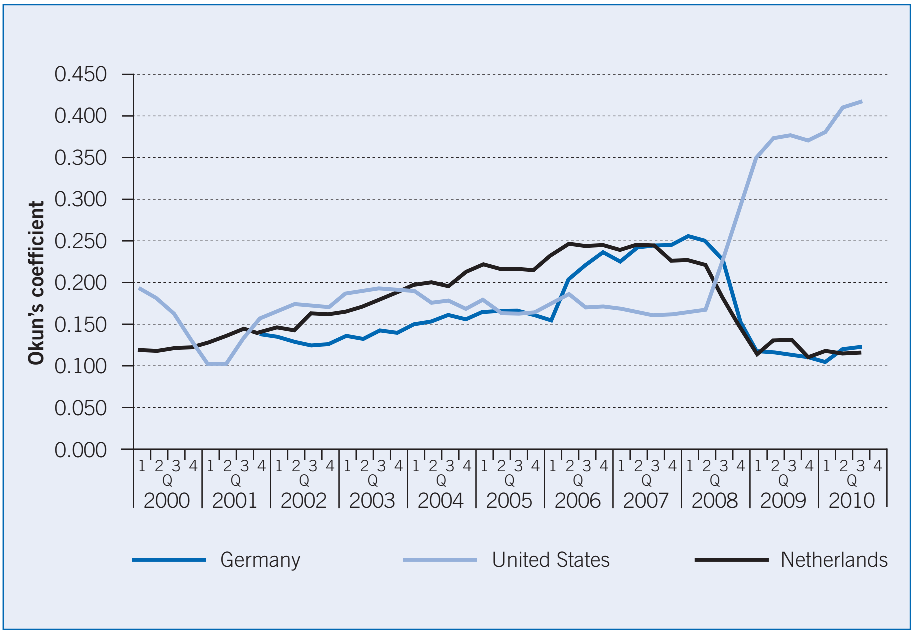
Source: Authors' calculations based on IMF (2010a, Apr.) and Eurostat Labour Force Survey Database.

variation in the responsiveness of unemployment to the global crisis. The unemployment in the United States has risen far more than in other countries with a comparable economic contraction. The increase in the Spanish unemployment rate departs even further from the average than the case of the United States. The worst-hit countries are Estonia, Ireland, Latvia and Lithuania, which have all suffered both a severe fall in output and deterioration in the labour market.

Drawing on estimates derived from a static model of Okun's law, figure 9.2 presents estimated coefficients for the period Q1 2000–Q3 2010 for Germany, the Netherlands and the United States. The elasticity of unemployment or Okun's coefficient is estimated using quarterly data.[5] The

[5] As per the growth rate version presented in Okun (1962), the relationship between the change in the unemployment rate and the growth in GDP can be stated as the following linear specification: $\Delta u_t = \alpha - \beta \gamma_s + \varepsilon_s$, where $\Delta u_t$ is the change in the unemployment rate from period t-1 to t, $y_t$ the real GDP growth rate and $\varepsilon_t$ a random error term. Similar to IMF (2010g) and Knotek (2007), $\beta$ is estimated using a technique known as rolling regressions, which means that the equation is estimated using different sample periods each covering 40 quarters of data, starting with the first

Figure 9.2 Divergence in Okun's coefficients during the global crisis, Germany, Netherlands and United States, Q1 2000–Q3 2010




Note: The coefficients are obtained from estimating the equation specified in footnote 5 using a technique known as 'rolling regression'.

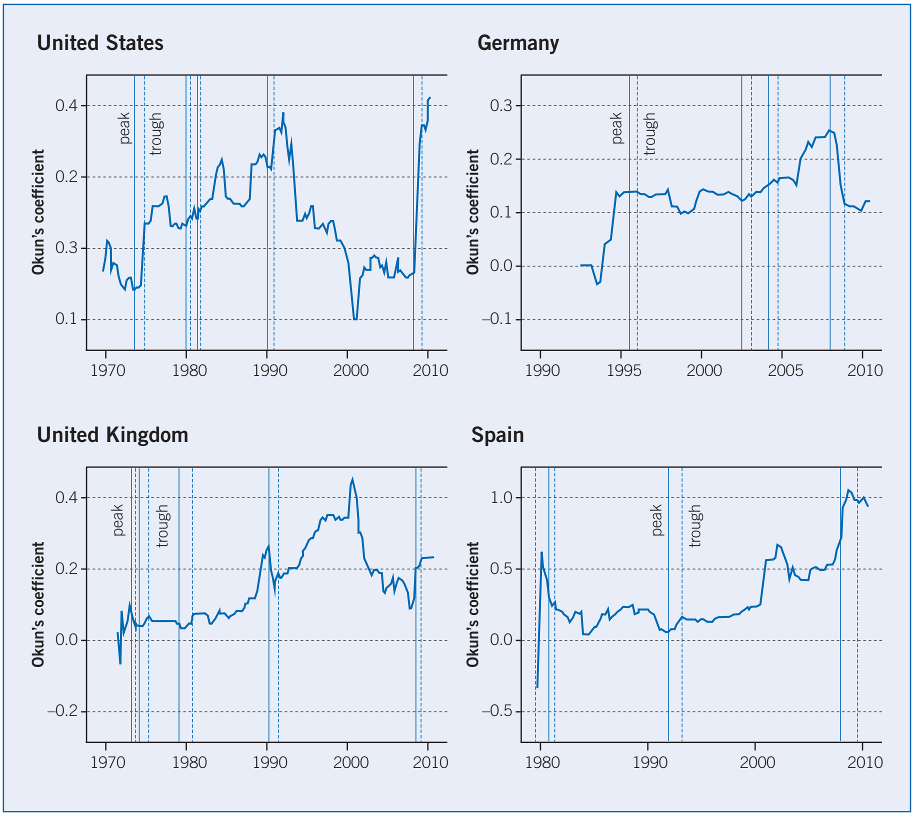
Source: Authors' calculations based on OECD data.

coefficient estimates derived from using this methodology reveal considerable divergence during the global crisis. As sharply illustrated by figure 9.2, the coefficient remained relatively stable over the 2000s in the United States, while it was increasing in Germany and the Netherlands where unemployment had been falling at a greater rate (with a corresponding increase in the elasticity) in the years leading up to the onset of the crisis. The first quarter of 2008 shows a dramatic deviation in the coefficient. In the case of the United States, it increased rapidly since the start of 2008 as the economy contracted and unemployment surged. At the same time, the coefficient declined markedly in Germany and the Netherlands, reflecting the point made in the introduction to this chapter: output contracted in these countries by more than 4 per cent in 2009 but unemployment barely moved.

Note 5 continued

observation for the unemployment and GDP series. For example, in the case of the United States, the model is estimated first for the period Q3 2000 to Q2 2010. The sample period is then moved forward one quarter and re-estimated for the next sample period, i.e. Q4 2000 to Q3 2010.

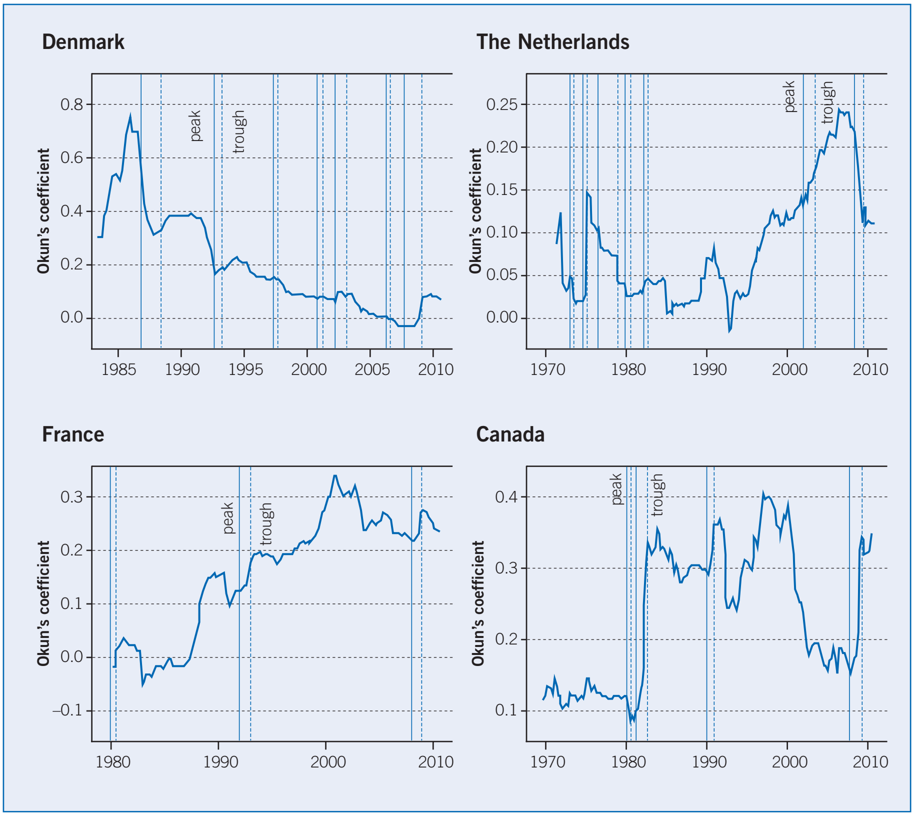
Figure 9.3 Okun's coefficients in selected OECD countries, Q1, various years, 1970–2010




## *9.2.2 A longer-term perspective on Okun's law*

In order to better understand whether such diverging trends are consistent over a longer time period, Okun's coefficients are estimated over a period of decades, which provides more comprehensive indication of parameter stability. Using the same methodology as in section 9.2.1 (see footnote 5), figure 9.3 presents these estimates for a number of selected OECD countries to highlight differences across countries and time. In order to see the movements of the coefficient occurring over the business cycle, it is necessary first to date the business cycles in terms of delineating phases of recession and expansion. Following Harding and Pagan (2002), local peaks and troughs (turning points) are identified using the quarterly changes in real GDP level series. The recession phase is defined as the peak to the trough and, symmetrically, the recovery phase

Figure 9.3 (cont.)




Note: The solid vertical line denotes a peak in the business cycle, i.e. the start of a recession, while the dashed vertical line marks a trough in the business cycle, i.e. the start of an expansionary phase.
Source: Authors' calculations based on OECD data.

is defined as the trough to the point where GDP returns to the peak level before the recession.

These graphs illustrate both different levels and varying trends over a span of three or four decades.[6] Across countries, the estimated coefficient ranges from even positive figures (suggesting a reverse relationship between output and unemployment) to a coefficient close to unity in the case of Spain during the global crisis. With regard to the time dimension, an upward trend is evident in such countries as France, the Netherlands and Spain, while in Denmark the coefficient has been declining since the

[6] Except of course for Germany (reunification in 1991).

mid-1980s. In other countries, there are large movements across time, which capture changes over both the business cycle and longer-term trends. This overall instability in Okun's parameter is found elsewhere in the literature (see for example IMF, 2010g; Knotek, 2007) and reflects both changes over the business cycle and structural movements in the relationship.

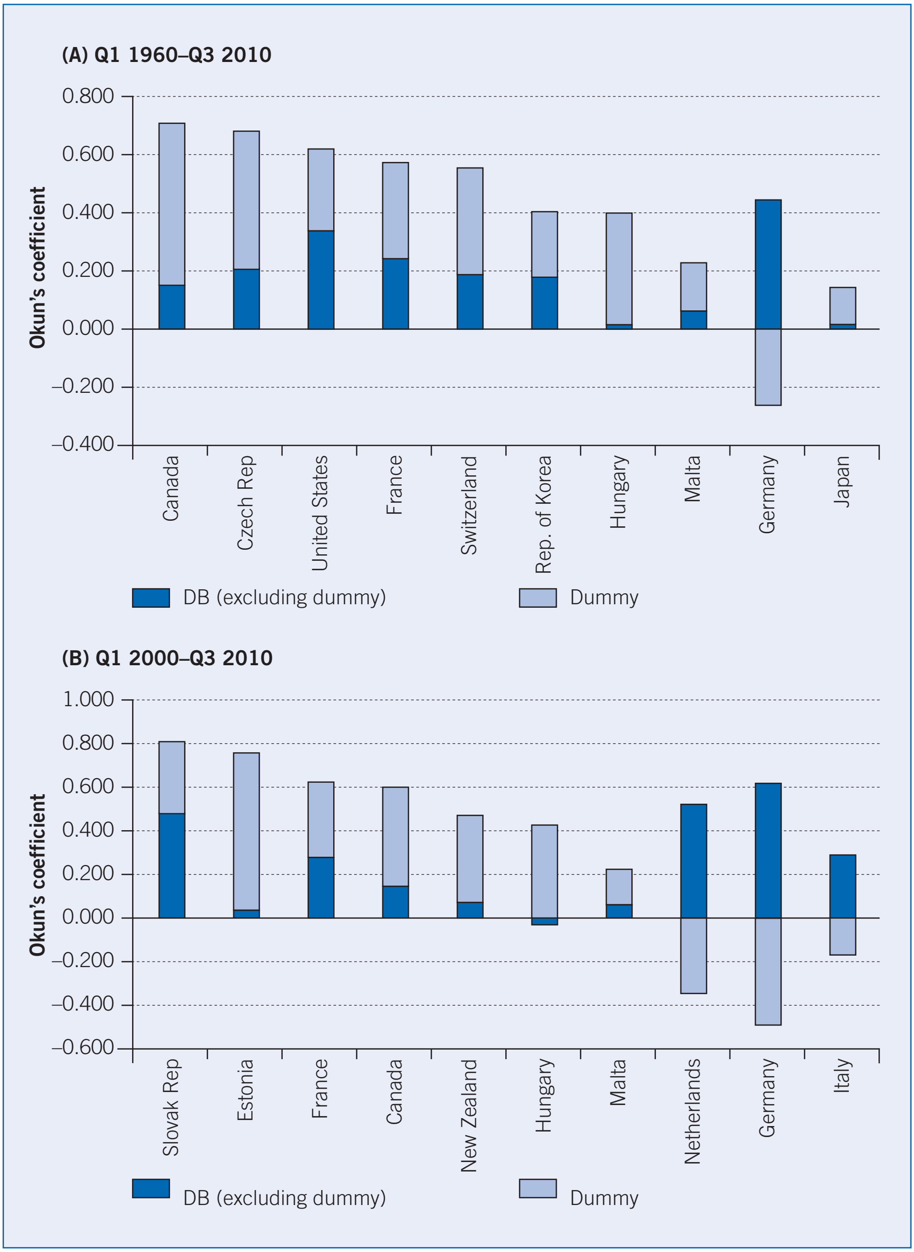
### *9.2.3 Asymmetry in Okun's law: Arguments and empirical evidence*

With regard to movements over the business cycle, unemployment is likely to rise more during contractions than decrease during periods of expansion, as a result of the different cyclical sensitivity of flows into and out of unemployment, which in turn are influenced by labour market institutions and other factors (see section 9.3). Indeed, the well-known lag in labour market recovery noted by IMF (2009c), Reinhart and Rogoff (2009) and others is a reflection of this asymmetry. A number of studies have investigated the extent of asymmetry in Okun's law (see for example Lee, 2000; Harris and Silverstone, 2001; Beaton, 2010). However, while these studies assessed empirically the existence of asymmetry in Okun's law over the business cycle, most do not provide a detailed explanation for this behaviour and how labour market institutions might affect it (IMF (2010g) is an exception).

Turning to the 36 countries covered in this chapter, there is statistical evidence of asymmetry in the case of only ten countries for the period Q1 1960–Q3 2010 (Canada, Czech Republic, France, Germany, Hungary, Japan, Republic of Korea, Malta, Switzerland and United States, see figure 9.4A).[7] For Germany, the recession dummy has in fact the opposite sign, indicating that during recessions unemployment tends to fall despite the economy contracting. This probably reflects the impact

[7] In this section, Okun's coefficient is estimated using a dynamic specification rather than the static one used in the equation specified in footnote 5. By including lagged changes in unemployment rates and contemporaneous and lagged growth rates, it is possible to capture the lag effect (i.e. the delay between the change in the growth rate of output and the unemployment rate) (see, for example, IMF, 2010g and Knotek, 2007). Moreover, by including a dummy for periods of recession, the specification can explicitly account for asymmetry. This results in the following model: $\Delta u_t = \alpha + \Sigma_{i=0}^{\gamma} \beta_i \gamma_{t-i} + \Sigma_{k=0}^{\gamma} \gamma_k \, (d_t \cdot \gamma_{t-k}) + \Sigma_{j=1}^{q} \theta_j \, \Delta u_{t-j} + \varepsilon_t$, where $d_t$ is dummy that equals one if the economy is in a recession, p and q are the optimal number of lags for the growth rate and the change in the unemployment rate, respectively. These lags are chosen based on the Bayesian information criterion (BIC) and the Akaike information criterion (AIC). In comparison to the static model (section 2.1), the Okun's coefficient from the dynamic model is represented by what IMF (2010g) calls the 'dynamic beta': $\frac{\Sigma_{i=0}^{\gamma} \beta_i + \Sigma_{k=0}^{\gamma} \gamma_k}{i - \Sigma_{j=1}^{q} \theta_j}$. This expression provides an estimate of the long-run relationship between changes in the unemployment rate and growth. To arrive at this estimate, the equation is estimated with 80 quarters of data using the rolling regression technique.

Figure 9.4 Asymmetry in Okun's coefficient, Q1 1960–Q3 2010 and Q1 2000–Q3 2010 (averages)




Note: DB (excluding dummy) = dynamic beta coefficient without dummy for recession periods ($d_t$). Dummy = coefficient on the dummy for recession periods ($d_t$).

Source: Authors' calculations based on OECD data. See footnote 7 for the methodology.

of the global crisis of 2009 on the estimate for Germany since the series starts only in 1990.

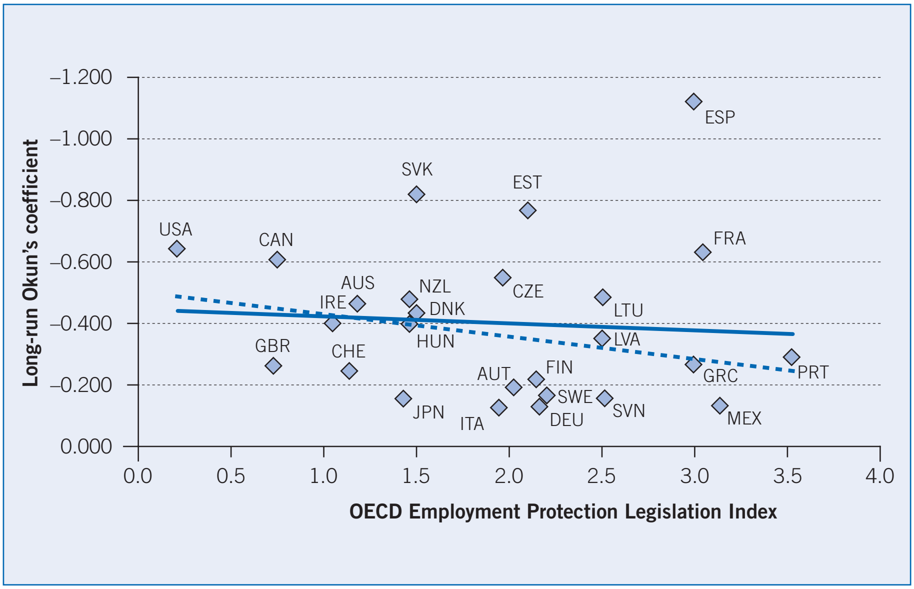
Focusing on the most recent decade (Q1 2000–Q3 2010), the evidence of asymmetry shifts in favour of other countries such as Germany that demonstrate counterintuitive results. As captured by figure 9.4B, in Germany, Italy and the Netherlands unemployment falls during periods of recession when using data only for the period Q1 2000–Q3 2010. Consistent with the previous figure, Canada, France, Hungary and Malta continue to show a significant positive impact of the recession dummy on the overall Okun's coefficient. There is also evidence of asymmetry for this shorter time period in Estonia, New Zealand and the Slovak Republic.

## 9.3 WHAT IS THE ROLE OF LABOUR MARKET INSTITUTIONS IN EXPLAINING DIFFERENCES IN OKUN'S LAW?

### *9.3.1 The impact of labour market institutions on unemployment dynamics*

The effects of labour market regulations on labour market outcomes have been extensively studied, both theoretically and empirically. Most theoretical models quite clearly predict that "stricter" EPL should make employment more stable and individual employment relationships more durable. So, when EPL is less stringent, job turnover is more cyclical (for example the United States), while a more protective EPL will reduce job destruction in recessions as well as the variability of layoffs, and limit the contribution of inflows to fluctuations in unemployment (as in many European economies) (Bertola et al., 1999). The vast empirical literature on this topic suggests that while aggregate unemployment levels are not strongly correlated with cross-sectional indicators of EPL, they do seem more stable when EPL is more stringent. The cyclical volatility of employment, for example, is much more pronounced in the relatively less regulated labour markets of the United Kingdom and the United States than in France, Germany or continental Europe as a whole (Bertola and Ichino, 1995; OECD, 2009b; Elsby et al., 2008). Unemployment insurance schemes are another institutional setting that has been argued to drive cross-country differences in labour market adjustment. According to theoretical arguments, job destruction should be higher and job creation lower, the higher the unemployment benefits (see for example, Mortensen and Pissarides, 1994; Millard and Mortensen, 1994; Garibaldi, 1998). As

Figure 9.5 Relationship between the long-run Okun's coefficient and employment protection legislation (EPL), Q1 2000–Q3 2010



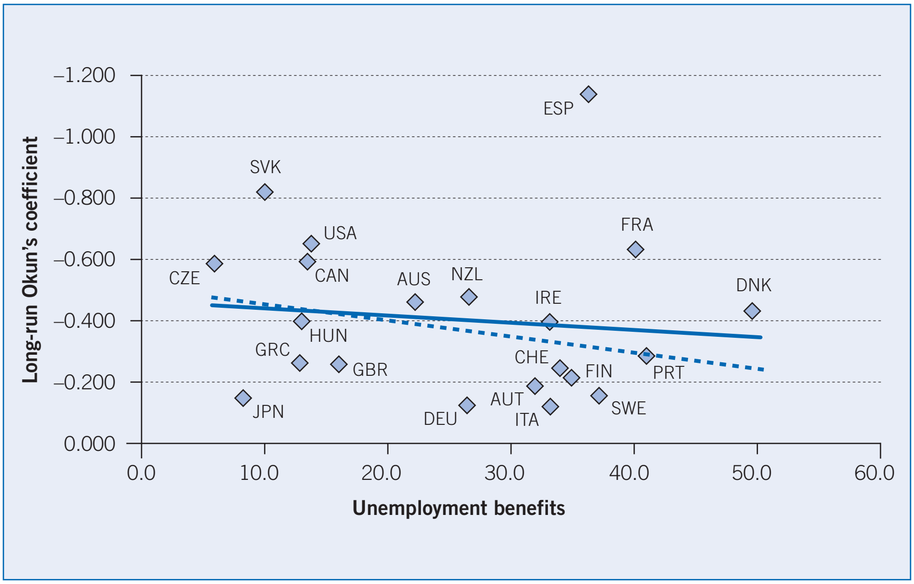

Note: Dashed line is the fitted regression without Spain. The countries covered are Australia, Austria, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Lativa, Lithuania, Luxembourg, Mexico, New Zealand, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

Source: Authors' calculations based on OECD data. See footnote 7 for the methodology.

for labour supply effects, some economists have argued that increasing the generosity of the unemployment system or extending its coverage leads to an increase in the unemployment rate because receiving benefits acts as a disincentive to undertake job search (by increasing the reservation wage of the unemployment). Cyclical conditions are also important to consider, as evidence suggests that the "discouragement" effect of unemployment insurance on job search is likely to be much lower during a recession.

Another potential driver of asymmetric behaviour on the part of employers and workers is uncertainty. During the recovery phase of the cycle, employers are still uncertain about the future and hence reluctant to hire new staff; consequently, they tend to increase hours of work first and make other organizational changes.

Figure 9.6 Relationship between the long-run Okun's coefficient and the OECD summary measure of benefit entitlements, Q1 2000–Q3 2010




Note: Dashed line is the fitted regression without Spain. The countries covered are Australia, Austria, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Luxembourg, Mexico, New Zealand, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States.

Source: Authors' calculations based on OECD data. See footnote 7 for methodology.

## 9.3.2 *Empirical evidence on the relationship between labour market institutions and Okun's law*

As a first attempt to delve deeper into the empirical evidence on this link between institutions and Okun's law in general, and asymmetry in particular, figure 9.5 presents a scatter plot of the estimated long-run Okun's coefficient for Q1 2000–Q3 2010 and the strictness of employment protection legislation, using the OECD index. The fitted regression line using the whole sample shows no significant relationship: there are countries with weak employment protection such as the United Kingdom which have nonetheless a lower coefficient than other countries with similar legislation. However, as denoted by the dashed fitted regression line, the relationship strengthens once Spain is removed from the sample. In this case the correlation is negative, as would be expected: a lower long-run Okun's coefficient is associated with stronger employment protection. A similar picture emerges when using just the sub-index for regular contracts.[8] In the same manner, figure 9.6 reveals little in terms of robust evidence on a relationship between unemployment benefits and estimates of a long-run Okun's coefficient.

Ultimately, it is difficult to identify a robust statistical relationship between labour market institutions and the responsiveness of unemployment to changes in output. This is not surprising, as the labour market is influenced by a number of factors: macroeconomic, institutional (both labour market and product market regulations), demographic and external (trade openness, capital flows, etc.). Moreover, the initial conditions found in the labour market play an important role in how employers will react. For instance, in countries such as Germany and the Netherlands, the labour market was very tight when the global financial crisis hit, and for this reason, employers were aware of the likelihood of returning to skills shortages once the global crisis was over. This is indeed a problem that is only likely to worsen over time, due to demographic trends. As a next step, it would be important to investigate the relationship between labour market institutions (employment protection legislation and unemployment insurance) and the degree of asymmetry in Okun's law.

## 9.4 CONCLUSIONS

The global financial and economic crisis has resulted in the most severe deterioration in the US labour market since the Second World War. This is reflected in both the unprecedented increase in the unemployment rate and the persistence of the rate well into the recovery phase. At the same time, unemployment has remained subdued in a number of European countries, notably the ones that have often been labelled sclerotic in the past, such as Germany and Italy. Many commentators have thus been led to question some of the fundamental relationships in the labour market, including Okun's law.

The results presented in this chapter confirm that the Okun's coefficient varies across countries and time. The latter is due to both longer-term trends and movements in output over the business cycle. Focusing on the period of the global crisis, the findings show that there was considerable divergence in the estimates of Okun's coefficient during 2007–2010. In Canada, Spain, the United States and other badly affected economies the coefficient increased rapidly, departing from pre-crisis levels. In other

[8] These results are available upon request from the authors.

countries where unemployment has remained subdued, namely Germany and the Netherlands, the coefficient has fallen dramatically.

As recognized in the literature, it is to be expected that unemployment reacts differently to a downturn than to an upswing in the economy. Using long-run estimates of Okun's coefficient, this chapter has presented empirical evidence of asymmetry in a number of countries. Going beyond the standard treatment in the literature on Okun's law, it outlines why unemployment adjustment should be asymmetric over the business cycle, focusing on labour market flows and how labour market institutions affect these transitions. However, it is difficult to identify a robust empirical relationship between cross-country estimates of Okun's coefficients and labour market institutions as measured by employment protection legislation.

# 10 THE FISCAL STIMULUS PACKAGE IN INDONESIA AND ITS IMPACT ON EMPLOYMENT CREATION

*Kazutoshi Chatani and Christoph Ernst**

## 10.1 INTRODUCTION

Indonesia weathered the global financial and economic crisis better than neighbouring countries. Economic growth slowed but maintained a positive rate, even in mid-crisis: the GDP growth rate fell from 6.1 per cent in 2008 to 4.5 per cent in 2009. The unemployment rate also fell, from 8.4 per cent in 2008 to 7.9 per cent in 2009, but it was the quality of employment that bore the brunt of the crisis in the Indonesian labour market (ILO, 2010l). Since exports fell by 28.9 per cent in the first half of 2009 compared to the same period in 2008, formal employment in export sectors was shed. A sharp decline in the inflow of foreign direct investment (FDI) also reduced formal employment, from US$9.3 billion in 2008 to US$4.9 billion in 2009 (UNCTAD, 2010b). The decline in unemployment was thus concomitant with an increase in casual employment and unpaid workers, with the former increasing by 265,800 between 2008 and 2009 and the latter by 818,900 during the same period (Statistics Indonesia, 2010).

Wages were depressed as a result of the slowdown in demand: the monthly real average wage of production workers below supervisory level in industry declined by about 6.5 per cent between March 2008 and March 2009 (Statistics Indonesia, 2010). That Indonesia weathered the crisis better than other neighbouring countries does not necessarily mean that the country's labour market performance was outstanding. In fact, the labour market had not yet fully recovered from the damage caused

* The authors are Technical Officer, Labour Market Analysis and Employment Policy, ILO Country Office for Indonesia in Jakarta and Senior Economist, Employment-Intensive Investment Programme, Employment Sector, ILO, Geneva, respectively.

Table 10.1 Indonesia: Components of the stimulus package and actual expenditure, 2009

| Stimulus package focus | Fiscal instrument | Budget (Rp billions) | Expenditure (Rp billions) | % expenditure to budget |
|---|---|---|---|---|
| Maintaining and improving people's purchasing power | Personal income tax cut | 24 500.0 | 19 527.7 | 79.7 |
| | Value-added tax cut | 1 350.0 | 828.2 | 61.4 |
| Preventing termination of employees' contracts and improving product competitiveness | Employee income tax cut | 6 500.0 | 5 180.6 | 79.9 |
| | Corporate income tax cut | 19 300.0 | 19 300.0 | 100.0 |
| | Value-added tax cut | 2 500.0 | 1 006.7 | 40.3 |
| | Tariff import tax cut | 2 500.0 | 7.2 | 0.3 |
| | Subsidy | 4 172.8 | 4 157.8 | 99.6 |
| | Transfer to state-owned enterprises | 500.0 | 500.0 | 100.0 |
| Investment in infrastructure | Public works | 6 601.2 | 6 433.4 | 97.5 |
| | Transport | 2 198.8 | 2 079.7 | 94.6 |
| | Energy and mineral resources | 500.0 | 492.3 | 98.5 |
| | Public housing | 500.0 | 493.9 | 98.8 |
| | Trade infrastructure | 315.0 | 289.2 | 91.8 |
| | Agricultural infrastructure | 650.0 | 0.0 | 0.0 |
| | Labour and transmigration | 300.0 | 253.3 | 84.5 |
| | Public health | 150.0 | 149.8 | 99.8 |
| | Community empowerment | 601.5 | 601.5 | 100.0 |
| | Primary commodity warehouses | 120.0 | 120.0 | 100.0 |
| Total | | **73 259.3** | **61 420.4** | **83.8** |

Source: Government of Indonesia, Jakarta.

by the Asian financial crisis of 1997 by the time the global crisis hit the country just over a decade later. Youth employment, for instance, hardly increased at all between 1995 and 2009.

This chapter examines the impact of the recent fiscal stimulus package of Indonesia, covering tax cuts, subsidies and infrastructure investment, on the economy and on employment based on a Dynamic

Social Accounting Matrix (DySAM) analysis. The package, even though not big in size, helped to mitigate economic slowdown, as it boosted consumption and internal demand with related positive impact on employment, in particular through public infrastructure investment.

## 10.2 IMPACT OF THE STIMULUS PACKAGE ON SECTORS AND HOUSEHOLD INCOME

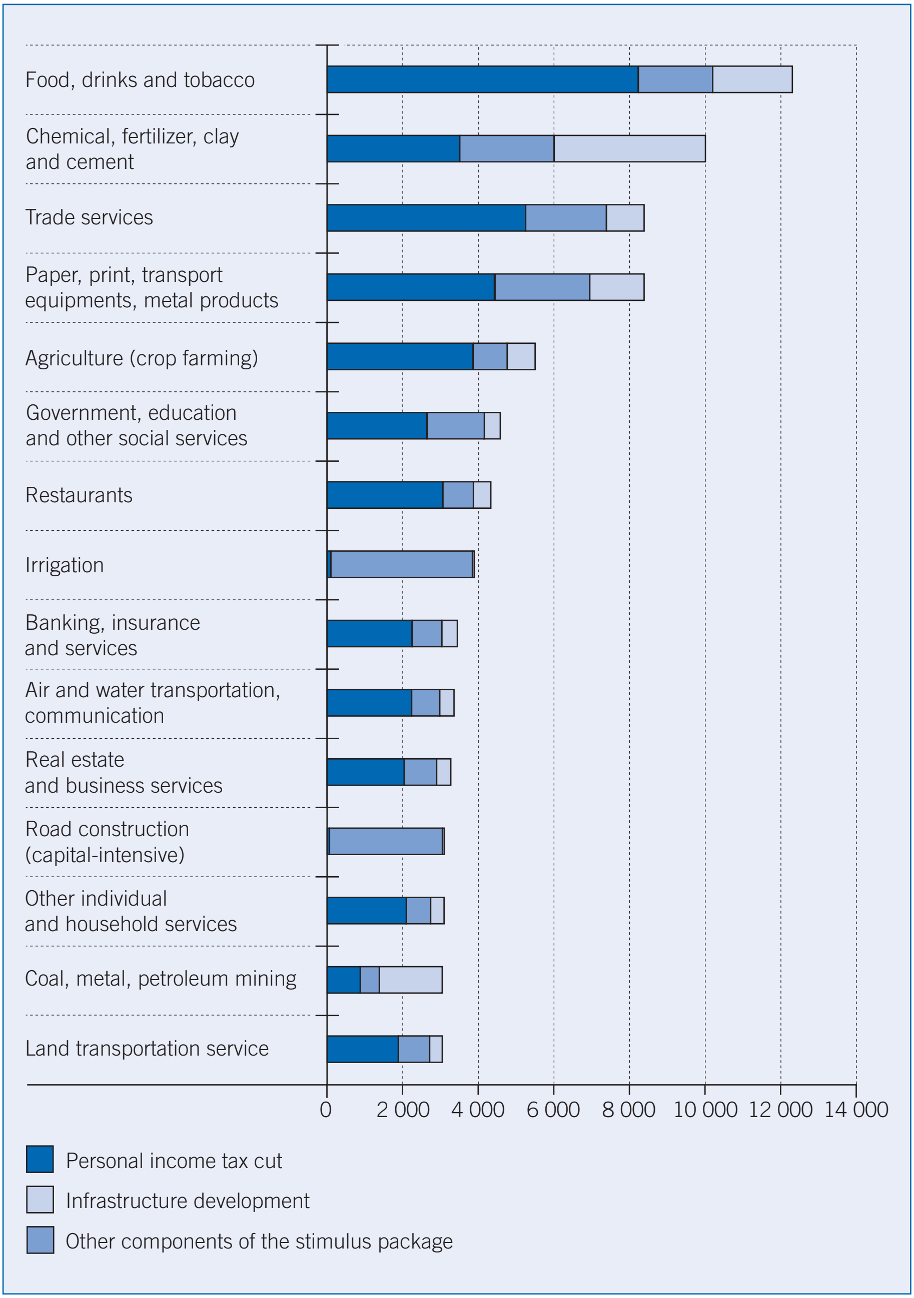
In anticipation of the impact of the crisis, the Government and the Central Bank responded quickly to alleviate damage to the economy. On the monetary policy front, the Bank lowered its policy rate (BI rate) in consecutive moves from 9.5 per cent in November 2008 to 6.5 per cent in August 2009. It also loosened loan approval criteria to support the financing of small and medium-sized enterprises (SMEs). On the fiscal policy front, the Government approved a fiscal stimulus package (FSP) of 73.3 trillion rupiahs (Rp) (US$8.1 billion) in February 2009, roughly equivalent to 1.4 per cent of Indonesian GDP. About 83.8 per cent of the budget allocated was realized by the end of the 2009 financial year's budget cycle, as shown in table 10.1. Social stabilizers did not mitigate the impact of the crisis, because of the lack of an unemployment insurance system and poorly enforced severance payments (World Bank, 2010a). This section examines the impact of the FSP on production and household income using the DySAM.[1]

The FSP-related injections of Rp61.4 trillion (US$6.8 billion) stimulated economic sectors to varying degrees, reflecting the composition of the package, and through backward and forward linkages. Figure 10.1 shows the estimated impact of the boost on selected sectors according to the size of the stimulus packages. Since the personal income tax cut alone accounted for 31.8 per cent of the stimulus-package-related expenditures, it had a significant impact on the outcome, increasing demand for food and beverages as well as restaurants. The trade services sector and the agricultural

---

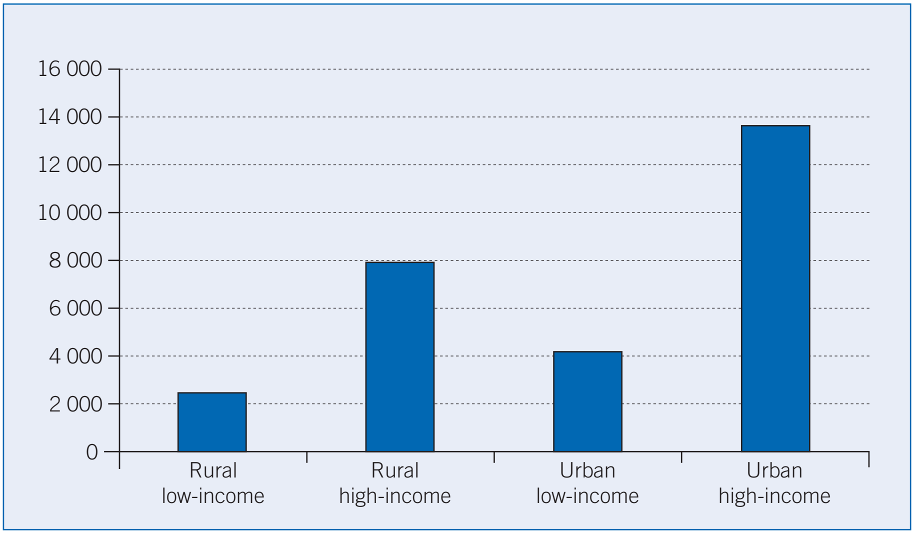
[1] In cooperation with the Coordinating Ministry for Economic Affairs of the Republic of Indonesia, the ILO EMPINVEST Programme has been developing a DySAM in order to better understand the impact of government spending on employment creation and poverty reduction. DySAM allows users to simulate the effect of policy scenarios and identify the best policy option to invigorate job creation in the economy, as distinct from a social accounting matrix (SAM), which records transactions within an economy between the three institutions, households, enterprises and government, for a specific year. The DySAM includes new elements, wherein it shows the consistent evolution of the economic structure over time, for periods covering the years before and after the static SAM; it reduces the need to calculate expenditure income elasticities in order to introduce behaviour, as in the SAM fixed-price model (see Pyatt and Round, 1979); coefficients are not fixed anymore and with the help of DySAM one can demonstrate the intersectoral transactions and transmission channels of an economic shock or a policy scenario more accurately than through a SAM.

Figure 10.1 Indonesia: Impact of the fiscal stimulus package on production, by sector (Rp billions)




Source: Hartono (2010).

Figure 10.2 Indonesia: Impact of the fiscal stimulus package on household income (Rp billions)




Source: Hartono (2010).

crops sector also benefited, through backward linkages, from the higher demand for food consumption. After tax cuts, infrastructure investment was a main component of the fiscal stimulus package, which constituted 17.8 per cent of the total spending (Rp10.8 trillion). Infrastructure investment stimulated the construction sector and increased demand for raw materials in the manufacturing sector, such as cement, metal products, etc.

The stimulus package generated a skewed pattern of income effects, since the direct beneficiaries of the tax reductions on personal income and payroll were relatively wealthy citizens and formal-sector workers. It is important to note that the poor, whose income is below the taxable threshold, and informal workers are seldom taxpayers. According to a DySAM simulation, the fiscal stimulus package was most beneficial to urban high-income households, followed by rural high-income households (figure 10.2). The impact of the stimulus package on production thus reflected the consumption pattern of high-income households, boosting the banking and financial services, air/sea travel-related services and communications in addition to food and beverages (see figure 10.1). Poor rural farmers also benefited through the increase in food consumption but the income effect per low-income household was modest, due to the fact that rural low-income households by far outnumber high-income households.

## 10.3 IMPACT OF INFRASTRUCTURE INVESTMENT ON THE ECONOMY AND EMPLOYMENT

This section examines the employment effects of the infrastructure development component of the package, and the impact of the infrastructure spending on the economy and on employment creation. The fiscal stimulus package announced by the Government of Indonesia included infrastructure investment amounting to Rp12.2 trillion (US$1.4 billion) in the fiscal year 2009, of which 88.7 per cent (or Rp10.8 trillion) was actually spent. In order to simulate the different economic and labour growth impacts of the infrastructure investment, a figure of Rp10.8 trillion was injected into the capital formation account of an Indonesia DySAM model. To gain a global picture of the FSP impact, two simulation outcomes were compared: one of capital formation with the injection and one without the injection. The annual average capital formation in construction over the 2000–2008 period amounted to Rp416,549.2 billion. The results, showing the impact of the programme on each of the main four accounts, can be found in table 10.2, where in column (A) the forecast for 2009 plus the impact of the injection is presented, while in column (B) the forecast for 2009 without the injection is shown. The difference between the two is the net injection impact; the values by main account are presented in column (A-B), the FSP impacts vary from Rp14,407.1 billion for income of institutions (government, households, enterprises) to Rp30,545.4 billion for commodity output. The total effect of the FSP is close to Rp2.3 trillion for the government budget. The total effect of the infrastructure component of the FSP is approximately Rp89.9 trillion. Put into perspective, the Rp10.8 trillion worth of infrastructure investment, which amounts to only 0.19 per cent of GDP,[2] generated about 1.60 per cent of GDP growth.[3] In terms of growth, the impact on production (commodity and activity account) translates into growth rates slightly over 0.3 per cent. In contrast, income generation growth reaches 0.27 per cent for factor income (GDP at factor cost) and 0.26 per cent for institutional income (see table 10.2, last column).

Since the FSP infrastructure investments increased taxable profits and income, an increment in government tax revenue was estimated in the DySAM model. According to the simulated result, government tax revenue was increased by Rp2.2 trillion, implying a net cost of the programme for the Government at Rp8.5 trillion.

---

[2] GDP in Indonesia for 2009 was Rp5,613.4 trillion according to Statistics Indonesia.

[3] The total fiscal stimulus package is also one of the smallest among G20 countries, at less than 2 per cent of GDP (see IILS, 2011a).

Table 10.2 Indonesia: Economy-wide infrastructure investment impacts, 2009 (Rp billions)

| Accounts | A: Forecast 2009 + injection | B: Forecast 2009, base | Injection effect (A–B) | Growth effect (%) |
|---|---|---|---|---|
| Commodity output | 10 117 070.7 | 10 086 525.3 | 30 545.4 | 0.30 |
| Activity output | 9 717 032.2 | 9 687 837.2 | 29 195.0 | 0.30 |
| Factor income value-added or GDP (factor cost) | 4 904 091.1 | 4 890 629.3 | 13 461.8 | 0.27 |
| Institutional income | 5 663 943.4 | 5 649 536.3 | 14 407.1 | 0.26 |
| Government income | 860 800.0 | 858 511.5 | 2 288.6 | 0.27 |

Sources: Authors' calculations based on DySAM output; see also Alarcón et al. (forthcoming).

The DySAM model allows the creation of satellite accounts with real values. An employment satellite account with detailed employment data has been created to understand better the employment impacts of external shocks, public investments and policies. Therefore, the Rp10.8 trillion infrastructure component of the FSP is estimated to have generated 287,000 jobs (see table 10.3). Looking at construction by type, 9 per cent of these jobs were created by labour-intensive road construction works and only 1.7 per cent by irrigation-related works. It is interesting to note that the largest employment effect of the spending was found in agriculture, which generated about 82,000 labour places or 28.5 per cent of the additional employment originating from the infrastructure component of the FSP. The share of agriculture in total employment is about 20 per cent, thus the employment effect on this category of employment was relatively high. This result was most probably due to a high consumption propensity of construction workers and their consumption patterns.

The results need to be corrected for over- or underemployment, using working-hour data by occupation. Manpower equivalence (ME) factors of the 2005 SAM were used in this analysis. For the entire labour force the factor is 1.02 (table 10.3, fourth column) if 40 hours is taken as a standard;[4] thus the actual employment impact of the additional infrastructure spending was close to 293,000 labour-equivalent places. For construction the ME factor is 1.16, which pushes up estimated

[4] Construction, for example, has average weekly working hours of 46.4, whereas underemployment is a current phenomenon in agriculture, especially crop farming with 31.8 average weekly working hours (authors' calculations, adjusted to SAM and based on Statistics Indonesia (BPS) data).

Table 10.3 Indonesia: Total impact of the fiscal stimulus package on total economy, construction (by type) and agriculture

| Activity | Employment increase (% growth) | Share (%) | ME factor* | ME no. of persons* | ME share (%) |
|---|---|---|---|---|---|
| Total economy | 287 060 (0.26) | 100.0 | 1.02 | 292 801 | 100.0 |
| Road construction (labour-intensive) | 25 722 (9) | 9.0 | 1.16 | 29 791 | 10.2 |
| Road construction (capital-intensive) | 8 539 (9) | 3.0 | 1.16 | 9 890 | 3.4 |
| Irrigation | 4 851 (9) | 1.7 | 1.16 | 5 619 | 1.9 |
| Rest of construction | 11 125 (9) | 3.9 | 1.16 | 12 884 | 4.4 |
| Agriculture – crop farming | 81 951 (0.22) | 28.5 | 0.80 | 65 204 | 22.3 |

Note: * Total manpower, manpower equivalence (ME) and average work hours per week, by business classification: Badan Pusat Statistik (BPS) SAM Indonesia, 2005.

Source: Authors' calculations bas.ed on DySAM output; see also Alarcón et al. (forthcoming).

employment creation in construction. Labour-intensive road construction, for example, is estimated to have created 29,800 full-time jobs, not 25,700 jobs.[5] Contrary to construction, employment in agriculture is characterized by underemployment and thus has a low ME factor (0.80). The actual employment effect on this category of employment (on a full-time basis) is smaller than the number of workers who were estimated to have gained employment.

For policy discourse it is important to understand how the total employment effect is generated. The employment effects were decomposed into induced and intra-account effects. The intra-account effect arises out of intra-account transactions only and shows how far an activity is integrated with the rest of the economy.[6] Table 10.4 shows that the intra-account effect dominates for all construction activities, that is 99.5 per cent of the total impact. However, the share contributions vary, to the extent that labour-intensive road construction now contributes 22.5 per cent of the total intra-account effect (it was previously only 9 per cent,

[5] Other national studies estimated different sizes of employment creation, which can be explained by differences in assumptions when applying their models, mainly on: (1) economic growth forecasts; (2) definition of a job; (3) definition of multipliers; (4) application of economic versus engineering methods of calculating multipliers; and (5) time span.

[6] In SAM modelling, the multipliers Ma can be decomposed into M1 or the effect within (intra group) the account in which the injection takes place; O (open loop), the effect when the injection moves to the other accounts (in this case Fp and iE); and C (closed loop) when the effect comes back to the account where the injection took place. For our purpose, O+C is defined as induced (extra group) effect.

Table 10.4 Indonesia: Intra-account impact on job creation

| Activity | Employment increase | Share (%) | ME no. of persons* | Share of total (%) |
|---|---|---|---|---|
| Total economy | 113 803 | 100.0 | 116 079 | 39.6 |
| Road construction (labour-intensive) | 25 602 | 22.5 | 29 652 | 99.5 |
| Road construction (capital-intensive) | 8 499 | 7.5 | 9 859 | 99.5 |
| Irrigation | 4 829 | 4.2 | 5 602 | 99.5 |
| Rest of construction | 11 073 | 9.7 | 12 845 | 99.5 |
| Agriculture – crop farming | 2 314 | 2.0 | 1 841 | 2.8 |

Note: All construction sub-sectors have the same value of 99.5 per cent as we could disaggregate the intra-account effects only at the sector level.

Sources: Authors' calculations based on DySAM output; see also Alarcón et al. (forthcoming).

Table 10.5 Indonesia: Shares of new employment, by location and gender (percentages)

| | Urban | | | Rural | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| | Male | Female | Total | Male | Female | Total | Male | Female | Total |
| Economy-wide | 25.4 | 15.6 | 41.0 | 36.9 | 22.1 | 59.0 | 62.3 | 37.7 | 100.0 |
| Construction | 46.9 | 1.6 | 48.4 | 50.8 | 0.8 | 51.6 | 97.7 | 2.4 | 100.0 |

Sources: Authors' calculations based on DySAM output; see also Alarcón et al. (forthcoming).

see table 10.3). The other construction activity shares have also increased considerably. For agriculture, the effect is only 2.8 per cent since most of it arises as induced via the "workings of the economy" or via the cascading effect throughout the economy (through other accounts, such as factor income or institutions). At economy-wide level, there is also a dominance of the induced effect (60.4 per cent compared to 39.6 per cent of the intra-account effect).

As for the geographical location of new jobs, table 10.5 shows that most of the additional employment was created in rural areas (59 per cent). Sixty-two per cent of the newly created employment opportunities was estimated to have been taken by men (urban and rural areas). For construction, the figures show a lower share of urban workers (48.4 per cent) among beneficiaries in comparison with the total economy, and a very strong domination of male workers with over 97.7 per cent of jobs, which is fairly common in this sector, but also high in the case of Indonesia compared with other countries in the region.

## 10.4 CONCLUSIONS

In announcing the fiscal stimulus package worth 1.4 per cent of GDP the Government of Indonesia reacted swiftly to the anticipated impact of the global financial and economic crisis. The package certainly helped the country cushion the impact of the crisis by boosting consumption and thus internal demand and by easing the financial distress of companies. Almost three-quarters of the stimulus package was allocated to fund tax rebates. This design of the package skewed the distribution of income effects on households. Urban and rural high-income households received a dispropotionately greater benefit than low-income households. The package increased consumption and thus boosted sectors such as food, beverages and restaurants, as well as the transportation and agriculture sectors, which are rather labour-intensive (particulary agriculture). Still, it can be argued that the direct impact of the tax cuts on the poor and their indirect impact through consumption by taxpayers and subsequent job creation were modest compared with a scenario where the same amounts were channelled directly to low-income households through public works, labour-intensive investment programmes, cash transfers or other policy measures.[7]

As part of the stimulus package, Rp10.8 trillion was invested to develop infrastructure, which is a relatively modest value in international comparison. Net government spending is estimated to be Rp8.5 trillion after subtracting an increase in tax revenue. According to the simulation based on our Indonesian DySAM model, this government spending pushed GDP up by 0.27 per cent and generated about 287,000 jobs or 292,801 full-time equivalent jobs. The largest employment gains were realized in agriculture, since additional income to the government spending resulted in higher consumption and since this sector is highly labour-intensive, but with low-productivity jobs. Rural male workers benefited most from the infrastructure expenditures in terms of employment.

While timeliness of response to the global crisis was crucial, and thus the Government opted for implementation of the fiscal stimulus package through tax cuts, these cuts apparently had only a modest effect on poverty alleviation, instead benefiting high-income households more. Poor rural farmers appear to have benefited from the package through the employment creation effect of higher consumption by taxpayers, but also through direct investment in infrastructure programmes. A future research task is to estimate the impact of the package were the design of the stimulus to be geared toward increased spending on social policies such as public works and conditional cash transfers.

---

[7] For more detailed information on this issue, see Fiszbein and Schady (2009).

PART IV

# ACHIEVING INCOME-LED GROWTH

# WAGES AND ECONOMIC CRISIS: TOWARDS A NEW PERSPECTIVE ON WAGES, PRODUCTIVITY AND ECONOMIC GROWTH

# 11

*Patrick Belser and Sangheon Lee**

## 11.1 INTRODUCTION

With the dominance of neoclassical thinking in economics and economic policies, the macroeconomic function of wages tends to be considered only partially and, as a result, wage moderation is seen as beneficial to economic growth. However, the recent global financial and economic crisis offers the painful lesson, among many others, that sluggish wage growth constrains economic growth by suppressing growth in consumption demand. This constraint has been overcome in some countries either through debt-financed consumption or through accelerating exports, which in turn exacerbate global imbalances.

These developments indicate that policy decisions at national, regional and international levels should be based on a sound understanding of the macroeconomic effects of wages on aggregate demand and labour productivity as well as labour costs. Indeed, a growing number of economists have recently spoken out on the possibility that wage moderation and growing wage inequality in advanced countries may have been part of the structural roots of the crisis. For instance, Fitoussi and Stiglitz (2009) now consider that "the aggregate demand deficiency preceded the crisis and was due to structural changes in income distribution" (p. 3). Because the propensity to consume among low income households is higher, the general surge of inequalities in favour of high incomes "would

* The authors are Wage Specialist and Senior Economist, Conditions of Work and Employment Programme, ILO, Geneva, respectively.

have had the macroeconomic effect of depressing aggregate demand." (p. 4) (See also Rajan, 2010; Reich, 2010.)

However, these increasing concerns about the macroeconomic dynamics of wages have not been accompanied by comparable research efforts, so that there is a risk that the global debates on wages will be reduced back to the familiar rhetoric games. In light of these research demands, this chapter is intended to outline the key issues for research and how they can be addressed. In order to contextualize these research questions, we will first review the overall trends in wages, with a strong focus on the period of the global economic crisis. This brief review will confirm that sluggish growth in wages with widening inequality is a global phenomenon. The chapter will then discuss major aspects of the relationship between wages and economic growth and highlight research gaps in terms of concepts, theories and empirical evidence. In light of common confusion over the term "wage-led", we will attempt to clarify this concept in terms of aggregate demand, economy and policies. The chapter will conclude by emphasizing the need for more research work with a view to developing a better understanding of the relationship between wages, productivity and economic development.

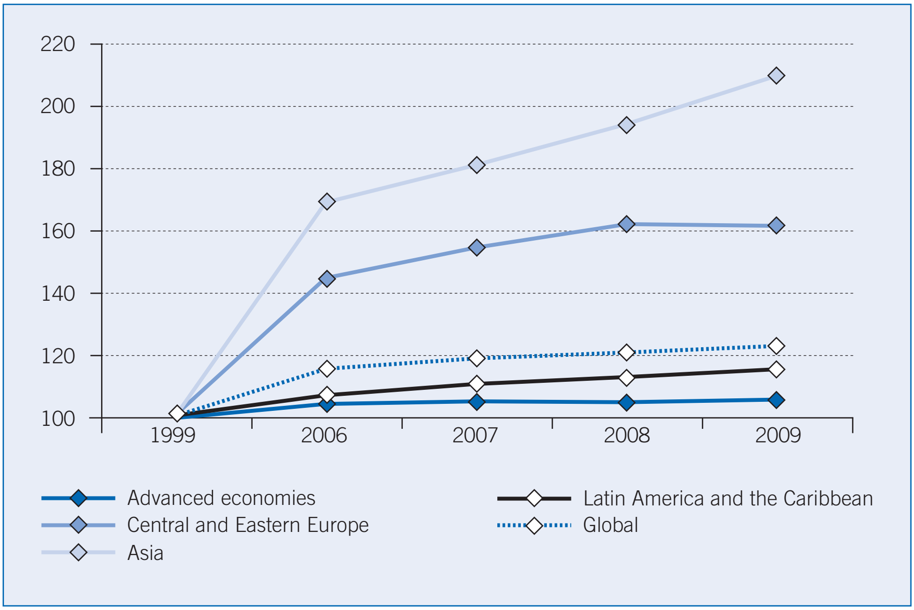
## 11.2 WAGES AND ECONOMIC CRISIS: A GLOBAL OVERVIEW [1]

### *11.2.1 Average wage growth*

Based on complete and incomplete wage data for 115 out of a universe of 177 countries and territories in the ILO Global Wage Database, figure 11.1 looks at how average wages have evolved over the full decade of the 2000s (taking 1999 as the base year). We see that global average wages increased by almost one-quarter over this period. This increase was driven by developing regions such as Asia, where wages have more than doubled since 1999, or countries in Eastern Europe and Central Asia where wages more than tripled (which partly reflects the depth of the wage decline in the 1990s). By comparison, real wages grew only modestly in Latin America and the Caribbean, in Africa and in the Middle East. In advanced economies, real wages increased by only about 5 per cent in real terms over the whole decade, reflecting a period of wage moderation.

[1] This section is drawn from *Global Wage Report 2010/11: Wage policies in times of crisis* (ILO, 2010d) which is an outcome of collective work by a number of ILO researchers including Malte Luebker, Kristen Sobeck and Manuela Tomei as well as the authors of this chapter.

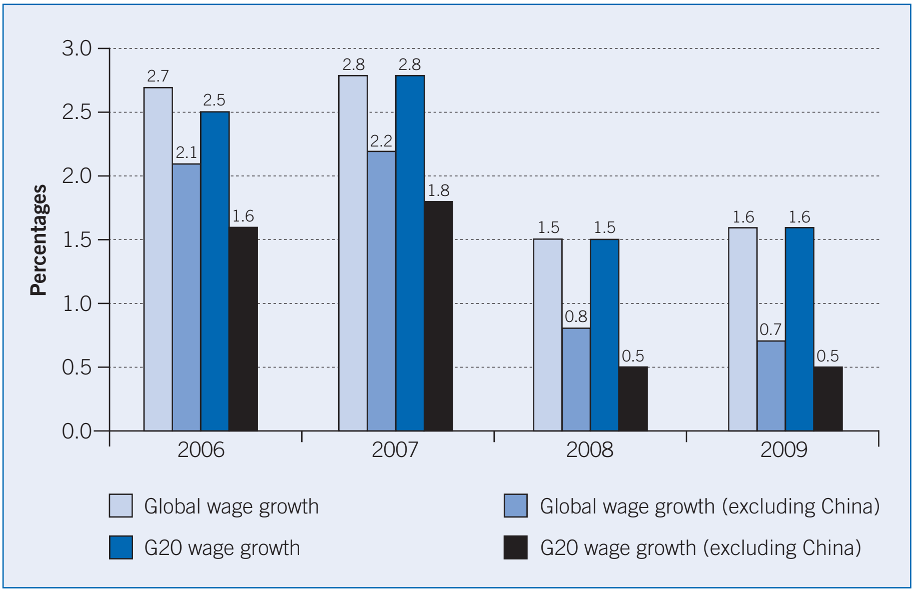
Figure 11.1 Cumulative wage growth, by region, 1999–2009 (1999 = 100)




Note: For coverage and methodology, see ILO (2010d, Technical appendix 1).
Source: ILO Global Wage Database, http://www.ilo.org/travail.

How did the global crisis affect average wages? Figure 11.2 shows that the crisis cut the global wage growth by half, representing a loss of perhaps around US$800 billion for the world's 1.5 billion or so employees. We see that, globally, real monthly wages grew at 2.7 and 2.8 per cent in the two years before the crisis (2006 and 2007) and that the crisis cut this growth rate to 1.5 and 1.6 per cent in 2008 and 2009. Restricting our sample to the G20 countries, which account for about 70 per cent of the world's wage earners (and an even larger fraction of the world's wage bill), we find very similar results. We estimate that the G20 average wage grew by 2.5 per cent in 2006, 2.8 per cent in 2007, 1.5 per cent in 2008 and 1.7 per cent in 2009. This highlights the fact that our global estimate – which is a weighted average – is highly dependent on the reliability of official wage statistics from large G20 countries. Figure 11.2 also illustrates the importance of China's wages in determining the global wage growth. During the period of 2008 and 2009, the global wage growth, if China is excluded, would have been further reduced to 0.8 per cent and 0.7 per cent respectively. In other words, China accounted for almost half of the global wage growth during the turbulent years of global crisis.

Figure 11.2 Wages, economic crisis and "China factor": Average global wage growth, 2006–2009 (percentages, year-on-year changes, real terms)



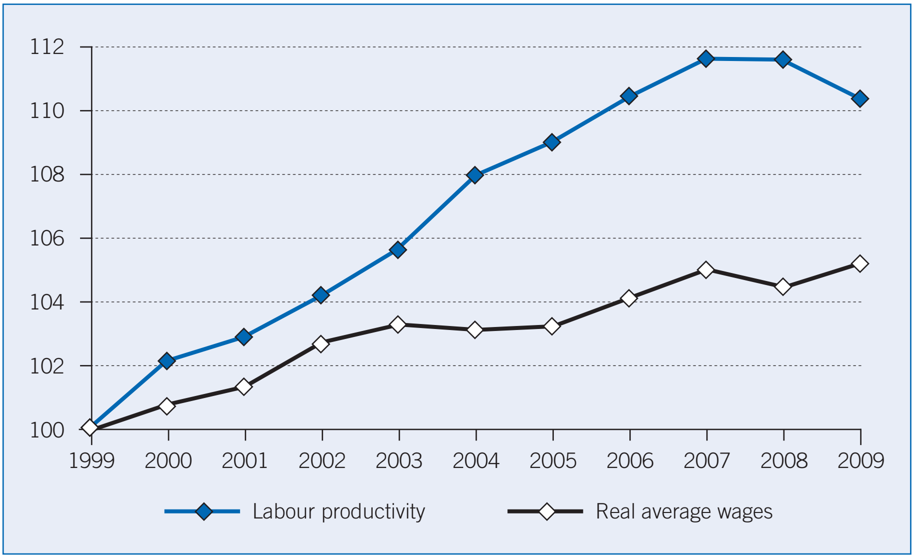

Note: The global wage growth is calculated as a weighted average of actual or estimated year-on-year growth in real average monthly wages in 113 countries, covering 94 per cent of all employees in the world (see description of the methodology in ILO (2010d, Technical appendix I).

Source: ILO Global Wage Database.

## *11.2.2 Wages and productivity in advanced economies*

How did recent wage trends relate to changes in labour productivity? This question is important since growing labour productivity – producing more output with the same input of labour – has historically been one of the most powerful driving forces behind rising living standards and increases of real wages. In particular, labour productivity is often a key factor in wage determination and is widely used by the social partners as a reference point in collective bargaining. While there are a number of different ways to measure labour productivity, they all define economic output in relation to labour input. In line with the United Nation's Millennium Development Goals (MDGs), we use GDP per person employed as a simple measure of labour productivity. While more refined approaches that adjust for hours worked are often useful for single-country studies, this simple measure keeps the data requirements to a minimum and allows us to cover a large number of countries.

Figure 11.3 Advanced economies: Cumulative wage and productivity growth, 1999–2009 (1999 = 100)




Source: ILO Global Wage Database; ILO Key Indicators of the Labour Market Database (KILM).

Taking the long-term view, and looking at figure 11.3, we see that while average wages in advanced economies grew by 5.2 per cent over the entire decade (level in 2009, as compared to 1999), labour productivity grew by 10.3 per cent over the same period and thus almost twice as fast as wages. The divergence between wages and productivity finds its main cause in low wage growth during the pre-crisis period. Despite robust economic growth and annual gains in labour productivity between 1.0 and 2.1 per cent during the years from 2002 to 2007, annual wage growth in advanced economies was less than one per cent during that boom period. This long-run deviation has led to a decoupling of wage growth from productivity growth in advanced economies. Since the figures refer to a weighted average, developments in the three largest advanced economies (Germany, Japan and United States) have a particular impact on this outcome.

### 11.2.3 The "wage share" in advanced economies[2]

What are the consequences of these trends on the "wage share"? Most frequently, the "unadjusted" wage share is defined as the ratio of the

[2] This section draws on the contributions of Rebecca Freeman and Jean-Michel Pasteels prepared for ILO (2010d).

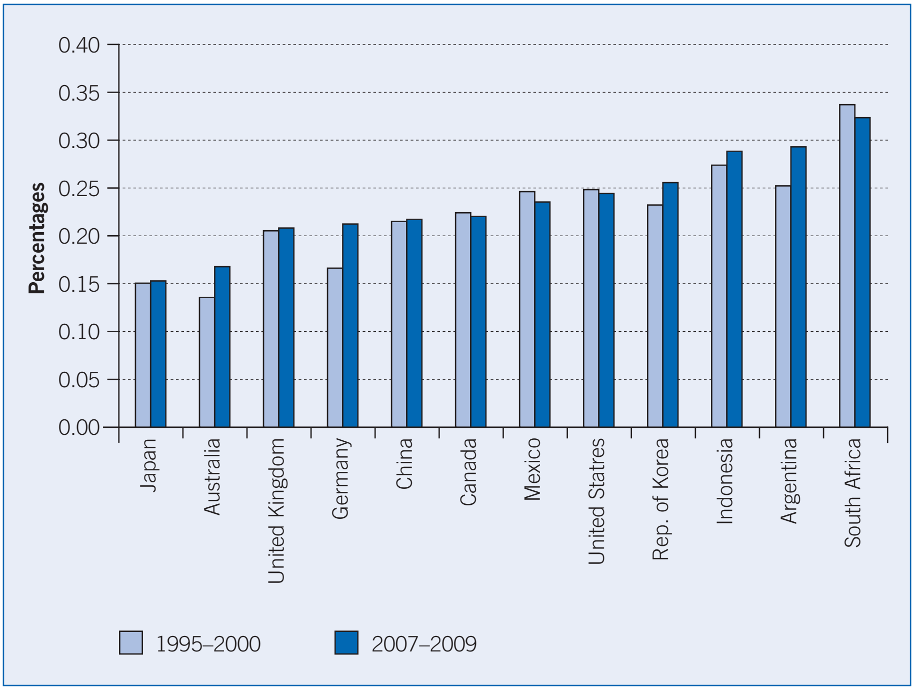
total compensation of employees to gross value-added, both measured in nominal terms, which can be calculated from national accounts. By highlighting the amount of income accruing to paid labour, the wage share can shed light on various issues of interest, including the extent to which economic growth translates into higher incomes for workers. However, while the concept of the wage share may appear to be straightforward, there is much debate on the implications of this “crude” measure (see Lübker, 2007 for details). In particular, standard measures of employee compensation in national accounts (i.e. wages plus salaries and social contributions paid by the employer) omit the labour income of the self-employed. As such, the “unadjusted” wage share ignores the labour income of proprietors of their own businesses. In countries or sectors where there is a high proportion of self-employment in total employment, the exclusion of self-employed workers can cause a significant underestimation of the actual share of national income which rewards workers.

We examine the “wage share” by sector among OECD member countries, using the OECD Database for Structural Analysis (www.oecd.org/sti/stan) and the OECD System of National Accounts (www.oecd.org/std/ana). The analysis reveals that there was a predominantly negative long-term trend in the “real economy” wage share (i.e. leaving out financial intermediation, real estate, renting and other business services) in a majority of countries with available data. Overall, for the period 1980–2007, 17 out of 24 countries with available data registered a falling wage share, although there was substantial cross-country variation. This overall decline can also be observed at the level of individual sectors, including labour-intensive sectors such as manufacturing or construction. In manufacturing, for example, the long-term trend in the wage share has been negative for 26 out of 29 countries. In construction, the negative trend has been much less obvious – but was nevertheless observed in 17 out of 30 countries. Analysis of such sectoral data through a so-called “shift-share” calculation dismisses the hypothesis that the wage share has been going down in OECD countries mostly because of structural change of economies moving towards more capital-intensive sectors. On the contrary, these calculations show that the bulk of the downward trend in the wage share is due to falling wage shares within sectors.

### *11.2.4 Wage inequality*

Although the focus on aggregate measures such as average wages or the wage share is informative, these measures do not provide any evidence on the distribution of wages among different classes of wage earners. To understand who benefited most from productivity gains, a number of

Figure 11.4 Share of low-pay employment in total employment, selected G20 countries, 1995–2000 and 2007–2009




Source: ILO Global Wage Database.

indicators can be used: the Gini index for wage distribution, the gender wage gap, the ratio of top-to-bottom 10 per cent of wages, or the share of low-paid workers whose hourly wages represent less than two-thirds of median wages. Whatever indicator is used it appears that a majority of countries experienced increases in inequality over the last ten to 15 years – the only exception being inequality between men and women. Indeed, evidence shows that in 80 per cent of countries with available data the female wage ratio (the ratio of female average wages to male average wages) has narrowed (ILO, 2010d). This decline has usually been slow when compared to women's recent educational achievements and the closing of the gender gap in work experience.

Other indicators all point towards more inequality in a majority of countries. The ILO *Global Wage Report 2008/09* (ILO, 2008) calculated, for example, that the wage gap between those in the top 10 per cent and those in the bottom 10 per cent of the wage distribution increased in 23 out of 31 countries with available data between 1995 and 1997 and between 2004 and 2006. The subsequent edition of the report (ILO, 2010d) showed that the proportion of people on low pay also increased in 25 out of 37 countries with data available – again indicating an increase in inequality in about two-thirds of countries. Figure 11.4 illustrates recent changes in G20 countries for which data are available. Case studies show that women, low-skilled workers, young people and migrant workers are most likely to be affected by low pay. The type of enterprises and employment characteristics are also significant, with higher risk of low pay for workers in small enterprises and on short-term contracts. In recent years, these people have all faced an increased risk of falling behind the median worker.

## 11.3 A NEW PERSPECTIVE ON WAGES, PRODUCTIVITY AND ECONOMIC GROWTH: THE POTENTIAL OF "WAGE-LED" GROWTH[3]

The global trends in wages in the 2000s, which can be characterized by wage moderation and growing inequality, are now widely believed to have had grave economic consequences. Not surprisingly, the need for a better and more balanced understanding of the "macroeconomics of wages" is high. In this regard, the post-Keynesian approach to wages, especially through the concept of "wage-led growth", has attracted much interest from both academics and policy-makers. Similar concepts, such as "income-led" growth, have also been used in policy debates. However, to advance the debate, a conceptual elaboration of the "macroeconomics of wages" needs to be thoroughly developed and presented in a systematic way for the consideration of policy-makers, especially in developing countries which are caught in the neoclassical policy doctrine that wage moderation is the key to economic success. In this regard, it is particularly important to revisit the existing theories and empirical evidence concerning "wage-led growth" and develop the policy implications for the labour market and the economy, considering different circumstances across countries.

### *11.3.1 What does "wage-led" mean?: Conceptual clarifications*

There appears to be confusion, at least among policy-makers, over what is meant by "wage-led". Unfortunately, it is often understood to mean unconditional support for high wages and is categorically denounced.

[3] This section benefits from inputs and comments from the members of the research project on "New Perspectives on Wages and Economic Growth": E. Hein, M. Lavoie, R. Naastepad, O. Onaran, E. Stockhammer, S. Storm, S. Sturn and T. van Treeck.

Unless these misunderstandings are properly addressed, meaningful policy debates will be difficult.

In the academic debate the most widely used term is that of "wage-led" *demand*. In the standard macro model, the aggregate demand ($y$) is defined as the sum of consumption ($c$), investment ($i$) and net export ($nx$). Wages ($w$) are known to affect all three components. Thus,

$$y = f(w) = g(c(w), i(w), nx(w))$$

Aggregate demand is wage-led if an increase in the wage share leads, other things equal, to an increase in aggregate demand, with the supply side of the economy assumed given:

$$\Delta y/\Delta w = \Delta c/\Delta w + \Delta i/\Delta w + \Delta nx/\Delta w > 0$$

This is based on the theoretical work of Bhaduri and Marglin (1990) and Blecker (1989), who established that the nature of the demand regime is not a priori defined. Demand in actual economies could be either wage-led or profit-led, because consumption is usually thought of as being wage-led while investment and net exports are expected to be profit-led ($w\uparrow \rightarrow c\uparrow, i\downarrow, nx\downarrow$). (Private) aggregate demand is the sum of consumption, investment and net exports and the total (or net) effect is thus ambiguous. This has recently given rise to a rich empirical literature trying to identify demand regimes by econometric means (Bowles and Boyer, 1995; Onaran and Stockhammer, 2005; Naastepad and Storm, 2006–7; Hein and Vogel, 2008: Stockhammer et al., 2009). It should be noted that the analysis of the demand regime takes supply conditions as given and is thus (for purposes of economic policy) restricted to a short time horizon.

Wage-led *growth* is a stronger and more long-term concept than wage-led demand as it incorporates the supply-side effects of changes in wages. The concept is stronger because it requires that the growth of the capital stock is also wage-led. The concept is also concerned with a longer time frame, because several of the variables that are usually considered given in the short run have to be regarded as endogenous in the context of growth theory. For wage-led growth to occur it is crucial that investment is wage-led in the medium term (note that demand can be wage-led even if investment is profit-led if consumption is sufficiently strongly wage-led). There are two important channels that explain why investment could be wage-led. First, if demand is strongly wage-led then investment can be pulled along by wage-led demand via the standard accelerator effect in the investment function ($w\uparrow \rightarrow c\uparrow > i\downarrow$ [partial effect with given $y$] $\rightarrow y\uparrow \rightarrow i\uparrow$ [total effect]). Second, if productivity is wage-led (which it is likely to be) and investment reacts to productivity growth, then investment can be pulled along via the link ($w\uparrow \rightarrow$ productivity $\uparrow \rightarrow i\uparrow$). These channels will be discussed later in this chapter (section 11.3.5).

For *economic policy* purposes wage-led growth should be the key concept. It basically describes a virtuous circle where wage growth leads to higher demand and higher productivity growth and, as a consequence, to higher investment. The concept of wage-led growth is important because of the failure of neoliberalism to deliver a growth regime that is equitable, stable and sustainable. In this respect, wage-led growth can be contrasted with two growth regimes which have emerged: "finance-led growth" (also called credit-led growth), where growth was fuelled by increasing household debt made possible by asset and property price bubbles and financial engineering (for example in Ireland, the United Kingdom and the United States); and "export-led growth", where the main engine of growth has been net exports (as in China, Germany, Japan and Republic of Korea). Both of these neoliberal growth regimes have come with wage suppression (and often with wage polarization) (Stockhammer, 2009; van Treeck, 2010; Hein, 2010; UNCTAD, 2010c). Simply put, stagnant demand from stagnating wages was substituted by demand fuelled by credit in the finance-led regime and by external demand in the export-led regime. A wage-led growth model aims at restoring wage growth and argues that this is consistent with long-term growth.

### 11.3.2 Wage-led growth as an economic policy strategy

Wage-led demand and wage-led growth point to the hard reality of economic structure where the size of the wage share plays a significant role in determining economic growth (irrespective of the types of the policies and institutions "imposed" on the economy). Note that neither wage-led demand nor wage-led growth require wages (or the wage share) to increase. It is therefore important to distinguish between changes in income distribution (or distributional policy) and the nature of the demand and the growth regime. Indeed, empirical studies (for example Naastepad and Storm, 2007) suggest that many OECD countries are "wage-led economies", but wage shares have fallen throughout OECD countries.

In order to establish a wage-led growth process, therefore, economic policy will have to address issues of income distribution as well as economic structure. As illustrated in table 11.1, all four combinations – wage-led and profit-led growth demand regimes and "active" and "passive" distributional policies – are possible, but not all are equally consistent. In a wage-led economy, active distribution policies will result in a growth process, but passive policies will result in stagnation (or instability). Conversely, in a profit-led economy active distribution policies will lead to stagnation and passive policies will lead to a profit-led growth process. This latter scenario is essentially the trickle-down argument that neoliberal economists have been making.

Table 11.1 Possible conceptual framework for assessing distribution policies

| Economic regime | Distribution policies | |
|---|---|---|
| | Active | Passive |
| Wage-led | Wage-led growth process | Stagnation (or unstable growth) |
| Profit-led | Stagnation (or unstable growth) | Profit-led growth process |

Source: Second author.

As an *economic policy strategy*, wage-led growth refers to an economic growth strategy where a range of policies is introduced to boost the wage share (such as redistributive polices, stronger minimum wages and more active use of collective bargaining), which results in higher consumption demand and higher productivity growth – which in turn lead to higher investment. As a consequence the productive capacity of the economy is also growing.[4] In short, a *wage-led growth strategy* is the *coherent* growth strategy which applies an active distributional policy to a wage-led growth regime.

For clarification, the wage-led growth strategy as defined above should not be understood to imply that it is concerned only with the employed wage earners and thus fails to appreciate the importance of unemployment. The key concern in the framework of wage-led growth is the distribution of total income to capital and labour (that is, functional income distribution) and the key indicator is the wage share which can be expressed in its simplest form as follows:

Wage share = total wage compensation/total income = (average wages * total wage employment)/total income

It is clear that the wage share can be increased not only by increases in average wages but also by increases in wage employment. For instance, work sharing during economic downturn, which proved effective in maintaining wage share (that is, stagnating wages plus stable employment) in some countries such as Germany, can be seen as an important part of

[4] The set of such policies can be extensive. For instance, it is argued that “redistributive, pro-worker interventions in the labour market need not to lead to higher (steady-inflation) unemployment if labour productivity is raised at the same time by proper fiscal, monetary, income and technological polices” (Storm and Naastepad, forthcoming).

the wage-led growth strategy. Therefore, the wage-led growth strategy is in a sense both "wage-led" and "employment-led", effectively addressing both quantity and quality dimensions of employment. (However, it is, overall, focused on formal employment and research is needed to find ways of incorporating informal employment into the macroeconomic framework.)

### *11.3.3 Is the wage-led economy a global norm?: Need for a global mapping*

With conceptual clarifications about wage-led growth, it is important to identify which countries belong to the "wage-led economy" and to come up with a rough global mapping that indicates the distribution of different types of economies around the globe. Most existing studies are limited in country coverage (mainly to OECD countries) with few exceptions (such as Onaran and Stockhammer, 2005) and little is known about developing countries such as Brazil, China and South Africa. In addition, the results of these empirical studies are sometimes sensitive to econometric methodologies.

As the issue of "wage-led" economy relates to economic structure, it is possible that an economy experiences a shift in economic regime: wage-led to profit-led, or vice versa. Research is rather scant on this issue. Earlier studies have pointed to the role of economic openness and globalization in converting wage-led to profit-led economies (for instance, Germany and Japan, as suggested by Bowles and Boyer, 1995).

Therefore, there is a need for global mapping from the perspective of wage-led growth (at least for G20 countries). One important issue underlying this mapping exercise is the proposition of "asymmetry": while all countries can be wage-led economies simultaneously, all countries cannot be profit-led economies. Of course, this proposition is based on the assumption (or empirical fact) that a profit-led economy is likely to be export-oriented. Considering that this assumption may not hold for some countries (such as the United States), a weaker version of this proposition is that only a small group of countries can be profit-led. In other words, a wage-led rather than a profit-led economy is the global norm, and therefore this should be the basis for development policies in developing countries. This issue is related to ongoing debates on global rebalancing.

### *11.3.4 Falling wage share: Causes and consequences*

There has already been a growing body of research which documents the declining trend of wage share and its causes (for ILO contributions, see

ILO, 2008 and 2010d; IILS, 2008). This trend is particularly puzzling, given that the wage share has also been falling in wage-led economies. This raises two interesting questions: determinants of wage share and the consequences of falling wage share.

First, concerning the determinants of wage share, the role of technological changes appears to have been misrepresented and overestimated (IMF, 2007d and 2007e; EC, 2007). This "conventional wisdom" has already been challenged by ILO (2008) and IILS (2008). More recently, Stockhammer (2009) checked the robustness of the earlier studies and found that their conclusions suffer econometric problems. In his econometric model, which corrected these problems, technological changes are no longer statistically significant. Interestingly, Stockhammer found that globalization (as measured by economic openness) and labour market institutions such as union density are the major determinants of the wage share. However, these studies are limited to OECD countries, and questions remain as to whether these findings can be extended to the global economy. Some pioneering studies which cover developing countries (ILO, 2008 and IILS, 2008) indicated the importance of globalization and labour market institutions, largely in line with Stockhammer (2009). Yet these conclusions are still tentative and further empirical evidence based on more rigorous statistical analysis is needed.

Second, the consequences of falling wage shares deserve serious attention as well, as they may give invaluable policy lessons. According to the simple conceptual framework in table 11.1, falling wage share (due to "passive" policies) in the wage-led economy may carry the risk of leading to lower growth and/or macroeconomic instability. Given the trend of growing inequality in income distribution before the "global crisis", one crucial hypothesis is that such widening inequality, coupled with financialization, has been the key contributor to the crisis (Fitoussi and Stiglitz, 2009; Rajan, 2010; Reich, 2010). In fact, the critical importance of the linkage between income distribution and macroeconomic stability has already been recognized in the post-Keynesian literature (see Godley and Lavoie, 2007), and advances have been made in macroeconomic modelling and econometric studies (for example, Kumhof and Rancière, 2010; Horn et al., 2009; as well as ILO contributions such as Charpe et al., forthcoming; La Marca, 2010).

### 11.3.5 Do high wages reduce or increase investment/productivity?: The linkage between wages, investment, and productivity

One of the most familiar arguments against high wages is that they kill investment and cut productivity growth. This view is well established in the conventional NAIRU (non-accelerating inflation rate of unemployment) approach which assumes a straightforward trade-off between high wages and low investment. However, this "conventional wisdom" can be questioned from the perspective of wage-led growth. Simply put, what is missing from this view is the macroeconomic benefits of high wages in terms of their impacts not only on consumption demands but also on investment and productivity. In fact, the productivity-enhancing effects of higher wages are well known at the workplace level as "efficiency wages" either in theories or empirical studies (such as Bewley, 1999). It will be interesting to see if this micro-level logic can be extended to the macroeconomic level. This constitutes a critical element of wage-led growth.

Evidence is already available. For instance, Storm and Naastepad (forthcoming) provide both theoretical and empirical cases for the macroeconomic version of efficiency wages. They identify three possible channelling mechanisms. Higher wages can lead to: (a) increasing capacity utilization; (b) increasing labour productivity through better use of production technologies or the deepening of division of labour; (3) promoting innovation and technological progress. However, higher wages as "beneficial constraints" for productivity growth do not seem to be automatically guaranteed. Rather, certain conditions must be met for the win–win outcome to materialize, and this is the issue which requires further research (ibid).[5]

## 11.4 CONCLUSIONS

Considering the growing need for an alternative macroeconomic framework based on the lessons from the global crisis, this chapter has explored the potentials of wage-led growth and basically challenged the perception of "wage moderation" as a necessary condition for economic growth. The premise of the chapter is that the wage-led economy can create economic outcomes which are more stable and sustainable at both national and global levels. Particular attention has been paid to the issues which the model of wage-led growth needs to address in order for it to be recognized as a serious alternative model for policy-makers. In doing so, attempts have been made to provide a way of clarifying the meaning of "wage-led" in terms of aggregate demand, economy and policy strategy.

[5] Importantly, in order to materialize this virtuous circle, favourable macroeconomic policies are needed, including the monetary policies which can address inflation pressures and the effective regulation of financial markets. The authors are grateful to Detlef Kotte for drawing our attention to it. See also Hein (2010).

Based on these conceptual clarifications, some common confusions over the concept of "wage-led" have been addressed. The chapter has also outlined key research questions, including the determinants and consequences of growing inequality in functional income distribution (such as wage share) and the macroeconomic dynamics which they may create, especially with a view to the developments leading to the global crisis.

It is hoped that more research efforts will be mobilized, especially within the ILO, to determine the possibility and conditions for wage-led growth as an alternative policy strategy. Such work will succeed only when reliable theoretical and empirical responses are provided to a number of key outstanding issues, some of which have been discussed in this chapter.

# SOCIAL SECURITY: THREE LESSONS FROM THE GLOBAL CRISIS 12

*Christina Behrendt, Florence Bonnet, Michael Cichon and Krzysztof Hagemejer**

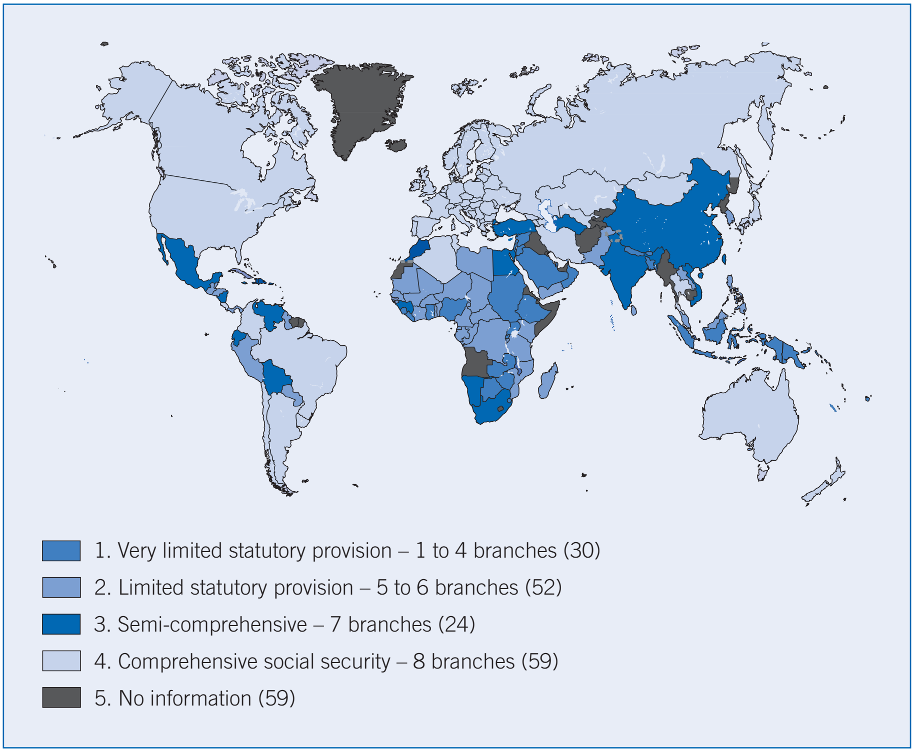
## 12.1 INTRODUCTION

The global financial and economic crisis has given new impetus to the debate on social security policies. Countries that had social security programmes in place strongly relied on them as automatic stabilizers in their stimulus packages. Where countries affected by the crisis did not have adequate social security mechanisms, the need to develop social security became more apparent. As a result, a number of social protection policy initiatives have begun or been stepped up at national, regional and global levels, including the UN Social Protection Floor Initiative and the Global Jobs Pact.

Positive changes had begun in many developing countries well before the crisis. But a large social security coverage deficit still prevails (ILO, 2010f; UNRISD, 2010). In many countries only a minority of the population has access – both statutorily and effectively – to existing schemes. Figure 12.1 shows the scope of statutory coverage through social security schemes around the world. It can be seen that in Asia, Africa and some parts of Latin America in particular there are large gaps in the scope of social security schemes statutorily available. It is estimated that only one-fifth of the global working-age population and their families have effective access to comprehensive social protection (ILO, 2010f, p. 1). The social security deficit is one of the main obstacles to achieving the Millennium Development Goals (UN, 2010).

* The authors are Social Policy Specialist, Social Policy Analyst, Director and Chief, Policy Development and Research, respectively, of the ILO's Social Security Department, Geneva.

Figure 12.1 Statutory social security coverage worldwide: Branches covered by a statutory programme, 2010 (number of countries in parentheses)




Note: The nine branches of social security as given in the Social Security (Minimum Standards) Convention, 1952 (No. 102) are aggregated to eight through the merging of sickness and health benefits. In addition, it is assumed that countries that have all eight classical branches in place also have functioning social assistance schemes.

Source: ILO (2010f, figure 2.4).

At the same time there is intense debate in some OECD countries on the adequacy and financial sustainability of social security options (ILO, 2010m). Some of the recent reforms have reduced levels of protection, in particular for those with broken or shorter careers or with non-standard employment status.

Against this background, this chapter[1] will focus on three lessons that can be drawn from responses to the global crisis:

[1] This chapter draws heavily on the report submitted to the 100th Session of the International Labour Conference in June 2011 (ILO, 2011g), as well as the analyses in other recent ILO publications on social security.

- People covered by different social security arrangements with respect to financing, design and coverage are exposed to economic shocks in different degrees.
- With adequate financing, design and coverage, social security acts as an economic and social stabilizer during a crisis.
- While the crisis has opened a window of opportunity for the extension of social security, particularly in low-income countries, more political will is needed both nationally and internationally to create the necessary fiscal space.

## 12.2 LESSONS FROM THE CRISIS

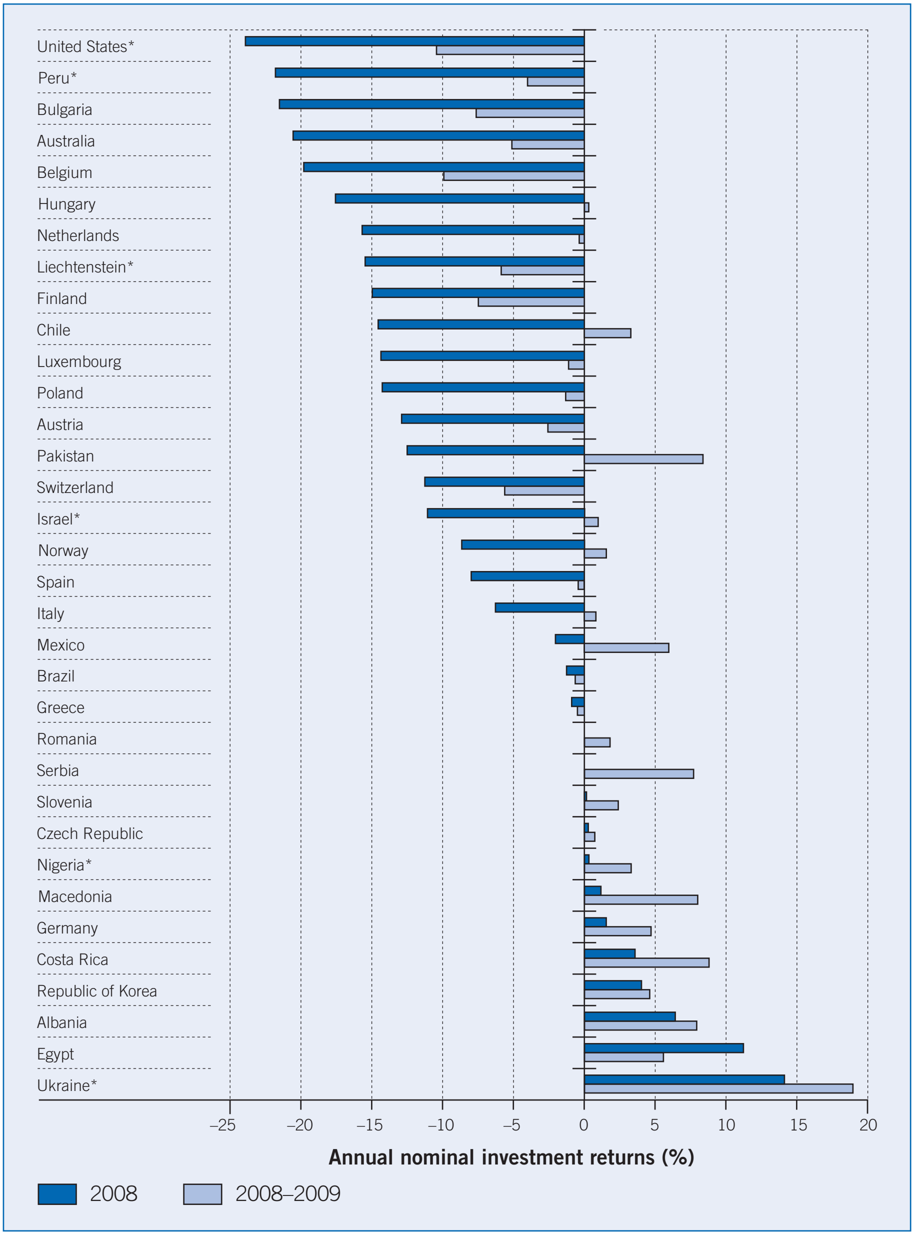
### *12.2.1 Exposure of different types of social security schemes to economic shocks*

The first lesson from the global crisis underlines the need for guarantees in the design and financing arrangements of social security schemes, particularly pension schemes. Recent pension reforms in some countries have shifted the financial risk to workers, exposing them unduly to the volatility of financial markets. Moreover, social security finances are both directly and indirectly negatively affected by rising unemployment, underemployment and informalization of employment. The crisis has highlighted the need to counterbalance these risks through appropriate guarantees.

The effect of the crisis on pension finances has received worldwide attention. Investment returns on pension funds dropped markedly during the crisis (figure 12.2), leading in many countries to a contraction of pension reserves (see for example OECD, 2010a, pp. 117–19; OECD, 2010b; World Bank, 2010b; Bonnet et al., 2010; Pino and Yermo, 2010).

Although the rates of return on many pension funds have recovered since the height of the crisis, there is no reason for complacency. The rebound veils the fact that many workers and retirees, especially cohorts retiring during or shortly after the crisis, have had to face markedly reduced pension levels, given that they have not had the chance to wait for a full recovery (Bonnet et al., 2010). Moreover, the crisis has brought to light the volatility of investment returns, the levels of financial risk carried by workers and the resulting insecurity and inequity (Burtless, 2000, 2009). It will take a long time for pension funds not only to recover losses but also to make up for the years of workers' lost contributions (Bluhm, forthcoming). As a result, in many countries higher levels of variance and volatility in pension incomes are likely and may result

Figure 12.2 Impact of the global crisis on the rate of return to pension funds, selected countries, 2008 and 2008–2009 (percentages)




Note: * Data for 2009 refer to January to June only. Data for the United States include individual retirement accounts (IRAs).

Source: ILO (2011g), based on OECD (2010a, Statistical tables).

in decreasing relative income levels for pensioners and higher risks of poverty for older women and men.

The crisis exposed the increased vulnerability of privatized pension schemes to the ups and downs of the financial markets. This has also temporarily attenuated the wide spread enthusiasm for the privatization of pension schemes which inspired a series of pension reforms in various parts of the world during the past three decades, particularly in Latin America and Central and Eastern Europe (World Bank 1994, 2006; for critical reviews of these policies, see Gillion et al., 2000; Diop, 2008). The OECD highlighted “the need for resilience to a future crisis” referring to the still “relatively minor” impact of the crisis on pension finances and workers’ entitlements in countries where private pensions have been introduced recently (OECD, 2009c, p. 3). While disenchantment with pension privatization policies had begun well before the crisis even amongst previous supporters of such policies (see for instance World Bank, 2006) in response to shrinking coverage, eroding benefit levels and high fiscal cost, the crisis has provided the impetus for countries such as Argentina, Bolivia, Hungary and Poland to reverse some of their previous reforms. Further efforts are necessary, however, to strengthen appropriate guarantees which would ensure at least a minimum level of income security for workers. International labour standards provide essential guidance in this respect.

The crisis also had a wide effect on other types of social security schemes. Rising levels of unemployment, underemployment and an increasing informalization of employment have led to a contraction in contribution and tax revenues, and in consequence – unless appropriate provisions are made – have narrowed the scope of manoeuvre available to finance social security benefits at a time when these are most needed (see Orton, 2010). The crisis has highlighted the need to review social security policies and governance structures in order to ensure that the design and financial architecture of social security systems are conducive to ensuring sufficient stability and flexibility even during major shocks.

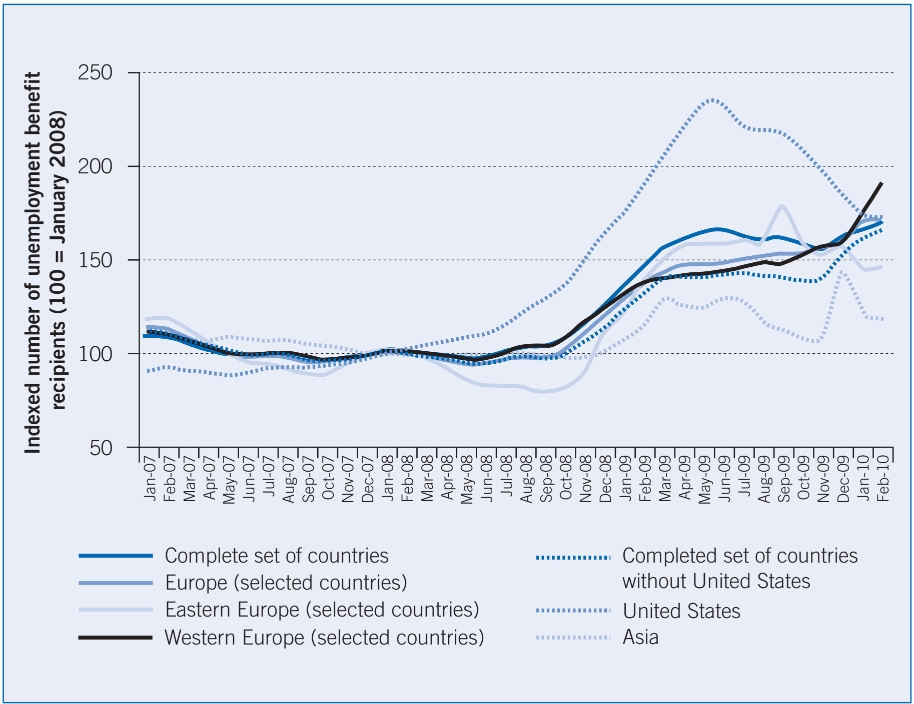
### *12.2.2 Recognition of social security as a social and economic stabilizer*

The second lesson of the crisis highlights the essential role of social security programmes as economic stabilizers, going beyond ad hoc crisis responses. While this function attracted much attention during the crisis, it is important to note that it is relevant not only during crises but as a permanent stabilizing element that can ensure balanced economic growth and social cohesion and facilitate adjustment to structural change. This view seems to have found wider support since the onset of the crisis, as demonstrated by the growing number of middle-income countries that are considering the introduction of unemployment insurance schemes, even though fiscal austerity measures may obstruct a systematic implementation of these policies in the short and medium terms.

In the wake of the crisis, the value of social security as an automatic economic and social stabilizer has been widely recognized in countries at all levels of development, as shown in a review of country responses to the crisis (ILO 2010f, pp. 112–16). Several examples describe how social security programmes were successfully used in different ways to alleviate the impact of the crisis on employment and incomes, to sustain aggregate demand and buffer economic growth. Such programmes played a strong role in the strategies of many OECD and G20 countries, which maintained social security programmes or even expanded them, or temporarily reduced contribution rates (ibid.; European Parliament, 2010). According to recent reviews some countries, including Italy, the Netherlands, Russian Federation, South Africa and the United States, allocated over 30 per cent of their fiscal stimulus packages to discretionary social protection expenditure (ILO, 2010m, p. 7).

The crisis has illustrated the critical importance of unemployment benefits in ensuring income security for workers (figure 12.3 highlights the increasing number of unemployed receiving unemployment benefits), facilitating job matching and skills upgrading in close coordination with employment services and other active labour market policies, and in stabilizing aggregate demand (see ILO, 2010f, pp. 106–12). Many countries have taken ad hoc measures to expand coverage, adjust benefit levels and extend the maximum duration of benefit payments. Such measures include relaxing eligibility conditions, increasing benefit levels and reducing contribution rates (ILO, 2010n, pp. 15–25). Unemployment schemes proved beneficial not only in OECD countries with traditionally well-institutionalized schemes, but also in countries whose unemployment insurance schemes have been introduced more recently and often as a response to previous crises, such as Argentina, Bahrain, Republic of Korea and Thailand (Prasad and Gerecke, 2009; Behrendt et al., 2009). Unemployment assistance programmes also played a critical role in ensuring a minimum level of income security for workers at the margins of the formal economy; these include the local programmes in Mexico and the programmes for fishers and domestic workers in Brazil. At present, however, statutory unemployment benefit programmes exist in only 78 out of 184 countries studied, and usually cover only some qualified formal employees. According to recent estimates, only 15.4 per cent of the unemployed are receiving some unemployment benefits, with

Figure 12.3 Number of unemployed receiving social security unemployment benefits, selected countries, 2007–2010 (weighted averages)



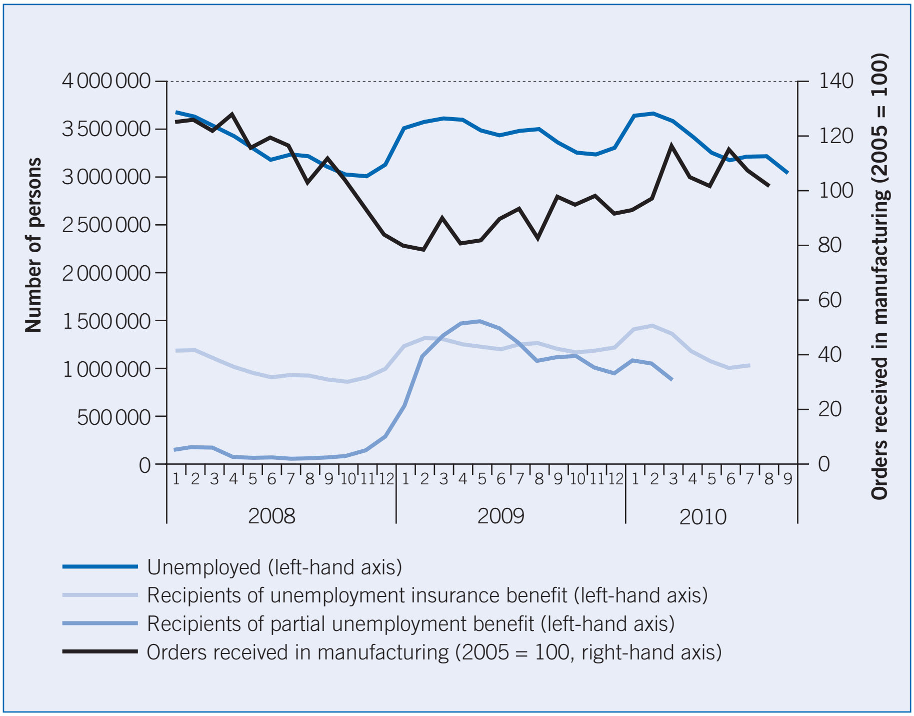

Note: The details and explanations are available in the source.
Source: ILO (2010f, figure 10.1).

about 1 per cent in the low-income countries and almost 40 per cent in the high-income countries (ILO, 2010f, p. 245).

Partial unemployment benefits also proved to be particularly helpful. By allowing a reduction in working time while at the same time maintaining income security for workers, these benefits helped workers and employers to maintain their employment relationship throughout the crisis (ILO, 2010o; ILO 2010f, pp. 107–10). They contained the rise in unemployment rates caused by the fall in demand, and enabled employers to react quickly as markets picked up again (see figure 12.4 for evidence from Germany).

While unemployment benefit schemes have attracted most attention as automatic stabilizers, other social security programmes play a similar role. For example, social assistance programmes prevent or alleviate vulnerability and poverty at the micro level, and a drop in aggregate demand at the macro level even though their effective outreach is sometimes

Figure 12.4 Germany: Partial unemployment benefits during the global crisis, 2008–2009, by month




Source: ILO (2011g), based on statistics from the German Federal Employment Agency and the National Statistical Office.

limited. The experience of Brazil (see Chapter 13 in this volume) illustrates the beneficial role played by social assistance programmes, together with other policies, in reducing poverty, boosting aggregate demand and stimulating broad-based growth. Programmes that facilitate access to health services can help to prevent situations where the loss of a job is coupled with loss of access to health services (through the loss of an employer-sponsored health insurance plan). Both types of programme are important elements of crisis response in the short run, but they also play a major role in preventing negative long-term effects of a crisis on people's health, well-being and perhaps also future productivity.

The crisis has once more confirmed that demand-strengthening crisis response strategies can be implemented much more quickly in countries where social security programmes, including administrative structures, are already in place and can be easily extended (Bonnet et al., 2010). The lack of effective programmes and institutional structures in many developing countries has further exacerbated pre-existing vulnerabilities (McCord, 2010). The importance of pre-existing structures has been demonstrated not only throughout the current global crisis, but also in earlier economic crises as well as in other kinds of crisis. For example, due to relatively broad social security coverage and access to health-care services, Sri Lanka after the tsunami in 2004 was able to confront at least some aspects of the situation more effectively than some other countries affected by that or similar natural disasters.

### *12.2.3 Opening a window of opportunity for the extension of social security*

The third lesson from the crisis stresses the opportunities arising from it. The crisis opened a window of opportunity to firmly anchor social protection policies in national economic and social development strategies as an essential component, and to harness the necessary international support for this matter. However, more intensive efforts are still necessary if sustainable political will is to be mobilized in creating the required fiscal space, primarily at the national level but also internationally.

National efforts to implement social protection policies as a key element of development strategies have been amplified since the crisis. Some prominent examples in middle-income countries include the conditional cash transfer programmes Bolsa Família in Brazil and Oportunidades/ Progresa in Mexico; recent pension and other reforms in Chile; the extension of effective access to health care and cash transfers in Thailand; and the high-coverage social grants programme in South Africa which includes non-contributory benefits for children, the disabled and the elderly (see ILO, 2010n). Similar efforts to introduce and extend social protection programmes have been undertaken or are under debate in a number of low-income countries too, including social pensions in Nepal and Timor-Leste, the extension of target cash social assistance ("food subsidy") in Mozambique and cash transfers in Zambia. Where effects on human development, poverty alleviation, employment and local economic development can be discerned, these have been largely positive (ILO, 2010p). While such efforts had already gained momentum before the crisis and were also reflected in a number of regional policy documents – such as the Livingstone Declaration in 2006, the African Union Social Policy Framework in 2009 and most recently the Yaoundé Tripartite Declaration on the Implementation of the Social Protection Floor in 2010 (see ILO, 2010q) – the crisis contributed to moving the issue higher on the international agenda.

All these efforts have gained international attention and support. Social protection is now widely accepted as a key element in national crisis response and prevention policies. This has been marked by the inclusion of the Social Protection Floor concept in the Global Jobs Pact (ILO, 2009d; UN, 2009) and as one of eight United Nations crisis response initiatives (UN-CEB, 2009). The Social Protection Floor Initiative of the United Nations, co-led by the ILO and the World Health Organization (WHO), promotes a set of guarantees aiming to ensure universal access to at least a nationally defined set of essential health-care services; at least a basic level of income security for children, older women and men and people with disabilities; and programmes for those in active age groups who are unable to earn sufficient income in the labour market. Several G20 documents have also highlighted the role of social protection as an element of national crisis response policies and of wider social and economic development.

## 12.3 POLICY IMPLICATIONS AND RESEARCH GAPS

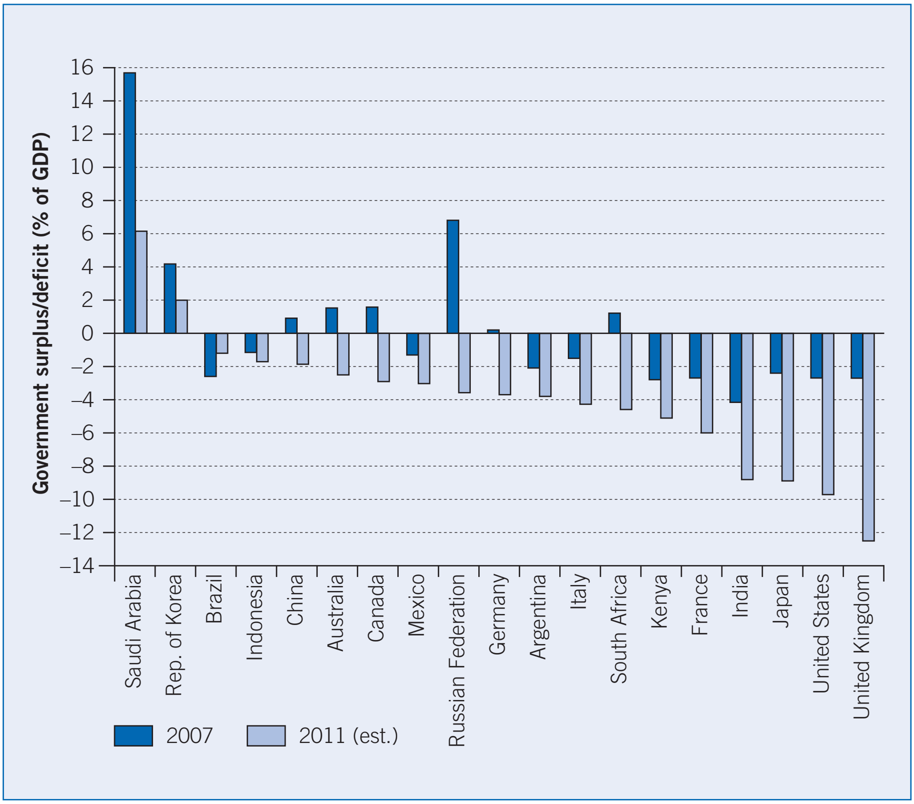
The lessons from the global crisis have several implications for future social security policies and for wider social and economic policies. The most fundamental is the call for a new global development paradigm focusing on income-led growth. The necessary change in policies is taking place in a context of widespread fiscal austerity which might obstruct the extension of social security. This requires a clear prioritization of social security needs in policy decisions at both national and international levels.

### *12.3.1 Prioritizing social security in the context of fiscal austerity*

The aftermath of the global crisis has left many countries with large and in some cases still growing government deficits. Estimates by the International Monetary Fund (IMF) show increasing levels of public debt in a majority of countries (see figure 12.5).

The surge in public deficits increases the pressure to contain public expenditure (IMF, 2010b). Obviously, social security expenditure is, in many countries, one of the targets of possible curtailments, along with public investments and public-sector wages. A premature consolidation of public expenditure may however lead to pro-cyclical contractions of demand and delayed investments in infrastructure, with negative effects on long-term growth and social cohesion. Such effects may be exacerbated in many countries by a structural bias in fiscal consolidation measures, which combine cuts in social security and labour market

Figure 12.5 Pre- and post-crisis levels of government deficit, selected countries (IMF estimates, percentage of GDP)




Source: ILO (2011g), based on IMF (2010h).

spending programmes with tax cuts for high-income earners and companies, negatively affecting low-income earners and the middle classes (IILS, 2010, pp. 57–75; Torres, 2010a). In many countries post-crisis fiscal consolidation is followed by temporary cuts in social spending, but also by measures aimed not only at cost-cutting but also at trimming down previously achieved levels of protection.

While there has been growing recognition of the need to prioritize social security spending and to increase the fiscal space for social security in many countries at all levels of development, the pressure on public budgets may close this window of opportunity prematurely. Some countries, however, have already embarked on large retrenchment measures in order to contain their public deficits (e.g. Greece, Ireland, United Kingdom), and others may follow.

Challenges arising from fiscal consolidation, demographic ageing and future economic downturns can be only partially addressed by changes in benefit design, eligibility conditions and financing mechanisms, which may weaken protection levels below the accepted standards. International experience has shown that a well-informed social dialogue can help to find, and agree on, solutions that ensure sustainable and adequate levels of protection.

The recognition of the need for effective social spending as a critical element of economic and social policies has to translate into appropriate policies at the national and international level. The increased pressure on public budgets may give way to a new wave of poorly balanced fiscal austerity measures which threaten to undermine the foundations of more balanced economic and social development (Ortiz et al., 2010; Zhang et al., 2010). The international financial institutions play a particularly important role in this respect. While in their policy statements the leaders of the IMF and World Bank have acknowledged the objectives of full employment and decent work and the need to better integrate economic and social policies, their institutions' policy recommendations at the international and country level do not necessarily keep pace.

In order to maintain or extend the fiscal space available for the promotion of policies conducive to income-led growth, more attention needs to be given to the structure of public expenditures and sources of revenue. Public expenditure reviews need to be focused more narrowly on the effectiveness and efficiency of allocated expenditure in reaching a country's strategic objectives and, if necessary, suggest a revision of spending priorities. What counts is not the level of social expenditure, but its efficient allocation so as to effectively achieve social outcomes. This puts a strong emphasis on policy design, coordination and coherence. A promising area for research in this context would be the role of rules, discretion and social dialogue in setting public spending patterns in the shorter and long run. To some extent, the analysis and sharing of good practice experiences can help policy-makers to develop new policy options adapted to the particular context.

Greater attention is also necessary to strengthen the domestic resource base available for the implementation of social policies, particularly with respect to enhancing the effectiveness, efficiency and equity of revenue collection. This is of particular relevance for middle-income countries, which are home to the majority of the world's poor (Sumner, 2010); and it also has important implications for national social and economic policies, as well as for international development policies.

### *12.3.2 Extending coverage and strengthening social security guarantees*

The lessons from the crisis call for a new development paradigm which reflects a more balanced understanding of the interdependency of economic and social development. The failure of the export-led growth model in a context of a fairly unchecked globalization has forcefully underlined the need to develop policies which would ensure that the benefits of globalization are more widely shared and more equitably distributed. While the export-led growth model has overemphasized export sectors and has depressed wages and incomes and exacerbated income inequality (WCSDG, 2004; IILS, 2008), a new development model should give more emphasis to domestic consumption supported by productive employment, fair wages and working conditions and adequate social protection.

A number of countries have moved towards income-led growth strategies during recent years, and already follow an income-led growth strategy with a strong social protection component. Brazil has followed a strategy of extending non-contributory social security benefits for the poor, combined with higher minimum wages. China has extended both contributory and non-contributory social security programmes in many provinces, and facilitated access to health care. Thailand's policy of granting universal access to health care and extending cash transfer programmes is equally notable, as are India's policy initiatives for the extension of social security benefits to unorganized workers. While it is too early for a full assessment, there is growing evidence that these policies have contributed to boosting resilience against the effects of the global crisis and have supported economic and social structural change. More systematic research on the role of social security in buttressing economic and social transformations in Africa, Asia and Latin America, as well as on earlier experiences in post-war and post-1989 Europe, would help to generate important lessons for other countries. In this context, more research assessing the long-term dynamic implications of investments in social security, especially in low- and middle-income countries, would help to ensure that such investments can be designed in the most effective and efficient way.

As a corollary to economic and labour market policies, income-led growth requires strong social security guarantees which can provide at least a minimum level of income security and access to social services, and thus contribute to achieving higher levels of health, education and productive employment in the short and medium term. These are at the core of the Social Protection Floor Initiative. Equally important is the protection of at least minimum adequacy standards and the gradual progression towards higher levels of protection in line with economic development. Together, these two aspects of the extension of social security – the "horizontal" dimension of extending coverage to all as reflected in the Social Protection Floor Initiative, and the "vertical" gradual progression towards higher levels of protection – represent the ILO's two-dimensional approach to the extension of coverage (ILO, 2011g). International social security standards play an indispensable – albeit often underestimated – role in setting internationally accepted benchmarks for social security.[2] In view of the key role of these standards in times of crisis and structural change, more research would be needed to assess their role in specific national contexts of acute crisis and structural change, and to develop proposals on how they can be applied more effectively.

Rights-based approaches to the extension of social security coverage are therefore necessary to underpin future economic and social development (Hagemejer, 2009). These go beyond the provision of safety nets, and require legislative foundations defining individual entitlements, clear and transparent eligibility criteria, and rights of appeal as well as adequate sources of funding. Such approaches are supported by policies driven by national strategies based on a broad social dialogue, and efficient institutional frameworks funded from reliable sources. In many developing countries, however, many of the new social protection programmes are still limited to pilot projects and temporary ad hoc support for which future funding perspectives, in particular with respect to incorporating these programmes into national policies, are uncertain. Further efforts are needed to ensure that these programmes become an integral part of national policies and budgets.

The design of future policies should take into account the growing evidence demonstrating the important role of social security in supporting the long-term development of countries, facilitating structural transition and change, cushioning the effects of economic downturns, letting all share the fruits of growth and globalization, reducing poverty and enabling social cohesion. The priority is to establish at least basic social protection to all in need everywhere.

[2] See for example the discussion on the practical application of such benchmarks in multi-pillar pension schemes in Drouin and Cichon (2009).

# INCOME-LED GROWTH AS A CRISIS RESPONSE: LESSONS FROM BRAZIL 13

*Janine Berg and Steven Tobin* *

## 13.1 INTRODUCTION

At the G20 meeting in Toronto in June 2009 the focus of policy-makers switched from emphasizing the need to continue fiscal stimulus measures to boost aggregate demand to the need to balance public budgets through austerity measures. In this respect, labour market and social policies – in particular wage policies and income transfers – were viewed as costly, and were thus to be avoided under the belief that a deterioration in public finances would jeopardize economic prosperity, rather than as a necessary tool for boosting aggregate demand to counter a recession.

Such an approach is ill-advised, given that labour markets continue to struggle in terms of both job quantity and job quality. Moreover, the experience of Brazil serves as an important case study in how income policies can play a critical role in mitigating an economic downturn, and how, rather than jeopardizing economic growth, they can drive economic recovery. In particular, the Government used social policies, wage and tax cuts to increase family incomes and prop up domestic demand, thereby allowing the internal market to compensate for the fall in exports suffered as a result of decline in external demand. As a result, the country's growth strategy shifted from the export-led, commodity-driven model that characterized the decade prior to the crisis, to a policy stance focused on boosting domestic sources of economic growth. This chapter shows how such a growth-cum-equity strategy was designed and implemented in Brazil. It also analyses the extent to which employment and social policies successfully contributed to overcoming the global crisis in Brazil.

* The authors are Employment Specialist, ILO Office in Brasilia and Senior Economist, International Institute for Labour Studies, ILO, Geneva, respectively.

## 13.2 BRAZIL BEFORE THE GLOBAL CRISIS

From 2001 to 2008 Brazil's economy grew at an average annual rate of 3.7 per cent, which, though not stellar, was a notable improvement over the lost decades of the 1980s and 1990s when the economy grew at an average annual rate of 1.6 per cent and 2.5 per cent respectively. This performance is in stark contrast to 1947–1980, when the economy grew at an average annual rate of 7.5 per cent while pursuing a strategy of import-substitution industrialization (ISI).

As in the rest of Latin America, the debt crisis of the 1980s led to a shift in development strategy away from ISI and towards external liberalization. In Brazil, this occurred in 1990 under the Collor administration. Import prohibitions and non-tariff barriers were removed and tariffs were reduced from an average of 32 per cent in 1990 to 13 per cent in 1995. Brazil's financial markets were also liberalized, by the removal of prohibitions on foreign investment in the stock exchange as well as the loosening of regulations on foreign financing of domestic firms. The Government also undertook drastic measures to ensure price stability in the wake of high inflation and in 1994 implemented the Real Plan, which was successful in reducing inflation to single-digit levels.

Financial liberalization resulted in a surge in portfolio investment that resulted in the appreciation of the real exchange rate. Unfortunately, this occurred at the same time as domestic companies were being exposed to foreign competition, after previously being protected under ISI. Domestic industries thus suffered from the high interest rates needed to attract capital investment and maintain the value of the exchange rate. From 1993 until the currency devaluation in January 1999, imports grew at an average annual rate of 18 per cent, compared with 3 per cent annual export growth, while the share of manufacturing in GDP plummeted from 27 per cent in 1990 to 17 per cent in 2000.

The Brazilian workforce underwent a difficult adjustment process. Unemployment increased from 6.4 per cent in 1992 to 9.7 per cent in 1999, while informality rose from 53.6 per cent to 56.1 per cent. From 1992 to 1999 annual formal job growth was a mere 1.3 per cent, whereas informal jobs grew at an average rate of 3.0 per cent annually.[1] Among formal jobs, growth was restricted to the service sector; from 1990 to 1999 there was an average annual formal job loss of 2.9 per cent in the mining sector, 8.0 per cent in the agriculture and fishing sectors and 1.9 per cent in

[1] Data from the PNAD household survey (Pesquisa Nacional por Amostra de Domicílios). Due to a methodological change, the data begin in 1992. There are no data for 2000 because it was a census year.

manufacturing.[2] In addition, the minimum wage fell in real terms – ending the decade at R$280 (measured in 2010 reais, approximately US$150) – and average real wages stagnated. As a result, labour's share in national income dropped by 5 percentage points during the decade, from 45 per cent in 1989/1990 to 40 per cent in 1999/2000 (IPEA, 2010).

With the arrival of the 2000s, the new economic model based on integration with the world economy was firmly in place. Following the devaluation of the real in 1999, and until 2005, the real exchange rate remained highly competitive, boosting exports and protecting domestic industries from import competition. The Brazilian labour market benefited from the new economic regime as new jobs were created, particularly in the export sector – where exports grew by 80 per cent between 2000 and 2008, driven by a boost in demand for commodities, especially from China – and in all other sectors of the economy as well. Indeed, from 2000 to 2008, 9.7 million formal jobs were created and formal job growth outpaced informal job growth by a three-to-one ratio,[3] reversing the trend of the 1990s.

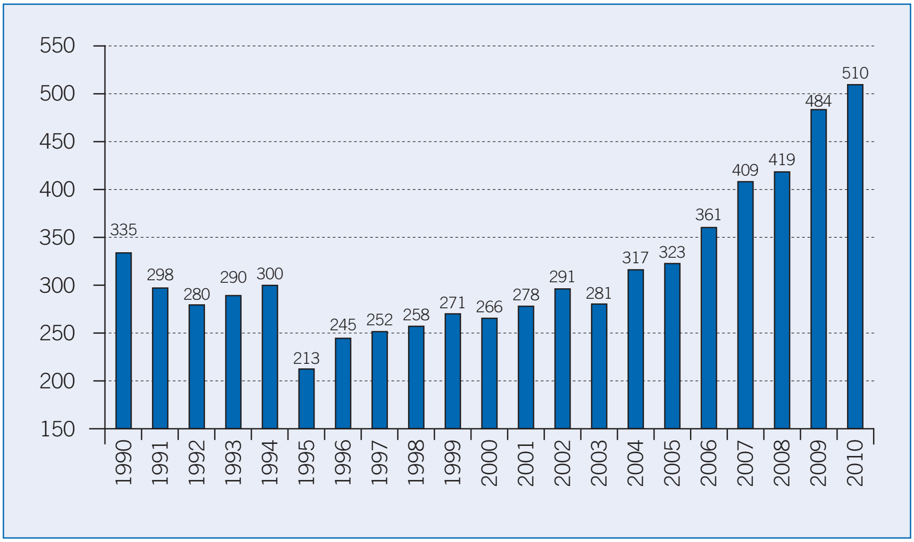
The economy also benefited from a boost in domestic consumption due to an increase in credit, and also because of inclusive wage and social policies. Beginning in 2003, the Government undertook a concerted policy effort to increase the value of the minimum wage; by 2008, its value had increased by 50 per cent in real terms (figure 13.1). The increase in wages coupled with strong job growth meant that labour regained some of its share in the national income, increasing to 43.6 per cent in 2008 from 40 per cent at the beginning of the decade (IPEA, 2010).

The minimum wage in Brazil plays a decisive role in boosting the incomes of workers at the bottom of the wage pyramid, who typically are not covered by collective bargaining. In 2008, 15.5 per cent of formally employed, private-sector waged workers earned the minimum wage, as did 16.1 per cent of informally employed waged workers. The minimum wage helped disadvantaged groups such as women, blacks and youths to earn higher salaries. The increase in the minimum wage has also played a critical role in the reduction in income inequality that took place over the past decade. Although still extremely high, the Gini index in Brazil fell from 0.59 in 1999 to 0.54 in 2008. Indeed, an analysis by Saboia (2007) of the

[2] The RAIS (Relação Anual de Informações Sociais) is a registry of formal establishments and jobs, administered by the Brazilian Ministry of Labour.

[3] Data on formal job growth are from the General Register of Employment and Unemployment (CAGED) administrative database of the Ministry of Labour. The data tracks workers who are covered under the CLT (Consolidação das Leis do Trabalho labour code dating from 1943) and excludes workers covered under public-sector work contracts (estatuario). Data comparing formal to informal job growth are from the PNAD household survey; the period studied is from 1999 to 2008, as 2000 was a census year.

Figure 13.1 Brazil: Real minimum wage (R$), 1990–2010




Note: Data are for February of each year, measured in January R$ 2010.

Source: DIEESE (Inter Trade Union Department of Statistics and Socio-Economic Studies), São Paulo, Brazil.

impact of the minimum wage on the reduction in inequality from 1995 to 2005 found that 64 per cent of the improvement in income inequality at the household level was due to increases in the minimum wage. In addition, the minimum wage is the reference value for a number of social programmes, including pension, disability and unemployment insurance benefits. Its increase during the 2000s significantly improved the living standards of low-waged workers while boosting aggregate demand in the economy.

Another important feature that characterized the 2000s was the development of a strong welfare state. With one of the highest levels of income inequality in the world and a purchasing power parity (PPP) US$1.25 poverty rate of 14 per cent in 1999, the Government took important steps to lower poverty and reduce inequality through the creation and expansion of a variety of social programmes. Though many of the programmes had been set forth in the 1988 Constitution, their implementation had been slow. Not until the 2000s did the programmes undergo a notable expansion in coverage and an increase in the value of the benefits. These programmes include the rural pension, the BPC (Prestação de Benefício Continuada) and the Bolsa Família conditional cash transfer programme (box 13.1).

In addition to social policies, there was growing recognition by the middle of the 2000s of the need to address bottlenecks arising from

### Box 13.1 Social programmes in Brazil

*Rural pension:* The rural pension accounts for 30 per cent of the benefits paid under the general pension system (Regime Geral de Previdência Social, RGPS). The programme provides a pension to rural workers upon meeting the retirement age, who can provide evidence of 15 years of rural activity. The number of beneficiaries has expanded significantly since the early 1990s, from 4.1 million in 1992 to 6.4 million in 2000 and 8.2 million in the first half of 2010. For 2010, this amounts to a transfer of approximately R$50 billion (1.6 per cent of GDP) to rural areas of the country that are typically the neediest.

*BPC (Prestação de Benefício Continuada):* The BPC is a social assistance programme that provides benefits equivalent to the monthly minimum wage to persons aged 65 or older, or to persons of any age who are unable to work due to disability, whose per capita household income is less than one-fourth of the minimum wage (the extreme poverty line). The BPC was the first social assistance programme started in the country on a national scale, beginning in 1996. In 2010, 1.6 million elderly and 1.8 million disabled households received benefits through the BPC. Total spending amounted to R$20 billion, equivalent to 0.6 per cent of GDP. The existence of the BPC and the rural pension has ensured a high level of pension coverage in the country – 85 per cent for persons aged 65 or older – approaching the level of Canada, at 90 per cent coverage, and exceeding that of the United States, at 74 per cent coverage (ILO, 2010f).

*Bolsa Família:* The Bolsa Família conditional cash transfer programme started in 2003 with the merger of four existing conditional and unconditional cash transfer programmes of the federal government. The aim of Bolsa Família is to reduce poverty and hunger and improve social development, by means of a direct income transfer to poor and extremely poor families. It also aims to break the cycle of intergenerational poverty by improving the well-being and skills of children so that they can overcome the social and economic barriers faced by their parents. Parents are required to maintain school-age children in school, have children vaccinated and, for women who are pregnant or breast-feeding, accept pre-natal and post-natal care. The programme has expanded rapidly from 3.6 million families in 2003 to 11.1 million in 2008 and 12.8 million in December of 2010, over one-quarter of the country's population. The value of the benefit varies according to the number of children in the family, and averaged R$97 per month (approximately US$60) at the end of 2010. The total programme cost in 2010 was R$14.4 billion, roughly 0.4 per cent of GDP.

poor infrastructure, as well as the need to stimulate domestic investment, which had been hovering at the low rate of 17 per cent of GDP for more than a decade. As a result, in 2007 the Government launched the Growth Acceleration Programme (Programa de Aceleração do Crescimento, PAC), with the aim of investing R$420 billion during 2007–2010 in energy, logistics and social and urban infrastructure. Although initial evaluations of the PAC during the target period estimate that only about half of the planned investments took place, the PAC nevertheless represents a substantial sum of funds dedicated to investment. More important, it is indicative of a paradigm shift in favour of a more active role of the State in investment, which can also be witnessed in the renewed interest given to industrial policy in the country. In 2004, the Government created the Brazilian Agency for Industrial Development (Agencia Brasileira de Desenvolvimento Industrial, ABDI), a semi-autonomous agency tasked with working with the private sector to support and develop leading sectors through productive investments.

## 13.3 THE GLOBAL CRISIS AND BRAZIL

Before the onset of the global crisis in 2008, Brazil's economic growth had been robust, averaging 4.4 per cent annually in real terms from 2004 to 2007 and 6.4 per cent (in accumulated growth) for the first three quarters of 2008. But the collapse of Lehman Brothers in September 2008 reverberated quickly across the globe, leading to a restriction in credit among private Brazilian banks and a sharp fall in the country's exports. As a result, fourth quarter GDP growth fell by 4.4 percentage points compared to the preceding quarter (seasonally adjusted) and there was a net loss of 634,000 formal jobs in the quarter, compared with a net gain of 10,400 formal jobs in the fourth quarter of 2007. The industrial sector was hit hard: production fell by 8 per cent in the fourth quarter of 2008, and between the months of November 2009 and March 2010, half a million formal manufacturing jobs were lost in the country.

The Government responded quickly to the crisis by injecting liquidity into the economy, through the establishment of credit lines for sectors experiencing difficulty and by increasing the resources of the National Economic and Social Development Bank (BNDES). It also guaranteed the maintenance of existing social programmes as well as the 6 per cent real minimum wage increase that had previously been negotiated. The Central Bank initiated, albeit slowly, a series of interest rate reductions in January 2009 that lowered the base interest rate, the SELIC, by 5 percentage points from 13.75 per cent to 8.75 per cent in September 2009. To directly mitigate the crisis, the Government also developed a fiscal stimulus package.

The stimulus package amounted to a US$20 billion injection into the economy in 2009,[4] equivalent to 1.2 per cent of Brazil's GDP, among the lowest amounts spent by G20 countries. As a result, the fiscal impact

[4] Calculated at the exchange rate of US$1 = R$1.8.

was limited, with the deficit estimated at 3.2 per cent of GDP in 2009. The main elements of the stimulus package were infrastructure investment (41 per cent) and tax cuts (35 per cent), followed by interest-rate subsidies to BNDES and the agricultural sector (15 per cent), extraordinary budget transfers to municipalities (5 per cent), extension of the Bolsa Família conditional cash transfer programme (2 per cent) and the extension of unemployment insurance benefits (1 per cent) (table 13.1). Infrastructure investments included an expansion of the PAC and a new housing programme, *Minha Casa, Minha Vida*, targeted at low- and middle-income households.[5]

Table 13.1 Components of Brazil's fiscal stimulus package

| Stimulus package | US$ billions | Percentage of GDP | Share of stimulus package (%) |
|---|---|---|---|
| Infrastructure | 8.3 | 0.51 | 40.3 |
| Increase in Growth Acceleration Programme (PAC) | 5.0 | 0.31 | 24.3 |
| Minha Casa, Minha Vida | 3.3 | 0.20 | 16.0 |
| Tax cuts | 7.6 | 0.40 | 36.9 |
| Subsidies | 3.1 | 0.20 | 15.0 |
| Agriculture | 2.2 | 0.14 | 0.7 |
| BNDES | 0.9 | 0.06 | 4.4 |
| Transfers to municipalities | 1.1 | 0.07 | 5.3 |
| Social protection | 0.5 | 0.03 | 2.4 |
| Expansion of Bolsa Família | 0.3 | 0.02 | 1.5 |
| Extension of unemployment insurance benefits | 0.2 | 0.01 | 1.0 |
| Total | 20.6 | 1.21 | 100 |

Source: IILS (2011b), table 2.1.

The stimulus package reflected the development agenda of the Lula government with its emphasis on consumption and investment as the drivers of economic growth. Consumption would be boosted by the reduction in the personal income tax rates of middle-income households as well as the reduction in the industrial products tax (IPI) on motor vehicles and appliances. To stimulate investment and counter the tightening of credit of the private banks, the Government capitalized BNDES,

[5] For a detailed analysis of the Government response to the crisis, see IILS (2011b).

providing subsidies on loans and developing special lines of credit for specific sectors, some of which were also made available through the two other public banks, the Banco de Brasil and the Caixa Econômica Federal. In addition, the Government directed additional funds to the construction of public infrastructure, which served to ease transport bottlenecks, provide social goods such as housing and create jobs.

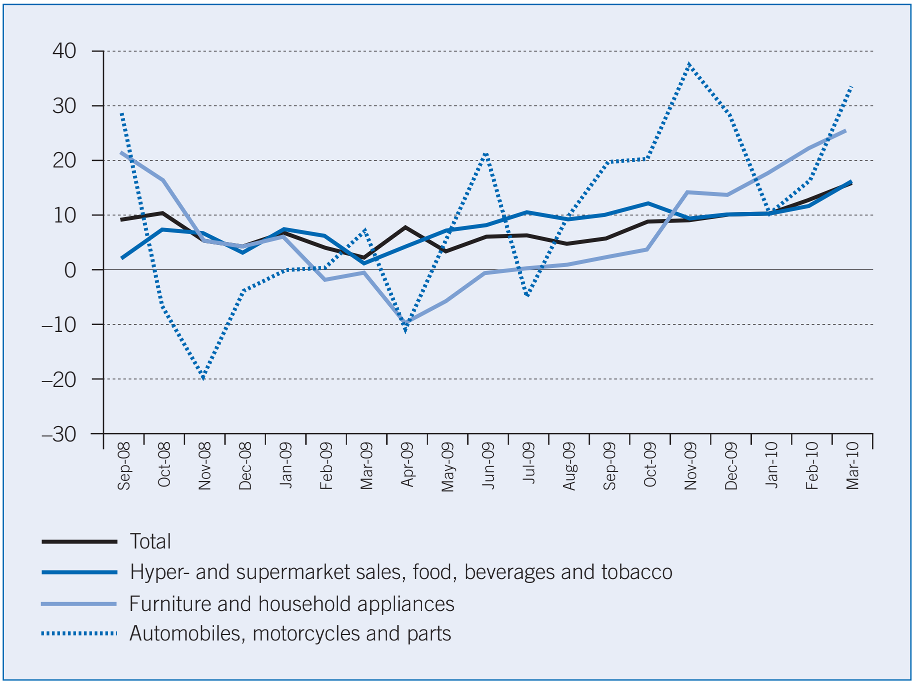
As Brazil had managed to establish an extensive social protection system during the 2000s, further investments in social protection did not figure prominently in the package. Nevertheless, the Government went ahead with its previously planned extension of the Bolsa Família programme by raising the eligibility ceiling to include an additional 1.3 million households and adjusting the benefit value to account for cost-of-living increases. The Government also enacted a limited, two-month extension of unemployment insurance benefits to workers whose sector of economic activity was severely affected by the recession. This measure benefited approximately 310,000 people.

The decision to maintain the increase in the monthly minimum wage to R$465 (a 6 per cent increase in real terms) in February 2009 and again in January 2010 (to R$510 per month, a 5.7 per cent increase in real terms) raised the incomes of wage-earners at the bottom of the pay scale, as well as the incomes of pension and BPC beneficiaries.[6] According to Jaccoud (2009), 64 per cent of pension benefits are set at the minimum wage, such that an increase in the minimum wage translates directly into an increase in pension benefits.[7] Similarly, benefits paid under the BPC are also tied to the minimum wage. As a result of its impact on wages and social benefits, the February 2009 minimum wage increase led to a direct injection of R$21 billion (0.7 per cent of GDP) into the economy in 2009. The indirect effects of this measure were also considerable. Based on a 2006 social accounting matrix (SAM) constructed by the Instituto de Pesquisa Econômica Aplicada (IPEA), each additional R$1 spent on the RGPS has a multiplier effect of 2.1 on family income and of 1.2 on GDP. The BPC programme, which is limited to families in extreme poverty, has a multiplier effect of 2.2 on family income and 1.4 on GDP, whereas Bolsa Família has a multiplier effect of 1.4 on GDP and 2.3 on household income (IPEA, 2010).

[6] In 2006 the Government, following consultation with representatives from workers' and employers' organizations as well as representatives of retirees, set out the terms of yearly minimum wage increases through 2011.

[7] Pensioners who receive benefits that are above the minimum wage also benefited from the increase but at a lower rate. The increase was not automatic and had to be approved by Congress, though the increase was given retroactively to the date of the increase of the minimum wage.

Figure 13.2 Brazil: Retail sales, year-over-year changes, September 2008–March 2010 (percentages)

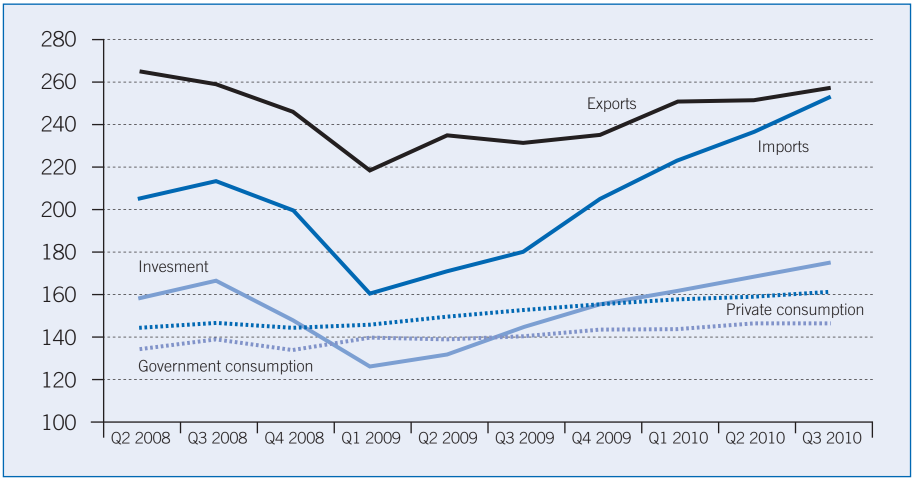



Source: Pesquisa Mensal de Comércio (PMC)/ Instituto Brasileiro de Geografia e Estatistica (IBGE), Brazil.

The strategy to boost consumption through wage increases, social transfers and tax cuts proved successful. Private consumption, which accounts for more than 60 per cent of GDP, dipped slightly in the fourth quarter of 2008, remained flat in the first quarter of 2009, and by the second quarter had begun to climb again. Throughout the global crisis, total retail sales remained positive. Sales of non-durable consumer goods grew robustly as a result of the increased purchasing power of the poorer segments of the population; sales of consumer durables, which depend on the middle class, fell at the beginning of 2009 but then recovered strongly by the middle of the year (figure 13.2).

Thus, despite a 0.6 percentage drop in GDP in 2009, private consumption continued to rise due to the fiscal policies implemented to respond to the crisis as well as to the wage and social policies that were already in place and were further enhanced. As Schettini et al. (2010) demonstrate in their empirical analysis of fiscal multipliers and consumption

Figure 13.3 Brazil: GDP by component, Q2 2008–Q3 2010 (1995 = 100)




Source: Central Bank of Brazil.

from 1995 to 2009, a 1 per cent reduction in taxes or a 1 per cent increase in social transfers is associated with a 0.46 per cent increase in family consumption. The strategy was therefore important for increasing aggregate demand through its largest component – private consumption.

By shifting policy towards consumption, the Government mitigated the effects of the fall in exports and investment associated with the international crisis, over which the country had little control. In the first quarter of 2009, for example, imports, exports and investment suffered a fall of roughly 15 per cent compared with the same quarter of the previous year. In contrast, private and government consumption – which account for over 80 per cent of GDP – remained relatively stable over the period of the crisis (figure 13.3).

Most important, the ability to harness consumption for the benefit of the economy lay in the survival and continued presence of an important domestic manufacturing base. Although Brazil experienced some de-industrialization as a result of trade liberalization in the 1990s, there remains a sizeable manufacturing sector that accounts for the production and sale of most consumer goods, especially those aimed at the lower and middle-class segments of the population. For example, in 2007 the average Brazilian owned 11.6 kilos of clothing, nine kilos of which were produced domestically. Imports have grown steadily since liberalization and there is a negative trade balance in the sector, yet sales continue to be largely domestic (da Costa and da Rocha, 2009). Moreover, automobiles, appliances and computers, though dependent on imported inputs, are primarily domestically produced. This differs radically from other Latin American countries whose manufacturing sectors were dismembered with trade opening, as in the case of Chile for example.

The existence of an important manufacturing base meant that the increase in income was directed primarily towards the purchase of domestically produced goods, as opposed to leaking out of the economy for the purchase of imports. Indeed, policies to boost income and consumption had important multiplier effects on the economy, boosting employment as well as incomes. For example, a study by IPEA (2009) calculated that each R$1.00 spent on cars has a multiplier effect of R$3.76 on aggregate output. With an estimated 25 jobs (direct and indirect) generated for each R$1 million spent on cars, the IPI cut is estimated to have contributed to maintaining between 50,000 and 60,000 direct and indirect jobs in the Brazilian economy in the first half of 2009 (IPEA, 2009).

## 13.4 CONCLUSIONS

In responding to the global crisis, the Brazilian Government intensified the shift in its economic model that had been slowly coming to fruition during the 2000s. The crisis made apparent the fact that Brazil could not rely solely on exports, especially of commodities, for its economic development. Development, rather, lay within its own borders, through income policies that boosted the purchasing power of the lower and middle classes and created a demand for goods and services, coupled with investment policies to improve physical infrastructure, synergizing business and advancing the progress of leading sectors. Such a response also took into consideration important multiplier effects, especially with regard to job creation. Indeed, enhanced social transfers are estimated to have led to an injection of US$30 billion into the economy and created (or saved) potentially 1.3 million jobs (Mostafa, 2010).

This strategy shift was facilitated by the existence of several key pre-crisis institutions. These include (i) an extensive social safety net – especially when compared with other middle-income countries – that combines traditional social security programmes with social assistance, and which was able to be ratcheted up to mitigate the effects of the crisis; as well as (ii) the existence of three important public banks, including the BNDES, which promote investment and which were able to counter the fall-off in liquidity from Brazilian private banks at the beginning of the crisis.

Brazil's success in using income policies to mitigate the effects of the international crisis demonstrates that a trade-off need not exist between economic and social goals; on the contrary, well-designed income policies promote economic growth while improving the living standards of the population.

PART V

# REBALANCING GLOBALIZATION

# THE TRADE AND FINANCIAL CRISIS IN INDIA AND SOUTH AFRICA 14

*David Kucera, Leanne Roncolato and Erik von Uexkull**

## 14.1 INTRODUCTION

The role played by trade as a transmission channel of the global financial and economic crisis was unprecedented and has been referred to as "the great trade collapse" (Baldwin, 2009a). As Baldwin writes, "For most nations in the world ... this is not a financial crisis – it is a trade crisis" (ibid., p. 12). That global trade would have fallen alongside global output is unremarkable. Yet real global output is estimated to have declined by 2.2 per cent in 2009 and real global trade by 12.2 per cent (World Bank, 2010b; WTO, 2010). The fact that global trade decline was over five times greater than global output is remarkable, and was unforeseen by most economic analyses at the onset of the crisis.

The ex post facto efforts of a number of economists to come to terms with the causes of the "great trade collapse" resulted in an edited volume of this name (Baldwin, 2009b). Baldwin's introductory chapter argues that there is an emerging consensus on the importance of the "compositional effect" and the "synchronicity effect". The "compositional effect" describes how the demand shock associated with the crisis focused on "postponeable" consumer durable and investment goods, including electrical and non-electrical machinery, transport equipment, chemicals, steel and other metal products and raw materials. Since these goods make up a much larger share of traded goods than GDP, a given change in the demand for them would have a much larger effect on trade than on

* The authors are Senior Economist, Policy Integration Department, ILO, Graduate student, American University and Economist, Employment Sector, ILO, Geneva, respectively. The authors are very grateful to Marion Jansen, who suggested this research, and Julia Urhausen for providing EU trade data.

GDP. The "synchronicity effect" describes how the expansion of global production networks – characterized by just-in-time supply of intermediate inputs – caused the effects of falling export demand to be rapidly transmitted across borders.

World trade began to recover in late 2009, and data from the World Trade Organization (WTO) show a real growth of 13.5 per cent in 2010 (WTO, 2010). It might be thought in this regard that studying the effects of trade contraction in the crisis is of only passing concern. However, the crisis in the labour market is far from over. According to the latest ILO data (ILO, 2011f), global unemployment, which increased by nearly 30 million persons in 2009, remained largely unchanged in 2010. The crisis is also found to have halted a long-run trend of reduction in vulnerable employment, and to have led to an increase in the number of working poor (below US$1.25 per day) of around 40 million persons. Youth unemployment, although declining slightly in 2010, is still way above its pre-crisis level. Of even greater concern is the increase in the number of discouraged youth that leave the labour force, at the risk of becoming a "lost generation" facing great difficulties in eventually reintegrating into the labour market.

Furthermore, even short-lived shocks may have irreversible consequences, so-called "scarring effects". This is all the more evident in countries such as India and South Africa where large numbers of people have limited means to cope with temporary losses of work and income. Such losses may mean that some families are unable to keep their children in school, lowering long-run educational attainment in the country (ILO, 2010r), or that they may even fail to provide them with food and health care. Friedman and Schady (2009) estimate that the global crisis increased the number of infant deaths in Africa by 30,000–50,000, mainly due to malnutrition. According to the Food and Agriculture Organization (FAO, 2009), the effects of the crisis increased the number of undernourished people by another 95 million on top of the effect of the food price crisis in 2007–08, with severe risk of permanent negative health effects. Even for non-poor people, permanent effects of a crisis can arise, for example through mortgage foreclosures or the inability to maintain premium payments for social insurance (Cameron, 2010). There is also evidence that the trade collapse weakened the bargaining positions of workers as well as of developing country governments with respect to natural resource concession agreements, both having potential long-run implications (Jansen and von Uexkull, 2010). More generally, studying the effects of the trade shock can provide a fuller appreciation of the potential costs associated with greater trade openness, which policy-makers can set against the potential gains from trade.

The policy responses of the Governments of India and South Africa to the global crisis differed in scale and scope, partly reflecting the different challenges these countries faced (Kucera et al., 2010). For example, real GDP in India grew by 5.7 per cent in 2009, down from 9.4 per cent in 2007 and 7.3 per cent in 2008, but still respectable nonetheless. In contrast, real GDP shrank in South Africa by 1.8 per cent in 2009, compared to growth rates of 5.5 per cent in 2007 and 3.7 per cent in 2008 (IMF, 2010a).

In terms of employment, however, the two countries faced similar challenges, as suggested by the employment growth rates for the first quarter of 2010, less favourable in both countries than for the fourth quarter of 2009. For India, the average monthly growth rate of employment was 1.7 per cent in the fourth quarter of 2009 but only 0.2 per cent in the first quarter of 2010, for the eight industries surveyed (Government of India, 2010). For South Africa, the quarter-to-quarter growth rate of employment was 0.7 per cent in the fourth quarter of 2009 after three quarters of negative growth, but was -1.3 per cent in the first quarter of 2010 (Statistics South Africa, 2010). Thus, the Governments of both India and South Africa continue to face the pressing challenge to create more employment.

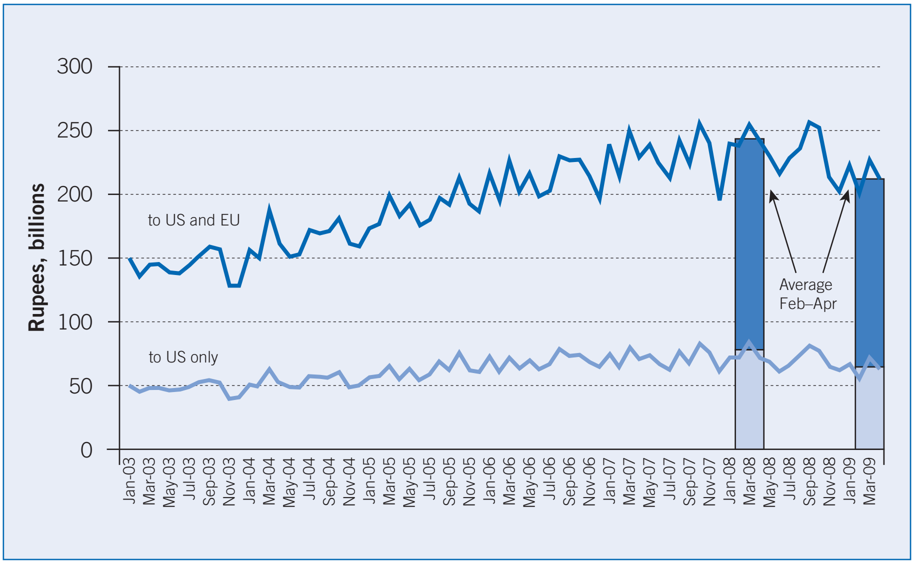
In this chapter, we estimate the effects of trade contraction in the global crisis on employment in India and South Africa, using social accounting matrices (SAMs) in a Leontief multiplier model. We evaluate employment effects in both tradeable and non-tradeable sectors as well as the gender bias of these effects, and also evaluate income effects for rural and urban households by income quintiles.

## 14.2 DATA AND METHOD

Due to the limited availability of high-frequency export data at a detailed industry level for India and South Africa, our analysis is based on mirror data on imports from the two countries for the European Union (from Eurostat) and the United States (from the US International Trade Commission). These are important markets for Indian and South African exports and so they provide a useful if partial account of the effects of the crisis through trade contraction. Regarding South Africa, the point is made by Marais, who writes, “Ultimately, a recovery depends primarily on developments in South Africa’s main trading partners in Europe and North America” (2009, p. 3).

Shown in figures 14.1 and 14.2 are exports (at constant prices) from India and South Africa to the European Union and United States from January 2003 to April 2009. For India, there was a substantial decline in

Figure 14.1 Indian exports to the European Union and United States, 2003–2009 (in 2003 Rupees)

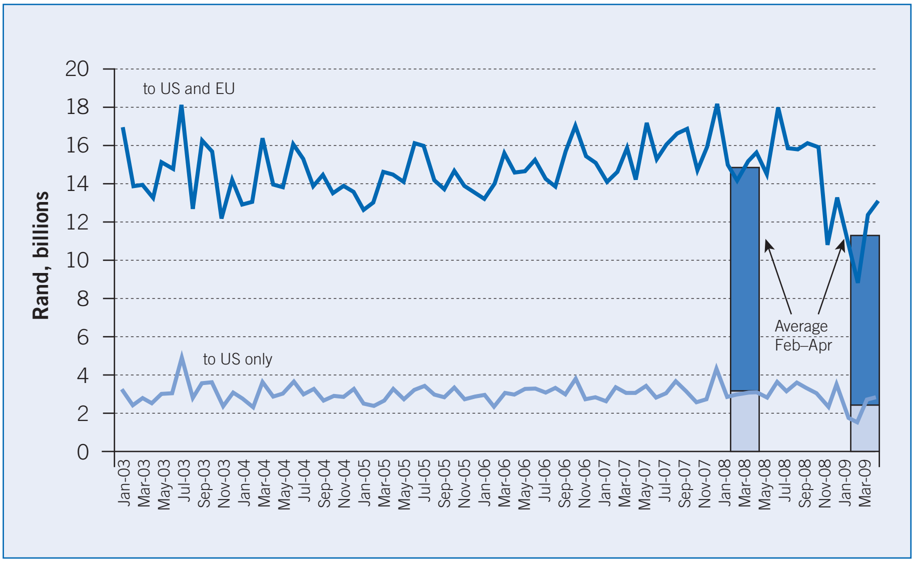



Source: Authors' calculations based on Eurostat and USITC data.

exports from early 2008 on, driven more by trade with the United States; for South Africa, the decline was even sharper, driven more by trade with the European Union. These differences in export patterns with respect to the European Union and United States are reflected, as we shall see, in our employment results. The trade data we use for the European Union and United States do not include trade in services. From 1990 to 2006, trade in services increased as a percentage of GDP from 3 to 15 per cent in India and 5 to 10 per cent in South Africa (World Bank, 2009). While global trade in services during the crisis has been referred to as "the collapse that wasn't", service exports did decline substantially for India, though not as much as merchandise exports (Borchert and Mattoo, 2009; Kumar and Alex, 2009). In this sense, our analysis underestimates the total effects of trade contraction in the crisis. It does, however, address the indirect and income-induced effects of falling merchandise exports on service industries, which turn out to be substantial. For the sake of expediency, we define tradeable goods industries as those for which we have trade data and define all other industries as non-tradeable, including service industries (see Kucera et al., 2010 for detailed definitions).

A social accounting matrix (SAM) is a representation of national accounts showing the two-way flows of economic transactions in a

Figure 14.2 South African exports to the European Union and United States, 2003–2009 (in 2000 Rand)




Source: Authors' calculations based on Eurostat and USITC data.

country. SAMs for India and South Africa – for 2003–04 and 2000, respectively – are used in a Leontief multiplier model to estimate the effects of the 2008–09 trade contraction. The analysis was conducted using both Type I and Type II multipliers. Type I multipliers address the direct effects of trade contraction on employment as well as indirect effects through forwards and backwards production (input–output) linkages. In addition to these direct and indirect effects, Type II multipliers address income-induced effects resulting from changes in household expenditures.

For employment, the Leontief multiplier model is defined as:

$$\mathbf{L} = \hat{\mathbf{E}}\,[(\mathbf{I}\text{-}\mathbf{A})^{-1}\,\mathbf{T}],$$

where,

**L** = the vector of changes in industry-level employment associated with the changes in trade, expressed as full-time equivalent (FTE) jobs lasting one year,
**Ê** = the diagonal matrix of industry-level labour coefficients (employment per unit of output),
**I** = the identity matrix,
**A** = the average propensity to spend matrix, and
**T** = the industry-level export demand vector.

**T** is constructed in two ways. **T1** is defined for each industry as the difference in exports between early 2008 and early 2009, coinciding with the "great trade collapse". More specifically, **T1** represents the annualized difference in exports between the three-month period from February to April of these years, shown by the shaded bars in figures 14.1 and 14.2. Because industry values for **T1** are mainly negative, using **T1** in the Leontief multiplier model yields estimates of what we define as "jobs lost" during the crisis as a result of trade contraction.

**T2** is constructed by assuming that, were it not for the crisis, exports would have continued to grow at the same rate to February–April of 2009 as they had in previous years. We base this on industry-level export growth for the years 2004–06 and exclude the years 2007–08 to filter out possible effects of commodity and food price shocks during this latter period. **T2** is then defined for each industry as the annualized difference between this hypothetical level of endpoint exports and actual exports in February–April of 2008. As with **T1**, industry values for **T2** are for the most part negative, resulting from most industries' favourable export growth prior to the crisis, particularly in India. In this sense, using **T2** in the model yields estimates of what we define as "jobs not created" during the crisis as a result of trade contraction.

Results are presented according to two scenarios based on **T1** and **T2**:

- Scenario A refers to estimated "jobs lost" (based on **T1** by itself).
- Scenario B refers to the estimated sum of "jobs lost" and "jobs not created" (based on **T1** plus **T2**).

Imports into India and South Africa also declined during the period we evaluate, and so results based on **T2** could be regarded as gross jobs not created rather than net jobs not created. We therefore regard scenario A results as more accurate and rely more on them in our discussion.

## 14.3 COUNTRY-LEVEL EMPLOYMENT RESULTS

In developing countries with extensive informal employment and underemployment, the estimation of changes in employment via changes in production is not straightforward. This holds particularly for India, where, as of 1999–2000, the vast majority of workers were in the "unorganized" sector – 77 per cent in urban areas and 95 per cent in rural areas (Sakthivel and Joddar, 2006). In this sense, what we refer to as employment declines represented in terms of FTE jobs may in many cases translate into movements from formal into informal employment or increases in underemployment. In any case, our results provide a measure of the negative impact for workers on average through some combination of job loss and income loss.

Country-level employment results based on Type II multipliers are presented in absolute and relative terms in table 14.1 for scenarios A and B, respectively. This table shows the number of FTE jobs and the number of such jobs as a percentage of the SAMs base year employment, broken down between trade with the European Union and United States and between what we define as tradeable goods and non-tradeable industries.

For India, taking trade with the European Union and United States together, employment declines are estimated to be 3.9 million FTE jobs for all industries based on scenario A and 10.1 million based on scenario B – equivalent to 1.1 and 3.2 per cent of base year (2003/04) employment. Trade contraction during the crisis is estimated to have resulted in 3.9 million "jobs lost" and an additional 6.2 million "jobs not created", as we have defined these. The large estimate for "jobs not created" reflects the rapid growth of exports from India prior to the crisis. Employment declines are driven more by trade with the United States than with the European Union. Estimated employment declines for non-tradeable industries are substantial, even though these do not include direct trade effects for these industries. These are equivalent to 17.6 and 19.1 per cent of estimated employment losses for all industries based on scenarios A and B respectively.

For South Africa, taking EU and US trade together, employment declines for all industries are estimated to be 886,000 FTE jobs based on scenario A and 963,000 based on scenario B. The trade contraction is estimated to have resulted in 886,000 "jobs lost" and an additional 77,000 "jobs not created". Though absolute employment declines are much lower for South Africa than for India, relative declines are much higher, equivalent to 7.2 and 7.8 per cent of base year employment based on scenarios A and B respectively. In contrast with India, employment declines are driven more by trade with the European Union than with the United States. Estimated employment declines for non-tradeable industries are also relatively higher for South Africa, equivalent to 41.3 and 42.5 per cent of estimated employment declines for all industries based on scenarios A and B respectively.

How important were income-induced effects versus direct and indirect effects in accounting for these findings? For India, taking EU and US trade together, the share of total employment effects resulting from income-induced effects is about one-half for tradeable goods industries, two-thirds for non-tradeable industries and one-half for all industries;

Table 14.1 Country-level employment effects from trade, India and South Africa (Type II multiplier)

| Country | India | | | South Africa | | |
|---|---|---|---|---|---|---|
| Trade with | European Union | United States | European Union & United States | European Union | United States | European Union & United States |
| Scenario A | | | | | | |
| *Number of jobs (FTE)* | | | | | | |
| Tradeable goods industries | -1 163 804 | -2 088 266 | -3 252 070 | -354 302 | -166 124 | -520 426 |
| Non-tradeable industries | -195 327 | -496 734 | -692 061 | -266 992 | -99 068 | -366 060 |
| All industries | -1 359 131 | -2 585 000 | -3 944 131 | -621 294 | -265 192 | -886 486 |
| *Number of jobs as a % of SAMs base year employment* | | | | | | |
| Tradeable goods industries | -0.46 | -0.82 | -1.28 | -8.30 | -3.89 | -12.19 |
| Non-tradeable industries | -0.19 | -0.48 | -0.66 | -3.32 | -1.23 | -4.56 |
| All industries | -0.38 | -0.72 | -1.10 | -5.05 | -2.16 | -7.21 |
| Scenario B | | | | | | |
| *Number of jobs (FTE)* | | | | | | |
| Tradeable goods industries | -3 741 618 | -4 400 303 | -8 141 920 | -369 835 | -183 822 | -553 657 |
| Non-tradeable industries | -845 412 | -1 076 805 | -1 922 217 | -298 954 | -110 290 | -409 245 |
| All industries | -4 587 030 | -5 477 108 | -10 064 137 | -668 789 | -294 113 | -962 902 |
| *Number of jobs as a % of SAMs base year employment* | | | | | | |
| Tradeable goods industries | -1.47 | -1.73 | -3.20 | -8.66 | -4.31 | -12.97 |
| Non-tradeable industries | -0.81 | -1.03 | -1.84 | -3.72 | -1.37 | -5.09 |
| All industries | -1.28 | -1.53 | -2.81 | -5.44 | -2.39 | -7.83 |

Source: Authors' calculations.

for South Africa, the comparable shares are about one-third for tradeable goods industries, two-thirds for non-tradeable industries (essentially the same as for India), and just over 40 per cent for all industries (see Kucera et al., 2010 for detailed results).

Trade patterns for India and South Africa provide some support for the importance of a "compositional effect" as described by Baldwin (2009b). For example, the three industries with the greatest drop in exports to the European Union and United States (taken together) can be classified as "postponeable" consumer durable and investment goods (Kucera et al., 2010). These are the same three industries in both countries: iron, steel and non-ferrous metals; non-electrical machinery; and miscellaneous manufacturing (the last including jewellery and precision instruments). However, not all industries fit neatly into this pattern, for there were increases in exports of chemicals for both India and South Africa, and large declines in exports of agriculture and manufactured food products for India.

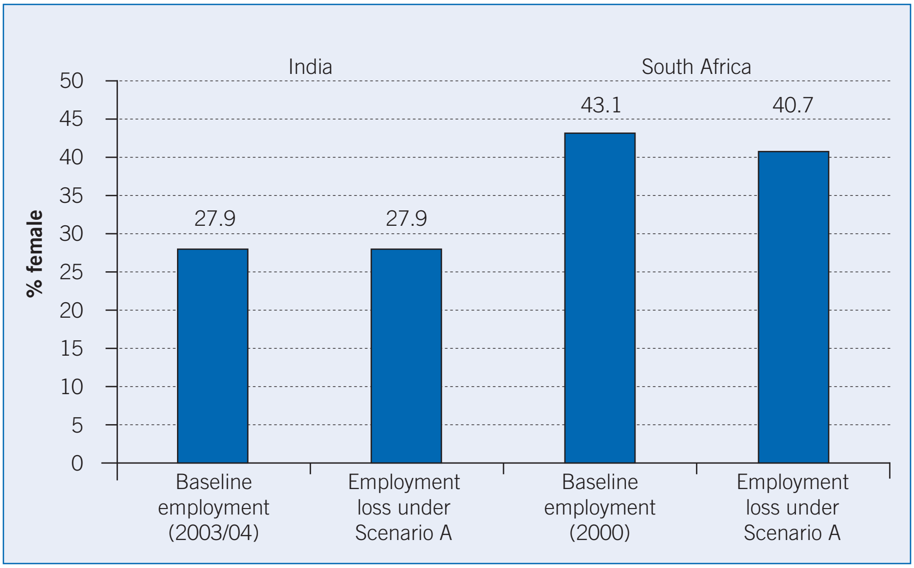
In sum, we estimate that India and South Africa experienced sizeable employment declines as a result of trade contraction with the European Union and United States during the 2008–09 global crisis, even based on our more conservative scenario A. In India and especially South Africa, a large share of these employment declines occurred in non-tradeable industries through indirect and income-induced effects originating from tradeable goods industries. Income-induced effects also accounted for sizeable shares of estimated employment losses in tradeable goods industries.

## 14.4 GENDER BIAS RESULTS

We evaluate the extent of gender bias by comparing the percentages of female workers in the SAMs base years with the percentages of female workers estimated to have lost jobs as a result of trade contraction in the crisis. Breakdowns between male and female workers are based on the assumption that employment changes are proportionate to actual shares of employment in the SAMs base years. [1]

[1] For example, if trade contraction is estimated to have resulted in a loss of 500 jobs in an industry in which one-fourth of workers are female, then the 500 jobs are broken down into 375 male and 125 female jobs. Thus, we assume that employers do not make distinctions by gender in the face of employment changes, maintaining the same proportions of men and women workers. This is, of course, a rather strong assumption, and there is a literature on how firms' hiring and firing patterns may differ for men and women workers over economic fluctuations (for example Rubery, 1988). In this sense, a precise interpretation of our results on gender bias is that they illustrate whether industries in which women workers are disproportionately represented are particularly affected by job loss as a result of trade contraction in the crisis.

Figure 14.3 Gender bias from trade contraction, India and South Africa, all industries, scenario A (percentage female)




Source: Authors' calculations.

Results are shown in figure 14.3, based on scenario A for all industries and for EU and US trade together. Regarding gender bias for India, an identical percentage of women workers, 27.9 per cent, is estimated to have lost jobs as the actual percentage of women workers in 2003–04. That is, the employment effects of the crisis through the channel of trade contraction are estimated to be gender neutral.

For South Africa a somewhat lower percentage of women workers is estimated to have lost jobs than the actual percentage of women workers in 2000, 40.7 to 43.1 per cent. For the economy as a whole, then, there is a gender bias in favour of women workers as a result of trade contraction in the crisis. That is, industries in which women were disproportionately concentrated were less affected by the decline in exports to the European Union and United States. Though the difference of 2.4 percentage points is not large, it is consistent with the results of two prior studies assessing the overall effect of the crisis on employment in South Africa using labour force survey data (Leung et al., 2009; Verick, 2010).

In the context of the gender results, the "compositional effect" (Baldwin 2009b) may come into play. A potential explanation of the observed gender patterns is the different representation of women and less-educated workers in "postponeable" consumer durable and investment goods industries. For example, the percentage of female and less-educated workers is lower than average in the non-electrical machinery and iron, steel and non-ferrous metal industries in both India and South Africa.

In sum, for India we estimate that there was no gender bias in employment effects resulting from trade contraction in the crisis. In South Africa, there was a small gender bias in favour of women workers. The result on gender bias in favour of women workers during the crisis is usefully set against an earlier study's findings of gender bias against women workers during the period of trade liberalization from 1993 to 2006 (Kucera and Roncolato, 2011). An important determinant of the gender bias against women workers prior to the crisis was the large numbers of jobs lost in the clothing industry as a result of trade expansion with developing countries, combined with the high share of women workers in the industry. In this sense, the gender bias observed in South Africa as a result of the 2008–09 trade contraction represents a break from the earlier trend.

## 14.5 INCOME INEQUALITY RESULTS

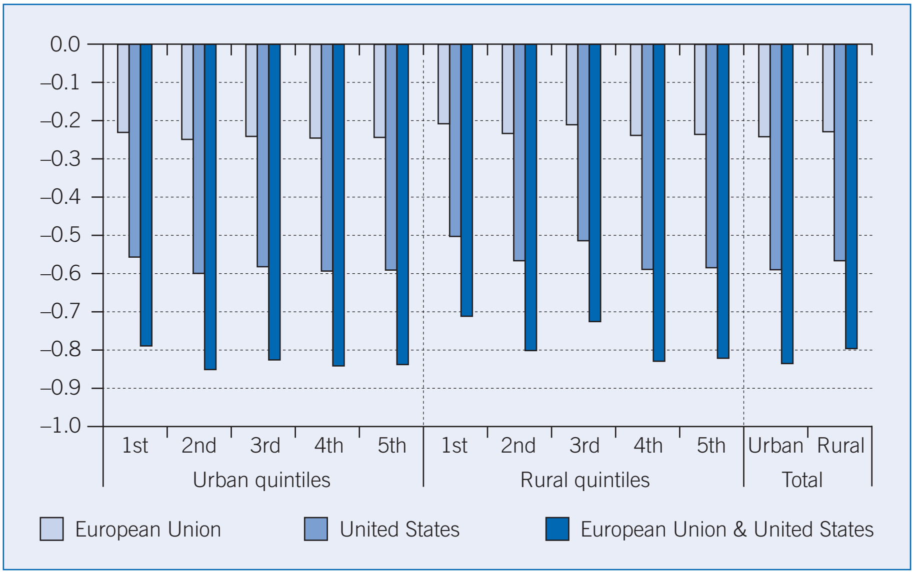
Shown in figures 14.4 and 14.5, for India and South Africa, respectively, are the estimated impacts of trade contraction on household income distribution relative to SAMs base year incomes, based on scenario A.[2] Breakdowns are shown within urban and rural areas by household income quintiles as well as for between urban and rural areas more broadly, and between EU and US trade.

For India, there is little difference between rural and urban areas for households within these areas, with trade contraction with the European Union and United States estimated to have reduced income by around 0.7 to 0.8 per cent relative to 2003–04 income. Consistent with employment results, income effects are driven more by trade with the United States than the European Union.

For South Africa, there is also little difference between rural and urban areas. But the effects of trade contraction on incomes are consistently weaker for lower income quintiles, indicating that world trade acted to reduce income inequality in the sense that poorer households lost less. For the poorest income quintiles, trade contraction with the European Union and United States is estimated to have reduced incomes by 3.1 per cent in rural areas and 3.6 per cent in urban areas, relative to

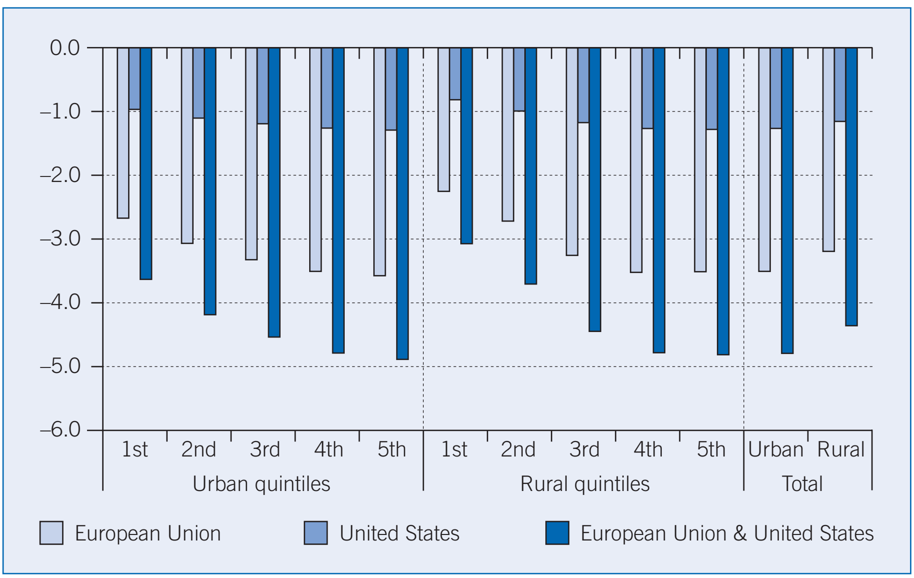
[2] Cf. Kucera et al. (2010) for scenario B results. These are similar to scenario A results in terms of distribution, but are higher by factors of about 2.5 for India and 1.1 for South Africa. The larger difference for India results from its more rapid export growth prior to the crisis.

Figure 14.4 Impact of trade contraction on incomes by urban and rural household income quintiles, India, scenario A (percentage of 2003–2004 income)




Source: Authors' calculations.

Figure 14.5 Impact of trade contraction on incomes by urban and rural household income quintiles, South Africa, scenario A (percentage of 2000 income)




Source: Authors' calculations.

2000 income; for the wealthiest income quintiles, the respective figures are 4.8 and 4.9 per cent. Consistent with employment results, income effects are driven more by trade with the European Union than with the United States. Worth remarking is the similar effect in rural and urban areas of trade contraction on household incomes.

## 14.6 CONCLUSIONS

This chapter finds that declining exports to the European Union and United States during the "great trade collapse" had a substantial negative effect on employment in India and, more so, South Africa. This development caught off guard many policy-makers, who had reasonably focused their concerns on financial transmission channels. The magnitude of trade contraction during the crisis arguably resulted from "compositional" and "synchronicity" effects, manifestations of our current wave of globalization are very much at odds with the notion of "decoupling".

The effects of trade contraction swept widely across these countries. The vast majority of industries are estimated to have experienced employment declines as a result of trade contraction, in both tradeable and non-tradeable sectors (see Kucera et al., 2010 for detailed results) and households in rural and urban areas were similarly affected by income losses. Even though the shock originated in the tradeable goods sector, a large share of total estimated employment declines result from ripple effects in non-tradeable industries. Moreover, a large share of estimated employment declines is income-induced, which has an important policy implication: stabilizing household incomes, in addition to its social benefits, can be an effective means of reducing job loss.

The importance of trade as a transmission channel has particular bearing on countries such as India and South Africa that have rapidly opened up to international trade in recent years. International trade is arguably a necessity for developing countries aiming to narrow the technology gap with developed countries, as it enables them to earn foreign currency and purchase foreign technology. Yet the global crisis reveals how greater trade openness can be a source of vulnerability in a volatile global economy, presenting a significant challenge to policy-makers. A common theme in many studies of the impact of the global crisis (as discussed in the introductory section of this chapter) is that even temporary shocks can have significant and lasting social and economic consequences, including malnourishment and increased infant mortality, declines in educational achievement and withdrawal from labour market participation. This underlines the importance of accompanying policies to cushion the volatility that comes with greater trade openness and in particular to protect vulnerable members of society. Strong social protection and active labour market policies have proven to be effective tools for governments to address these challenges.

This chapter also illustrates the value of using a SAMs-based Leontief multiplier model to estimate the employment effects of a short-term trade shock. Because of its relative simplicity, the method can help to design timely policy responses in an environment of great uncertainty, as created by the 2008–09 global crisis. Due to this simplicity and the transparency of underlying assumptions, results are well suited for informing non-specialist audiences and policy-makers. Despite its limitations, the model may be appropriate for analysing short-term shocks as more complex computable general equilibrium (CGE) models are typically designed to simulate dynamic adjustment processes to longer-run changes in the structure of trade.

# APPENDIX

## *Data sources*

**Trade data.** European Union: Eurostat; United States: US International Trade Commission (USITC). Monthly import data from India and South Africa at the Harmonized System (HS) eight-digit level.

**Social accounting matrices.** India: Saluja, M. R.; Yadav, B. 2006. *Social accounting matrix for India 2003–04* (Haryan, India Development Foundation); South Africa: Thurlow, J. 2005. *South African social accounting matrices for 1993 and 2000* (Washington, DC, International Food Policy Research Institute).

**Employment data (including by gender).** India: National Sample Survey Organisation (NSSO). 2006. *National Sample Survey: Employment-Unemployment NSS 61st Round, July 2004–June 2005* (New Delhi, Government of India National Sample Survey Organisation); South Africa: Statistics South Africa (Stats SA). 2003. *Revised estimates Labour Force Survey September 2000* (Pretoria, Statistics South Africa).

# THE ROLE OF INTERNATIONAL LABOUR STANDARDS IN REBALANCING GLOBALIZATION: A LEGAL PERSPECTIVE

# 15

*Eric Gravel, Tomi Kohiyama and Katerina Tsotroudi**

## 15.1 INTRODUCTION

The recent global economic and financial crisis and its socioeconomic costs are not an unprecedented challenge for the ILO. In the years following its creation in 1919, the ILO emerged from the Great Depression and the Second World War with a renewed mandate to "examine and consider all international economic and financial policies and measures in the light of [its] fundamental objective" – namely, to find sustainable solutions to poverty and social exclusion through the promotion of social justice within and among countries and the prevention of what was later to be labelled *social dumping* (ILO, 1944, para. II(d); Maupain, 1997, p. 582). This objective has been pursued through the ILO's main comparative advantage: the promotion of social dialogue in the form of tripartism and the adoption of international labour standards.

The more recent process of globalization has brought to centre stage the same concerns that had led to the Organization's establishment, while at the same time calling into question the relevance of its standards-setting action. The celebration of the ILO's 75th anniversary in 1994 sparked off a series of reforms. A global minimum social floor was advanced through a landmark instrument, the ILO Declaration on Fundamental Principles and Rights at Work, 1998, which aimed at promoting the rights and principles reflected in the ILO's eight fundamental Conventions and boosting their ratification levels.

* The authors are Senior Legal Officers at the International Labour Standards Department of the ILO, Geneva.

Nevertheless, while the essential role of international labour standards in achieving a fair globalization has received staunch support from ILO constituents, particularly through the adoption of the ILO Declaration on Social Justice for a Fair Globalization in 2008 and the Global Jobs Pact in 2009, the global crisis has brought to the forefront a number of questions, including the following: are ILO member States translating their commitments to the ILO and its standards into concrete action? Is the ILO sufficiently responsive to its Members' needs and is it assisting them effectively in taking the measures that are commensurate with the ongoing challenges?

This chapter answers these questions through an examination of three topics: the role of international labour standards in the context of the global crisis, as demonstrated in the work of the ILO supervisory bodies; current trends in the protection of workers in the informal economy; and labour provisions inserted into preferential trade arrangements.

## 15.2 INTERNATIONAL LABOUR STANDARDS IN THE CONTEXT OF THE CRISIS

International labour standards are part of the solution to the crisis, as widely acknowledged by the ILO constituents during the discussions which led to the adoption of the Global Jobs Pact, 2009. The Pact emphasizes the essential role of standards in preventing a downward spiral in labour conditions and building the recovery, notably by maintaining social cohesion and a global social floor (ILO, 2009c, para. 14). The minimum safeguards in the context of the crisis include the fundamental Conventions on freedom of association and collective bargaining, non-discrimination, forced labour and child labour; as well as the ILO instruments concerning employment policy, wages, social security, the employment relationship, the termination of employment, labour administration and inspection, migrant workers, labour conditions on public contracts, occupational safety and health, working hours and social dialogue mechanisms (ibid.).

The tripartite Committee on the Application of Standards (CAPP) – one of the cornerstones of the ILO supervisory system that functions as a standing Committee of the International Labour Conference – emphasized in 2009 that the crisis must not be used as an excuse for lowering standards; that there could be no sustainable economic recovery without sustainable and up-to-date labour standards; that treaty obligations, voluntarily undertaken, were to be fully respected and that ensuring respect for fundamental principles and rights at work results in undeniable benefits to the development of human capital and economic growth in general and, more particularly, to global economic recovery (ILO, 2009e, para. 97). This statement was echoed by the G20 leaders in their Pittsburgh Summit Statement. [1]

Against this background the adoption of a new instrument, which would have established guiding principles and policies to deal with preventive crisis action and effective crisis responses, was contemplated in 2010 as a possible standard-setting option (ILO, 2010s, para. 806). The CAPP decided not to move forward on such an option, thus confirming that priority should be given to the effective application of existing standards in line with the guidance provided in the Global Jobs Pact, and that the role of the ILO supervisory system is key in this regard.

This is not the first time that the ILO supervisory bodies have commented on the application of standards in situations of crisis and austerity. The Committee on Freedom of Association (CFA), a tripartite body entrusted with the examination of complaints alleging infringements of freedom of association principles, has a long record of decisions on the need to align structural adjustment programmes with collective bargaining structures and agreements. The CFA has spelled out the fundamental principles which should underlie any austerity package if international commitments under the ILO Constitution and ratified Conventions on freedom of association and collective bargaining are to be respected:

> If, as part of its stabilization policy, a government considers that wage rates cannot be settled freely through collective bargaining, such a restriction should be imposed as an exceptional measure and only to the extent that is necessary, without exceeding a reasonable period, and it should be accompanied by adequate safeguards to protect workers' living standards. (ILO, 2006, para. 1024)

The CFA has also emphasized that, in any case, a limitation on collective bargaining on the part of the authorities should be preceded by consultations with the workers' and employers' organizations in an effort to obtain their agreement; and that consultations should aim at ensuring that the public authorities seek the views, advice and assistance of employers' and workers' organizations, particularly in the preparation and implementation of laws and regulations affecting their interests (ibid., paras 999 and 1068).

[1] "We agree that the current challenges do not provide an excuse to disregard or weaken internationally recognized labor standards. To assure that global growth is broadly beneficial, we should implement policies consistent with ILO fundamental principles and rights at work." (G20, 2009, para. 43).

This guidance resonates well with the Global Jobs Pact, which provides that the success of measures to avoid wage deflation crucially depends on ensuring respect for core workers' rights and building the capacity of the social partners for dialogue and agreement-making.

### *15.2.1 Risk of social regression*

The Committee of Experts on the Application of Conventions and Recommendations (CEACR) is the ILO supervisory body that carries out legal examinations of the extent to which national laws and practices conform to international labour standards, and reports thereon to the International Labour Conference. The CEACR's immediate response to the crisis was to adopt a general observation on the application of the ILO social security standards, in which it emphasized the need to avoid the risk of social regression in the context of the crisis. It also emphasized that governments must manage the skyrocketing levels of budgetary deficit in such a way as not to endanger the social guarantees of the population and that measures taken by governments to salvage private providers could not be taken at the expense of cutting the resources available to public social security schemes (ILO, 2009e).

Two years later, the CEACR noted that, in 2010, several European countries took an abrupt turn away from the stimulus measures adopted in consultation with the social partners during the early part of the crisis towards austerity plans aimed at addressing public debt and budget deficits and enhancing fiscal consolidation.[2] The CEACR concluded:

> it appears that in some cases the imperative need to achieve fiscal consolidation has not been balanced with sufficient concern for the social and human costs of such rapid austerity measures. Not only social cohesion will be put at risk, but in such conditions, the economic recovery may be accompanied by a prolonged "human recession". One should also remember that governing only by financially oriented criteria may lead to an undermining of social justice and equity. Public opinion is much less ready to accept drastic austerity measures if it sees that the efforts requested are not equally distributed and shared by everyone. (ILO, 2011h, para. 567)

Although the comments of the CEACR concern the social security Conventions in particular, the austerity measures may also impact on the application of several other instruments. In Greece, for instance, the Greek trade unions submitted to the CEACR urgent observations alleging violations of no less than 12 ratified Conventions. Faced with this challenge, the CEACR had a choice between pursuing its traditional

[2] For instance in Germany, Greece, Iceland, Ireland, Latvia and the United Kingdom.

approach of making comments on the conformity of national law and practice with ratified Conventions, or taking a more innovative path consisting of an engagement in constructive dialogue aimed at assisting the country to honour its commitments while facing the challenge of fiscal consolidation. In its 2011 report, the CEACR invited the Government to avail itself of ILO technical assistance in the form of a High Level Mission, so as to facilitate a comprehensive understanding of the issues before examining the impact of the austerity measures on the application of the ratified Conventions (ibid., pp. 584–585).

The approach of the CEACR in this case has been in line with the integrated strategy pursued over the last few years on the basis of the decisions taken by the ILO Governing Body (see for example ILO, 2009f). This strategy consists of taking advantage of synergies among all standards-related means of action, including technical cooperation, in order to strengthen the standards system and promote the effective application of international labour standards on the ground.

For such a strategy to succeed, two conditions must be met. First, it is necessary to draw upon the technical competencies of the Office as a whole with a view to offering cutting-edge technical advice and realistic policy options within the framework of ratified Conventions. Second, the obligations voluntarily undertaken under the ILO Constitution and ratified Conventions, as well as the comments of the supervisory bodies on their application, should provide the necessary legal mandate and framework for the ILO to engage in dialogue with international institutions having a leading role in this domain, notably the International Monetary Fund (IMF) and the European Union (EU).

### *15.2.2 The crisis: A catalyst for progress?*

In some instances noted by the ILO supervisory bodies, the global crisis has functioned as a catalyst for progress, consolidating certain advances (sometimes initiated prior to the crisis) in the framework of efforts to overcome the negative effects of the global economic downturn. Notable examples emanate from developing and emerging countries, some of which have distanced themselves from the structural adjustment policies they had previously pursued.

For instance, with regard to the Employment Policy Convention, 1964 (No. 122), the CEACR noted the countercyclical measures adopted by the Government of **Brazil** (see Chapter 13 in this volume). The CEACR and the CAPP have taken note of similar measures adopted in **Argentina, China, India, Mexico** and **Turkey** (ILO, 2010s, paras 53, 63 and 620; ILO, 2011h, pp. 516, 603–606; ILO 2009g, p. 124).

The CEACR also took note of stimulus measures and active labour market policies adopted by industrialized countries, especially during the first stage of the crisis (**Austria, Canada, France, Germany, Italy, Japan, New Zealand** and **United States**; see ILO, 2010s, paras 560, 582, 584, 589–91). And in its 2011 General Survey, the CEACR noted that in several countries (**Belgium, Chile, Germany, Japan, Netherlands, Nigeria, Singapore, South Africa**), governments involved the social partners in the shaping of stimulus packages to mitigate the impact of the global economic downturn on workers and enterprises and to accelerate recovery (ILO, 2011h, para. 553).

In its 2010 General Survey, the CEACR, while taking note of policies pursued in the framework of Convention No. 122, requested the ILO Members concerned to evaluate their effectiveness and indicate their impact on the promotion of full, productive and freely chosen employment. The CEACR has also emphasized in its comments under Convention No. 122 that social dialogue is essential in normal times and becomes even more so in times of crisis. The employment instruments require member States to promote and engage in genuine tripartite consultations (ILO 2010s, para. 794). An important caveat is to ensure that such measures benefit the more vulnerable and marginalized segments of society in line with both Convention No. 122 and the Discrimination (Employment and Occupation) Convention, 1958 (No. 111). This issue is also addressed in the context of informal economy in the next section.

The examination by the ILO supervisory system of crisis response measures and their impact is ongoing, since it is based on a periodic reporting mechanism. This offers an opportunity to develop, over time, a global assessment of the extent to which crisis response measures correspond to the international commitments of member States under ratified Conventions.[3]

Despite the broad consensus on the relevance of international labour standards in addressing crisis situations and on the need for effective supervision to ensure their sound implementation on the ground, the ILO supervisory mechanisms are confronted with an unprecedented challenge: the European models of industrial relations and social protection – which, since the inception of the ILO and its standard-setting system, were often looked upon and replicated in the developing world – are now being reconsidered and, in some cases, fundamentally reorganized. At the same time, developing countries are offering new and innovative examples of how the application of international labour

[3] In its forthcoming sessions, the CEACR will examine information on the application of Conventions Nos 94, 95, 131 and 173 on income security by ratifying States (ILO, 2010t, pp. 32–35).

standards can be taken forward in a globalized world. This is particularly important in countries with large informal economies, as will be discussed in the following section.

## 15.3 THE PROTECTION OF WORKERS IN THE INFORMAL ECONOMY: CURRENT TRENDS

It is a daunting task to get a precise estimate of the size and dynamics of the informal economy, since definitions, concepts and measurements can differ. However, a recent study has estimated that informal employment comprises about 78 per cent of non-agricultural employment in developing Asia, 52 per cent in Latin America and 56 per cent in Africa (with substantial variation between North Africa and sub-Saharan Africa) (ILO and WTO, 2009). Jobs in the informal economy often fail to meet the criteria of decent work: workers have low incomes, low job security, no social protection and fewer possibilities for access to formal education and training. Countries with large informal economies are more than three times as likely to incur the adverse effects of the crisis as those with lower rates (ibid., p. 10), and this was evident in the present crisis.

The belief that workers in the informal economy are outside the scope of application of international labour standards is a common misconception (ILO, 2010u, p. 9). The fact that international labour instruments may not be widely applied in practice in the informal economy does not mean they are not relevant to it (ibid., p. 81). Several Conventions and Recommendations have provisions referring specifically to the informal economy, while a number of ILO instruments apply explicitly to "workers" rather than the legally narrower term "employees", or do not contain language limiting their application to the formal economy (Trebilcock, 2004, p. 590). For instance,

> ILO fundamental Conventions on freedom of association (Nos. 87 and 98) explicitly state that all workers (including those in informal economy) without distinction enjoy the fundamental rights which flow from freedom of association. Thus, workers in the informal economy have the right to organize and engage in collective bargaining (where there is an employer). They may freely establish and join trade unions of their own choosing for the furtherance of their occupational interests and may carry out their trade union activities (elections, administration, formulation of programmes) without intervention from the public authorities. Most importantly, they have the right to represent their members in various tripartite bodies and social dialogue structures. (ILO, 2010u, pp. 58–59).

Since 2002, when a conceptual framework of employment in the informal sector was presented to the International Labour Conference in the context of a discussion on decent work and the informal economy (ILO, 2002, p. 25/53, para. 2), the ILO's supervisory bodies have systematically addressed issues relevant to the informal economy. The CEACR has formulated comments concerning freedom of association, discrimination and labour administration, in particular with regard to the scope of application of the relevant instruments. But most of the Committee's comments relate to the Conventions on child labour and, to a lesser extent, employment policy. Under Conventions Nos 138 and 182, it has systematically pointed out to governments that the situation of children working in the informal economy deserves special attention; and that Convention No. 122 provides that measures taken in relation to employment policy should take fully into account the experience and views of the social partners, including the opinions of those working in the rural sector and the informal economy, with a view to securing their full cooperation in formulating and implementing employment policies (ILO, 2010u).

Moreover, in its 2010 General Survey on employment instruments (ILO, 2010s), the CEACR made a comprehensive review of the policies governments have adopted towards the informal economy, noting that most countries stated that they had policies targeted towards the informal economy, women, youth, older workers, people with disabilities and migrants.

The CAPP has for its part emphasized in recent years the importance of a cooperative framework between the ILO and its member States to deal with the informal economy's lack of labour rights protection. It has insisted on the need for labour inspectors to be better trained to enhance communication with the informal economy's actors, and has stressed the need to collect better statistical data related to this sector (ILO, 2010u, p. 42). Further, "those who work in the informal economy may bring a complaint to the CFA if they feel that their freedom of association rights have been infringed by their government (or by a person and their government has not taken the necessary measures to ensure the free exercise of freedom of association)" (ibid., p. 59). Complaints relating to issues linked to the informal economy have already been submitted to the CFA in recent years (including in cases relating to Argentina, Guatemala and El Salvador) (ibid., pp. 60–62).[4]

[4] All these laws and regulations addressing informality of workers can be consulted on the ILO database on national labour and related human rights legislation (NATLEX).

## 15.4 LABOUR PROVISIONS IN PREFERENTIAL TRADE AGREEMENTS: ADDRESSING KNOWLEDGE GAPS

Labour provisions in preferential trade arrangements are increasingly anchored in ILO standards, and some envisage a contribution from the Organization to their implementation. The proliferation of such provisions – involving not only North–South trade agreements but also a growing number of agreements between developing and emerging economies (Ebert and Posthuma, 2010, pp. 3 and 19; IILS, 2009b, p. 77) – could potentially provide important leverage towards the realization of the ILO's objectives and the strengthening of its standards system and related technical assistance. The ILO was a pioneer in responding to the first significant manifestations of the trade and labour link in the context of globalization (ILO, 1994, p. 1), but its contribution to the rich analytical work that has been carried out within other fora has been, on the whole, limited.

### *15.4.1 Gaps in knowledge base and research*

Regarding the issue of labour provisions in trade arrangements, three interrelated gaps in information and analytical work are apparent. Until they are filled, it is unlikely that there will be any conclusive evidence of the impact of labour provisions in trade arrangements, and in particular, of whether such provisions might contribute to limiting the adverse effects of the crisis on workers' rights and conditions, including those in the informal economy.

*Knowledge base.* A key problem relates to the difficulties inherent in gaining access to the relevant information stored in various national and international sources, including websites. What is needed is a comprehensive, reliable and user-friendly knowledge base into which up-to-date information on these trade-related labour provisions is regularly fed. Such a knowledge base could be used by States in their trade negotiations, thereby ensuring that trading partners have equal access to information. It could also be used by the social partners and other representatives of civil society, who are playing an increasing role in monitoring the implementation of the respective labour provisions. The ILO has recently created a portal on free trade agreements and labour rights as a first contribution to addressing the aforesaid knowledge gaps.

*Analysis of the nexus of trade-related labour provisions and ILO standards.* The coherence of trade-related labour provisions with the ILO standards has not so far been analysed. Any determination of coherence would require an examination of the terms of such provisions (and their relationship with other provisions in the trade arrangement) in light of the ILO Constitution and the provisions of the Conventions ratified by the member States concerned. Such an analysis could contribute to exploring synergies between ILO standards and trade-related labour provisions. This might in the long run also imply coordination between diverse (and perhaps diverging) labour provisions contained in different trade arrangements to which one country may be subject (IILS, 2009b, p. 78).

In the case of trade agreements that envisage a dispute settlement mechanism for labour matters and whose labour provisions refer to ILO Conventions, the question arises as to which forum should be seized with the alleged violations of the ILO Conventions set out in the agreement: the ILO constitutional supervisory system or the trade dispute settlement mechanism? Four considerations appear relevant in this respect. First, as a matter of principle, it would not be acceptable for a trade advantage enjoyed by an ILO Member to be withdrawn for alleged failure to observe its obligations under ratified Conventions without the ILO having had the opportunity to express its views on the matter (ILO, 2007, p. 34). Second, under the ILO Constitution, a member State may be obliged to have recourse in the first place to the ILO supervisory system to determine whether another Member has failed to observe a Convention that they have both ratified, regardless of the context in which the allegations of non-observance have arisen. Third, because the implementation of ILO Conventions gives rise to problems of considerable diversity and complexity, time and expertise are required. ILO Members would need to consider whether it would be more cost-effective to have recourse to the well-established procedures and expert bodies of the ILO, rather than to an ad hoc body. Indeed in most cases, the issues arising from the non-observance of ILO Conventions will already have been closely analysed by the ILO supervisory bodies before being raised under trade arrangements. Fourth, there is the important issue of transparency: while the analysis of the supervisory bodies ultimately becomes public, it is not clear whether the various formulas used in the trade arrangements would provide the same. Thus, it remains to be seen if and to what extent the information concerning the first labour-rights-related dispute under a regional trade agreement (the United States–Guatemala labour rights dispute under the Dominican Republic-Central America-United States Free Trade Agreement filed in July 2010) will be made available to the public.

*Evaluation of the impact of trade-related labour provisions.* The impact of trade-related labour provisions on national labour rights and conditions has been studied. However, most articles and reports are based on case studies or anecdotal evidence, rather than offering a systematic impact assessment or making international comparisons (Ebert and Posthuma, 2010, pp. 22–23; CARIS, 2010, p. 153). For this purpose, further reflection about the appropriate tools and methodology is essential. Adequate recourse to the findings of the ILO supervisory bodies should be considered where the relevant Conventions have been ratified. The methodology to measure progress towards the full application of fundamental rights at work, currently developed in the ILO, could become a relevant tool for the purpose of this evaluation. It would also seem important to combine the economic analysis with legal evaluations to achieve a meaningful assessment. In general, careful consideration will have to be given to certain methodological constraints. For instance, many trade arrangements involving labour provisions are quite recent. In contrast, the achievement of progress in labour legislation and practice takes time. In a number of cases, it will therefore be necessary to wait for a reasonable period before it is possible to assess the impact of the respective labour provisions. Another issue relates to the difficulty of isolating the impact of labour provisions from other important factors, such as foreign policy considerations and domestic politics. These issues constitute the parameters within which the ILO, and particularly its supervisory bodies, have worked for many years in assessing and monitoring progress in the full implementation of international labour standards and which could serve as an inspiration for a possible future assessment of the impact of trade-related labour provisions.

### *15.4.2 Legitimacy and authority of the ILO in addressing these gaps*

The ILO's role in relation to trade-related labour provisions was raised during the preparatory work for the adoption of the ILO Declaration on Social Justice for a Fair Globalization (ILO, 2007, pp. 33–35). At present, the ILO could undertake the necessary institutional follow-up, particularly by examining the designation of the competent body or bodies to undertake an impact evaluation, to assist ILO Members which are entering into trade arrangements or seeking advice on the implementation of the labour standards contained in these arrangements. The provision of such assistance is envisaged in the Declaration "subject to [the] compatibility [of the trade agreements] with ILO obligations". By following up on the development of labour provisions in trade arrangements and promoting appropriate coordination mechanisms between such provisions and the ILO standards system, the ILO would help to preserve the integrity of its standards and enhance their impact. In so doing, it would be acting to avert the risk of fragmentation of its body of standards through a form of "law shopping" (Supiot, 2010, pp. 155–158). It would also bring much-needed transparency to the expansion of labour provisions in trade arrangements and lend credibility to the efforts made by its member States to promote the Organization's principles and objectives.

## 15.5 CONCLUSIONS

Better enforcement of international labour standards has become an integral part of responses to global crisis for many emerging and developing countries. The CAPP has provided an important contribution in this respect. It has proposed ways to address the necessary adjustments due to the crisis in the framework of the system of international labour standards, as there are tools to address the economic challenges confronting governments. However, the ILO supervisory system relies increasingly on technical assistance and cooperation to complement its traditional function of controlling the application of ratified Conventions, in order to make the system part of the solution to the challenges raised by the global crisis, rather than a distant observer of them. Within this framework, it is important to strengthen the use of international labour standards and the supervisory mechanisms as a platform for promoting policy coherence at all levels.

Another issue that needs to be highlighted is the reference to workers in the informal economy by the supervisory bodies of the ILO, which translates into a new evolution in the way this issue has been addressed by the supervisory system in recent years. Further, to promote decent work it is necessary to eliminate the negative aspects of informality while at the same time ensuring that opportunities for livelihood and entrepreneurship are not destroyed, and promoting the protection and incorporation of workers and economic units of the informal economy into the mainstream economy (ILO, 2010u, p. 69). Addressing the informal economy is thus a central aspect of strategies for an exit from the crisis. It would also seem to be an important component of any action to ensure that trade liberalization benefits workers in developing countries with large informal economies. These countries are increasingly party to preferential trade arrangements, including labour provisions aimed at guaranteeing certain labour rights and conditions.

Within the framework of the ILO Declaration on Social Justice for a Fair Globalization, the ILO Governing Body is currently examining a standards review mechanism to reinvigorate and reinforce its body of standards, which also implies their effective implementation. If adopted, this mechanism could provide an ongoing programme of work in relation to standards for the Organization as a whole. The review process under discussion could open a new vista for research on international labour standards which would be indispensable in assessing their relevance and effectiveness, and would therefore require the mobilization of all the ILO's areas of expertise, in particular in the economic and legal fields. Such research, making full use of the information arising from the work of the ILO supervisory bodies, could contribute to the establishment of a valid and balanced overview of the global effectiveness of international labour standards.

# THE FUTURE OF FINANCE: SCENARIOS OF FINANCIAL SECTOR REFORMS AND THEIR LABOUR MARKET IMPLICATIONS

16

*Ekkehard Ernst**

## 16.1 INTRODUCTION

The global financial and economic crisis has profoundly changed the landscape of financial markets. The bankruptcy of Lehman Brothers – one of the oldest investment banks in the United States – has demonstrated to all the immense risks that the global financial system had accumulated over the past decade and the disastrous consequences that a sudden shift in risk perception was able to produce. Soon after the outbreak of the crisis a debate arose regarding the most appropriate changes to the regulatory framework of financial markets. This debate is still ongoing, but it has started to bear fruit. The current US administration has put forward some of the most substantial reforms to regulation that the financial industry has seen over the last seven decades. In Europe, similarly bold changes are on the verge of being implemented. And at the international level, new players are entering the scene and beginning to influence the workings of global capital markets. Many more currently debated changes are still in a consultative process or will be implemented gradually over time, such as the new Basel III agreement on stricter capital requirements. Other changes are still under discussion or lack a more operational layout.

There has been little discussion, however, regarding the implications of these changes for the real economy. The debates have focused almost exclusively on the extent to which different measures might help to stabilize

* The author is Senior Economist, International Institute for Labour Studies, ILO, Geneva. Many thanks to Federico Curci for excellent research assistance.

financial markets, if at all, and prevent the build-up of another asset bubble. Few voices have made themselves heard regarding the possible implications of higher costs of capital for investment growth and job creation. In part, this is related to the still imperfectly understood linkages between the financial sector and the real economy. This chapter aims to provide a preliminary look at these linkages, focusing on the possible labour market impacts of large-scale financial sector reform.

The few existing studies that have tried to identify the impact of financial market regulation on the real economy have principally looked at the effects on the banking sector, in particular as regards higher capital costs and the availability of credit due to stricter rules. Similarly, regulation of international financial flows, such as international transaction taxes, is also expected to reduce financial depth and credit market activity. However, reform options affect labour markets through at least three other channels: (i) to the extent that these rules lower financial market stress they will lead to less uncertainty, which in principle should reduce labour market instability; (ii) financial sector regulation that affects the share price dynamics of listed companies is likely also to influence investment and hence employment creation through balance sheet effects, as suggested by Phelps (1998); and (iii) changes in corporate governance rules will affect how revenues are shared at the enterprise level, which is likely to affect incentive structures of both share- and stake-holders. Evaluating the impact of financial market regulation on the labour market therefore requires that various transmission mechanisms are taken into account.

By building on the different elements of the reform debate, this chapter attempts to explore the implications of each of them for real economy dynamics, especially for the labour market. Adopting a political economy perspective, it argues that different reforms will be implemented as packages rather than individually. In this sense not all combinations of reform are feasible, as they run into political constraints. On the basis of a small political economy model, the chapter evaluates which reform packages are likely to arise and assesses their labour market implications.

## 16.2 THE POLITICAL ECONOMY OF FINANCIAL SECTOR REFORMS

The crisis has triggered substantial discussion of financial sector reforms, and some first initiatives have already been implemented (see table 16.1). Reform proponents favour different reform areas depending on where they see the origins of the crisis. Not every proposed solution is desirable or feasible. Most observers acknowledge, however, that financial market regulation needs to target three main areas: safeguards need to be set up against systemic risk arising from banking activities; the transparency of market operations needs to improve; and excessive risk-taking by financial actors needs to be diminished. These are laudable objectives, but it remains unclear whether and to what extent they can be achieved with the instruments currently available. More important, some of the suggested policy changes will trigger sharp reactions from the financial community, which considers that its business interests are being affected. Moreover, certain large-scale reforms require that diverse actors at different jurisdictional levels coordinate their activities, which so far has not been successful. The following discussion provides some of the keys to understanding the political economy dynamics behind the current reform debate.

Reforms of financial sector regulation work at three levels (see figure 16.1): international, national and enterprise. At each level, reforms will affect the availability of certain types of financial contracts, the ex-post gains from investment and the time horizon of investors. Moreover, regulations and provisions at different levels interact with each other and cannot be analysed separately. Moving from right to left in figure 16.1:

- Corporate governance provisions (investor protection, board composition, takeover restrictions, and so on) will affect profit-sharing among managers, workers and financial investors. In particular, they will influence managers' preference to enter a coalition either with workers or with financial investors at the expense of sharing the company's benefits with the remaining actor (i.e. either financial investors or workers) (Pagano and Volpin, 2005).
- Domestic regulation of the banking sector and non-bank financial activities (hedge funds, private equity) affects the protection of creditors (for example, through deposit insurance or bankruptcy laws) and the transparency of securities markets (for example, insider trading or accounting rules). This will influence the availability, cost and maturity of credit and equity, thereby affecting a firm's capital structure with consequences for the corporate governance interaction between managers, workers and financial investors. [1]

[1] For instance, a larger credit-to-equity ratio reduces free cash flow at the disposal of managers, which makes it less likely that they will enter coalitions with financial investors as the rent to be shared will be smaller.

Table 16.1 Planned or existing financial market regulation, G20 countries

| | Dealing with systemic risk | | Increase market transparency | | | Lower risk taking | |
|---|---|---|---|---|---|---|---|
| | Financial sector oversight | Regulation of credit growth | Market information | Regulation of OTC derivatives | Regulation of financial sector activities | Managerial compensation and bonus regulation | Financial transaction/ activities tax |
| Argentina | Market-based risk assessment | Cap on loan-to-deposit ratios | | | Planned lift of capital controls | | UC[1] |
| Australia | | N | | UC[2] | N | N | N[7] |
| Brazil | | | | | Capital controls (2% tax on inflows) | | UC[1,6] |
| Canada | | Cap on loan-to-value ratios in the mortgage market | | UC[2] | N | N | N |
| China | | Countercyclical adequacy rules | | | Capital controls | Reform of disclosure rules for executive compensation in SOFEs | Stock trading stamp duty (0.3%) |
| European Union | Extension of MiFiD; Hedge fund certifications; ESRB | Basel III recommendations; ESRB; EFSF | Centralized supervision of rating agencies | Standardization of products traded via CCPs | Restrictions on short-selling | Bonus linked to base compensation; max. 30% in cash | N |
| France | | Moderate increase in regulatory capital planned | Creation of a public rating agency | UC[2] | N | Surtax on bonus pay; bonus pay to be spread out over several years | Banking activity tax to finance rescue fund |

Table 16.1 (cont.)

| | Dealing with systemic risk | | Increase market transparency | | | Lower risk taking | |
|---|---|---|---|---|---|---|---|
| | Financial sector oversight | Regulation of credit growth | Market information | Regulation of OTC derivatives | Regulation of financial sector activities | Managerial compensation and bonus regulation | Financial transaction/ activities tax |
| Germany | Restructuring fund; enhanced powers to bank boards | Moderate increase in regulatory capital planned | | UC[2] | Ban on naked short-selling[3] | N | Banking surtax to compensate for crisis costs |
| India | | Countercyclical adequacy rules | | | Capital controls | | Securities transaction tax (0.075%) |
| Indonesia | | | | | Capital controls | | UC |
| Italy | | | | UC[2] | N | Surtax on bonus compensation exceeding three times base salary | |
| Japan | | N | | UC[2] | | Stricter disclosure rules for executive compensation | N[4] |
| Republic of Korea | | Countercyclical adequacy rules | | | Capital controls | | |
| Mexico | | | | | | | |
| Russian Federation | | | | | Ban on naked short-selling | | |
| Saudi Arabia | | | | | No short-selling permitted | | |

Table 16.1 (cont.)

| | Dealing with systemic risk | | Increase market transparency | | | Lower risk taking | |
|---|---|---|---|---|---|---|---|
| | Financial sector oversight | Regulation of credit growth | Market information | Regulation of OTC derivatives | Regulation of financial sector activities | Managerial compensation and bonus regulation | Financial transaction/ activities tax |
| South Africa | | | | | | | N |
| Turkey | | Adjustments to risk weights | | | | | |
| United Kingdom | | UC[5] | | UC[2] | Temporary ban on short-selling (in 2008) | Surtax on bonus pay | Stamp duty on stock market transactions (0.5%) |
| United States | Stricter banking oversight | Tightening of leverage ratio regulation; extension to shadow banking system | Consumer protection agency; legal accountability of rating agencies | Open-market trading planned[2] | No proprietary trading for deposit-taking institutions ("Volcker rule") | Temporary bonus limitation (2009) | N |

Notes: The table presents an overview of planned or existing measures to regulate the financial market. CCP: central-counterparty. SOFE: state-owned financial enterprises. ESRB: European Systemic Risk Board. EFSF: European Financial Stability Facility. MiFiD: Markets in Financial Instruments Directive. N: no planned/existing measures. UC: under consideration. [1] The recently created Banco del Sur is expected to levy parts of its funds through a financial transaction cost. [2] Participation in the OTC (over-the-counter) Derivatives Regulators Forum. [3] Limited to certain asset classes (10 major German financial institutions; CDS on euro area sovereign debt). [4] Securities transaction tax abolished in 1999. [5] Move to a cyclical-adjusted capital adequacy rule. [6] Brazil experimented with a financial transaction tax between 1993 and 2007. 7Australia had a bank debit tax for cash withdrawals between 1982 and 2002/2005.

Source: National sources, May 2011.

- Finally, restrictions and taxation of international capital flows affect the availability of funds, their volatility and their maturity structure. Easily available international capital will strengthen credit growth in the domestic economy. Domestic provisions for investor protection will interact with the maturity structure of these flows (so that weak protection is likely to shorten average maturity).

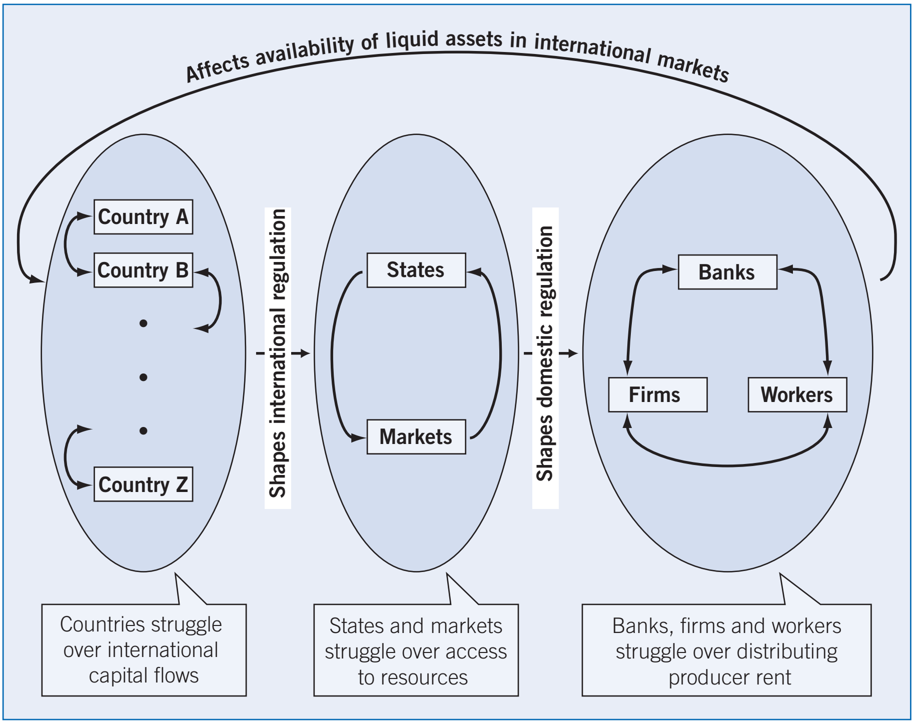
The impact of financial sector *development* on the real economy has been studied widely over the past two decades, using indicators such as the amount of credit available to the economy or an index for stock market valuation (e.g. Demirgüç-Kunt and Levine, 2001). Despite the vast amount of research produced, a consensus has yet to be reached regarding both the direction of interaction (does finance precede growth or vice versa?) and the impact of the financial market structure on the real economy (banking sector versus securities markets). Not surprisingly, in light of the absence of such a consensus, little is known about the impact of financial sector *regulation* on the real economy. For the purpose of this chapter, and given data limitations, indicators reflecting three specific reform areas (that cover – albeit imperfectly – the various reform issues presented) are used: securities market regulation and the development of derivatives markets, prudential supervision and capital account openness. The first indicator informs about the availability of financial instruments and – indirectly – about the characteristics of corporate governance structure. The second indicator measures the stringency with which banks are being regulated and limited in building up leverage. The third refers to the importance of international capital flows.

How will reforms in these areas affect labour markets? This chapter shows that both capital account opening and improved banking supervision have unambiguously positive effects on employment, lowering job destruction and increasing job creation. [2] On the other hand, deregulation of securities markets seems mainly to increase labour market instability. Deepening derivatives markets will tend to increase unemployment and its duration. Taken together, the impact of financial sector reforms will depend on the actual packages that countries adopt and the relative weight they assign to individual reforms in these three areas.

Whatever the costs and benefits of any particular financial sector reform, policy-makers are not free to choose the theoretically optimal level of regulation. Besides the fact that a single optimal reform package may in fact not exist, given the different layers of financial regulation, at least three considerations will limit the scope for reform:

[2] See the Appendix for a discussion of the data, methodology and econometric results.

Figure 16.1 Interaction of financial reforms




Source: Author.

- The financial and economic recovery actually complicates the task of substantial reform of financial markets. The popular political pressure that has so far kept up might wear off as business activities resume. The immediate sense of urgency will then recede, making policy-makers more lenient when putting forward an encompassing reform agenda. In addition, the crisis has somewhat limited the political influence of financial firms, but as the outlook improves they will regain a stronger political voice. Finally, financial sector (re-)regulation will take place in a substantially different macroeconomic environment. The risk appetite of investors has – so far – resumed only half-heartedly. Over the longer term, precautionary savings may go up as investors re-evaluate their environment and consider investing in lower-yielding but less risky assets.
- The scope for reform is also limited by the high level of public debt that has accumulated during the crisis. In other words, even if it were possible to identify ex ante the optimal package for financial

sector regulation, such a reform bundle is unlikely to be implemented, as policy-makers rely heavily on financial markets to (re-) finance their high and still increasing debt levels. Interestingly, in the past, periods of rapid increase in public-sector debt have often preceded periods of financial deregulation.

- Finally, regulatory competition between jurisdictions prevents countries from implementing much-needed reforms for fear of losing financial-sector market share to competitors. As countries compete to attract financial firms through favourable regulatory conditions, overly stiff prudential regulation may hamper further growth of the sector. Highly qualified staff may consider moving to different locations with more attractive tax and regulatory environments, for instance regarding bonus regulation. Similarly, financial firms may consider moving their activities to jurisdictions where limitations on leverage and credit growth are less stringent, offering their services to clients abroad or arbitraging across different regulatory conditions through branching.

## 16.3 REFORM SCENARIOS AND THEIR CONSEQUENCES FOR THE REAL ECONOMY

Considering the different levels of financial regulation and the political barriers to financial reform, four different reform scenarios and their overall impact on employment dynamics are presented in this section. Such reform packages – in contrast to individual reforms – are likely to have larger macroeconomic effects. First, changes to prudential regulation will have implications on financial market stress and volatility. Second, financial market regulation influences the cost of capital on both bonds and equity markets. With regard to the international side, changes in the international financial architecture may affect both international capital and trade flows. In constructing alternative reform scenarios, this section offers a contribution to a global assessment of the effect on the real economy of different reform packages. Table 16.2 summarizes the different assumptions that underlie the impact analysis of these reform scenarios on labour markets.[3]

[3] For an in-depth discussion of the different reform options, the political economy considerations underlying these reform scenarios and the assumptions about their macroeconomic implications, see IILS (2010), chapter 5.

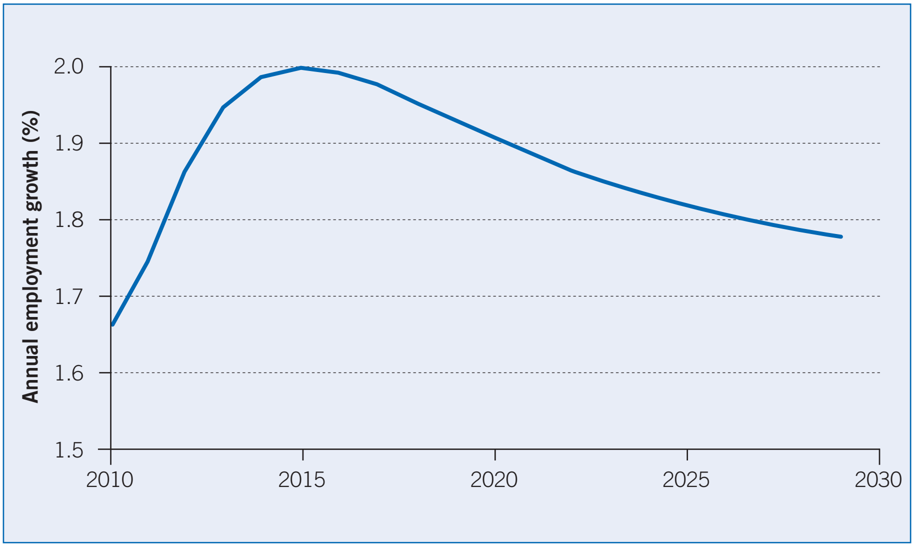
Table 16.2 Exit scenarios from the crisis: Macroeconomic implications

| International capital flows | Domestic financial markets | |
|---|---|---|
| | Unreformed | Tightened regulation |
| Unreformed | *Scenario I*<br>Permanent increase in financial stress<br>Return to high-value shares<br>Continued export and import growth<br>High international capital flows | *Scenario III*<br>Moderate reduction in financial stress<br>Moderate reduction in or stable share prices<br>Further export and import growth<br>Moderate increase in international capital flows |
| Tightened regulation | *Scenario II*<br>Moderate increase in financial stress<br>Stable share prices<br>Slower trade growth<br>Reduction in international capital flows | *Scenario IV*<br>Permanent reduction in financial stress<br>Lower real share prices<br>Slower growth of world trade<br>Reduction in international capital flows |

Source: Author.

On the basis of the different assumptions underlying the four reform scenarios, an empirical analysis has been carried out to assess the impact on employment dynamics in an archetypical advanced G20 economy. In scenario I (so-called business-as-usual), it is assumed that starting in 2010 the real value of outstanding shares increases permanently by 10 per cent, that trade growth continues at 10 per cent per annum and that capital flows increase by 10 per cent per annum. No further securities or prudential regulation in the banking sector would be introduced. This scenario also assumes a unit increase in global financial stress (one standard deviation), reflecting the heightened awareness of financial investors about global risks. The scenario assumes not only an impact of financial market stress on employment creation but also on labour supply through a discouraged-worker effect. In particular, according to the underlying estimates, labour force growth is permanently depressed by 1 percentage point if the financial market stress indicator rises by a unit increase. As shown in figure 16.2, employment growth continues to recover despite this additional financial market stress due to strong trade and share price growth. After a peak in 2015 it will gradually return to its long-term trend rate at around 1.7 per cent, in line with labour force growth (no change in demographics has been retained for these simulations).

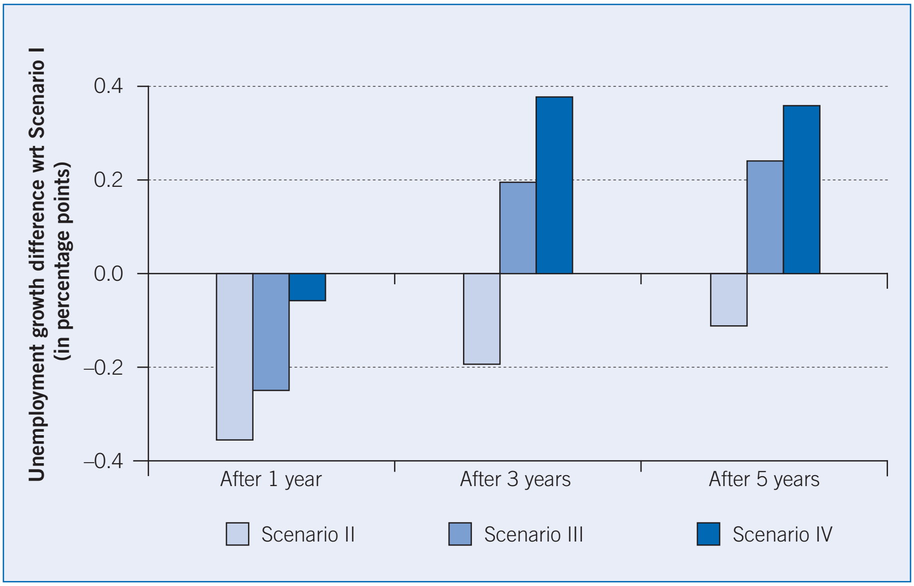
Figure 16.2 Employment dynamics in scenario I "business-as-usual"




Note: The chart shows average employment growth (in percentage point difference over baseline) in advanced G20 economies under the scenario of unreformed financial markets ("business-as-usual").
Source: IILS (2010), chapter 5.

In comparison, the other three scenarios assume – each to a different degree – a further tightening of either securities or banking sector regulation, whereby scenario IV makes the strictest assumptions on the evolution of these indicators. Trade is expected to decline in scenarios II and IV, whereas financial market stress and the real value of outstanding shares decline only in scenarios III and IV, with tighter domestic regulation. As demonstrated in figure 16.3, the effects on employment are negative in the short run, as expected, although certainly much less than predicted in other studies (IIF, 2010). After only three years some improvements can be felt, in particular due to the decrease in financial sector volatility. Under scenario II, where this effect is weakest, the adverse effects from reduced dynamics in world trade and financial market activity will keep the employment growth rate permanently below the baseline rate of unreformed financial markets. However, when policy-makers show more ambition, in particular as regards domestic re-regulation and the supervisory framework of the banking sector, stronger positive effects for employment creation can be expected. In other words, the increase in costs resulting from stricter banking sector regulation can be considered moderate in comparison to the benefits from lower financial market volatility, a point also made by Kashyap et al. (2010). This means that

Figure 16.3 Comparisons of employment dynamics, scenarios II–IV vs. scenario I




Note: The chart shows the differences of employment growth (in percentage points) of different financial reform scenarios compared to the business-as-usual scenario of unreformed financial markets.
Source: IILS (2010), chapter 5.

financial market regulation may not only have positive effects on financial sector stability but could at the same time improve the medium-term outlook for labour markets, a potential benefit that policy-makers should not lightly discard.

## 16.4 CONCLUSIONS

A full recovery of financial markets, which will be necessary to sustain vigorous job growth over the medium term, requires major financial sector reforms. The currently observed reduction in financial sector stress is unlikely to allow financial markets to return to pre-crisis trends. What is needed is an improved regulatory framework that reduces incentives for excessive risk-taking, enhances market transparency and strengthens the sector's resilience to systemic shocks. Such financial market reforms could bring about substantial benefits for labour market dynamics, especially over the medium term. While some adverse effects may be expected from tighter regulation, employment creation can strongly benefit from the reduced volatility that a more elaborate framework for securities, banking supervision and capital controls can bring. In this regard, policy-makers should use the momentum for reform to strengthen capital adequacy rules, as suggested by the current negotiations of the Basel III framework, in order to reduce disproportionate leverage and excessive incentives for risk-taking within the banking sector. Implementing these proposals could greatly reduce the still very high levels of uncertainty among market participants, and also reduce volatility and risk premia, thereby stimulating output and employment growth. The benefits of financial sector reform for the real economy will be greatest when they are implemented in a coordinated fashion, reforming both domestic financial markets and the international financial system.

# APPENDIX

## *The impact of financial reforms on unemployment dynamics*

The relation between financial market development and economic growth has attracted substantial interest over the last decade or so. Generally, researchers have been able to identify a robust causal relationship running from financial development to economic growth, and hence – by implication – to job creation, at least regarding the development of domestic financial markets. The role of international capital flows, on the other hand, has been seen more critically and to date no consensus in this area is emerging, even though some of the evidence points towards a positive role of international financial integration for economic dynamism. However, there is a lack of consideration related to financial market regulation and their concrete micro-economic transmission mechanisms through which regulatory changes affect the real economy and especially employment growth. The purpose of this Appendix is to identify the different transmission mechanisms between financial market development and regulation on the one hand and labour market flows on the other, as well as to quantify their effects.

Observed employment levels are the result of new jobs being created and old jobs being destroyed. Typically, financial markets exercise pressure at both margins, by providing new funds for investment and enterprise creation, and by forcing inefficient firms to leave the market or to close down plants. Under certain circumstances, it might be the case that further growth in financial markets takes place concurrently with unchanged employment levels as both job creation and job destruction increase, thereby raising labour market turbulence. To assess the effects of financial market development and regulation on labour markets, dynamic equations for unemployment inflows and outflows have been estimated, using system General Method of Moments (GMM) techniques. These estimates make use of recent panel data on labour market flows for a set of 14 OECD countries[4] (Elsby et al., 2008). In particular, the following generic equations have been estimated:

$$Inflows_t = Inflows_{t-1} + Macro_t + LM_t + Policy_t + Finance_t + \alpha_{ij,t} + \varepsilon_{i,t} \tag{A1}$$

and

$$Outflows_t = Outflows_{t-1} + Macro_t + LM_t + Policy_t + Finance_t + \alpha_{oj,t} + \varepsilon_{o,t} \tag{A2}$$

[4] These countries are Australia, Canada, France, Germany, Ireland, Italy, Japan, New Zealand, Norway, Portugal, Spain, Sweden, United Kingdom and United States.

where *Inflows* and *Outflows* refer to unemployment inflows and outflows respectively; $Macro_t$ refers to macroeconomic conditions (output gap, investment growth, etc.); $LM_t$ to labour market conditions; $Policy_t$ to (fiscally relevant) policy interventions; and $Finance_t$ to financial market variables. As the equations are estimated using the full panel of 14 countries, they also contain equation-specific country fixed effects $a_{ij,t}$ $a_{oj,t}$ alongside the error terms $\varepsilon_{i,t}$, $\varepsilon_{o,t}$.

Various indicators have been used to reflect different dimensions of financial market influences on labour market dynamics. These include financial sector development, growth and leverage of the banking sector and openness to international capital flows. The results of these estimates are presented in Appendix tables 1–3.

Financial market development as measured by the amount of private-sector credit as a share of GDP is shown to influence unemployment dynamics in the direction of more pronounced turbulence (see Appendix tables 1 and 2: column (1)). In particular, it leads to both higher in- and outflows in the unemployment pool, an indication that financial sector development may not be monotonically linked to the level of employment. In contrast, greater openness to international capital flows reduces labour market turnover but does not seem to be conducive to higher outflows (see Appendix tables 1 and 2: column (3)). Credit expansion seems to have ambiguous effects on employment: on the one hand, real credit growth goes hand in hand with lower unemployment inflows and higher unemployment outflows, hence unequivocally increasing employment (see Appendix tables 1 and 2: column (4)). On the other hand, banking sector leverage – that is, the exposure of the banking sector to lending booms and a reduced equity base – leads to higher unemployment inflows and lower unemployment outflows, hence decreasing overall employment levels (see Appendix tables 1 and 2: column (2)).

In order to understand the implications of the financial sector reforms discussed above, this empirical strategy was further developed to include more detailed information on changes in financial sector regulation. In particular, use has been made of a recently distributed database by Abiad et al. (2010) that includes information regarding the different approaches under which financial markets have been reformed in the countries for which labour market information was available. In particular, the distinction between securities market regulation, prudential banking supervision and regulation regarding international capital flows has proved useful in this respect. These results are shown in Appendix table 3.

Appendix table 16.1 Financial market determinants of unemployment inflows

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Inflows | 0.965*** | 0.966*** | 0.958*** | 0.962*** | 0.956*** |
| (lagged) | (0.010) | (0.010) | (0.011) | (0.010) | (0.011) |
| Labour force | 1.179** | 1.146** | 1.238** | 1.626*** | 2.170*** |
| growth (lagged) | (0.500) | (0.503) | (0.557) | (0.519) | (0.582) |
| Output | -0.029*** | -0.028*** | -0.027*** | -0.021*** | -0.024*** |
| gap | (0.005) | (0.005) | (0.005) | (0.005) | (0.005) |
| TFP growth | 0.284*** | 0.284*** | 0.308*** | 0.315*** | 0.270*** |
| | (0.052) | (0.053) | (0.055) | (0.053) | (0.056) |
| User cost of | 0.006** | 0.006** | 0.005* | 0.005* | 0.007** |
| capital (lagged) | (0.003) | (0.003) | (0.003) | (0.003) | (0.003) |
| Financial market | 0.033** | | | | 0.048** |
| development | (0.015) | | | | (0.020) |
| Banking sector | | 0.032* | | | 0.084*** |
| leverage | | (0.018) | | | (0.022) |
| International | | | -0.007** | | -0.013*** |
| financial openness | | | (0.003) | | (0.004) |
| Real credit | | | | -0.232*** | -0.259*** |
| growth | | | | (0.055) | (0.060) |
| Number of observations | 304 | 305 | 273 | 303 | 270 |
| Number of countries | 12 | 12 | 12 | 12 | 12 |

Notes: Standard errors in parentheses. *** p<0.01. ** p<0.05. * p<0.1. The countries included in the analysis are Australia, Canada, France, Germany, Ireland, Italy, Japan, Portugal, Spain, Sweden, United Kingdom and United States.

Source: Author's calculations.

Appendix table 16.2 Financial market determinants of unemployment outflows

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Outflows (lagged) | 0.750*** | 0.847*** | 0.646*** | 0.638*** | 0.810*** |
| | (0.036) | (0.030) | (0.043) | (0.040) | (0.033) |
| Employment rate (lagged) | 0.517 | 0.065 | 0.700 | 0.969** | |
| | (0.525) | (0.460) | (0.458) | (0.401) | |
| Output gap | 0.018*** | 0.019*** | 0.026*** | 0.022*** | 0.016** |
| | (0.007) | (0.007) | (0.007) | (0.006) | (0.007) |
| User cost of capital | -0.014** | -0.016** | -0.017*** | -0.015** | -0.016** |
| | (0.007) | (0.007) | (0.006) | (0.006) | (0.007) |
| Wage – interest rate ratio | -0.091*** | -0.086*** | -0.087*** | -0.083*** | -0.107*** |
| | (0.031) | (0.032) | (0.033) | (0.028) | (0.037) |
| Real share price growth | 0.132*** | 0.124** | 0.129*** | 0.140*** | 0.139** |
| | (0.048) | (0.052) | (0.047) | (0.045) | (0.055) |
| Gross fixed capital investment | 2.473*** | 1.516* | 1.992** | 2.872*** | 1.540 |
| | (0.882) | (0.907) | (0.880) | (0.823) | (0.984) |
| Real household disposable income growth | 2.206*** | 2.435*** | 2.132*** | 2.012*** | 2.510*** |
| | (0.617) | (0.659) | (0.611) | (0.578) | (0.691) |
| Financial market development | 0.131*** | | | | 0.127*** |
| | (0.039) | | | | (0.034) |
| Banking sector leverage | | -0.127*** | | | -0.094** |
| | | (0.036) | | | (0.037) |
| International financial openness (lagged) | | | -0.033*** | | -0.015*** |
| | | | (0.006) | | (0.006) |
| Real growth in liquid liabilities | | | | 0.459*** | 0.398** |
| | | | | (0.137) | (0.160) |
| Number of observations | 191 | 192 | 179 | 190 | 176 |
| Number of countries | 8 | 8 | 8 | 8 | 8 |

Notes: Standard errors in parentheses. *** p<0.01. ** p<0.05. * p<0.1. The countries included in the analysis are Australia, Canada, France, Ireland, Italy, Japan, Sweden and United States.

Source: Author's calculations.

## Appendix table 16.3 Unemployment dynamics under financial sector regulation

| | Lagged outflow | Output gap | Real short-term interest rate | Change in wage – interest rate ratio | Change in real share prices | Capital stock growth | Real disposable income growth | Stance of securities regulation | Capital account openness | Stance in prudential regulation | Development of OTC market |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Outflow | 0.857*** | 0.003 | -0.012** | -0.135*** | 0.136*** | 4.575*** | 1.851*** | 0.123*** | 0.035*** | 0.038*** | -2.851*** |
| | (0.027) | (0.007) | (0.005) | (0.036) | (0.053) | (1.015) | (0.685) | (0.035) | (0.016) | (0.009) | (0.711) |

| | Lagged inflow | Output gap | Lagged TFP growth | Lagged labour force growth | User cost of capital (lagged) | Real imports growth (lagged) | | Stance of securities regulation | Capital account openness | Stance in prudential regulation | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflow | 0.942*** | -0.007** | 0.188** | 0.775*** | 0.008** | -0.424*** | | 0.049*** | -0.048*** | -0.011** | |
| | (0.018) | (0.003) | (0.078) | (0.216) | (0.003) | (0.114) | | (0.015) | (0.009) | (0.005) | |

Notes: Standard errors in parentheses. *** p<0.01. ** p<0.05. * p<0.1. The countries included in the analysis for Outflows are Australia, Canada, France, Ireland, Italy, Japan, Sweden and United States; and for Inflows are Australia, Canada, France, Germany, Ireland, Italy, Japan, Portugal, Spain, Sweden, United Kingdom and United States.

Source: Author's calculations.

# BIBLIOGRAPHY


Abiad, A.; Detragiache, E.; Tressel, T. 2010. “A new database of financial reforms”, in *IMF Staff Papers*, Vol. 57, No. 2, pp. 281–302.

Agence France Presse (AFP). 2010. “India pledges education for all children”, in *Khaleej Times Online* (Dubai), 1 Apr.

Aidt, T.; Tzannatos, Z. 2002. *Unions and collective bargaining: Economic effects in a global environment* (Washington, DC, World Bank).

—; —. 2009. “Trade unions, collective bargaining and macroeconomic performance: A review”, in *Industrial Relations Journal*, Vol. 39, No. 4, pp. 258–295.

Alarcón, J.; Ernst, C.; Khondker, B.; Sharma, P. D. Forthcoming. *Dynamic Social Accounting Matrix (SAM): Concept, methodology and simulation outcomes: The case of Indonesia and Mozambique*, Employment Department Working Paper (Geneva, ILO).

American Chamber of Commerce in Romania. 2011. “AmCham Romania and its priorites related to the amendment of labor legislation”, press release, 18 Feb.

Association of Southeast Asian Nations (ASEAN). 2010. *ASEAN leaders’ statement on sustainable recovery and development*, statement presented at the ASEAN Summit, Hanoi, 9 Apr.

Baccaro, L.; Heeb S., 2010. *Social dialogue response to the financial crisis: A Boolean analysis*, unpublished mimeo (Geneva, ILO).

Baldwin, R. 2009a. “The great trade collapse: What caused it and what does it mean?” in R. Baldwin (ed.): *The great trade collapse: Causes, consequences and prospects* (London, Centre for Economic Policy Research (CEPR)).

—. 2009b. *The great trade collapse: Causes, consequences and prospects* (London, Centre for Economic Policy Research (CEPR)).

Bank for International Settlements (BIS). 2009. *79th Annual Report: 1 April 2008–31 March 2009* (Basel).

—. 2010. *80th Annual Report: 1 April 2009–31 March 2010* (Basel).

Beaton, K. 2010. *Time variation in Okun’s law: A Canada and U.S. comparison*, Working Paper, No. 7 (Ottawa, Bank of Canada).

Becker, K. 2004. *The informal economy: Fact finding study*, Department for Infrastructure and Economic Co-operation (Stockholm, Swedish International Development Cooperation Agency (SIDA)).

Behrendt, C.; Haq, T.; Kamel, N. 2009. *The impact of the financial and economic crisis on Arab States: Considerations on employment and social protection policy responses*, Policy Note (Beirut, ILO).

Bercusson, B. 2008. “Implementation and monitoring of cross-border agreements: The potential role of cross-border collective industrial action”, in K. Papadakis (ed.): *Cross-border social dialogue and agreements: An emerging global industrial relations framework?* (Geneva, International Institute for Labour Studies, ILO), pp. 131–157.

Berg, A. et al. 2009. *Fiscal policy in sub-Saharan Africa in response to the impact of the global crisis*, IMF Staff Position Note SPN/09/10 (Washington, DC, IMF).

Bernanke, B. 2005. *The global saving glut and the U.S. current account deficit*, remarks presented at the Sandridge Lecture, Virginia Association of Economics, Richmond, VA, 10 Mar.

Bertola, G.; Ichino, A. 1995. "'Wage inequality and unemployment: US vs Europe", in B. Bernanke; J. Rotemberg (eds): *NBER Macroeconomics Annual 1995*, Vol. 10 (Cambridge, MA, MIT Press), pp. 13–54.

—; Boeri, T.; Cazes, S. 1999. *Employment protection and labour market adjustment in OECD countries: Evolving institutions and variable enforcement*, Employment and Training Papers No. 48, Employment and Training Department (Geneva, ILO).

Bewley, T. F. 1999. *Why wages don't fall during a recession* (Cambridge, MA, Harvard University Press).

Bhaduri, A.; Marglin, S. 1990. "Unemployment and the real wage: The economic basis for contesting political ideologies", in *Cambridge Journal of Economics*, Vol. 14, No. 4, pp. 375–393.

Blanchard, O.; Summers, L. H. 1986. *Hysteresis and the European unemployment problem*, NBER Working Paper Series No. 1950 (Cambridge, MA, NBER).

—; Wolfers, J. 2000. "The role of shocks and institutions in the rise of European unemployment: The aggregate evidence", in *The Economic Journal*, Vol. 110, No. 462, pp. C1–C33.

—; Milesi-Ferretti, G. M. 2009. *Global imbalances: In midstream?* IMF Staff Position Note No. SPN/09/29 (Washington, DC, IMF).

Blecker, R.A. 1989. "International competition, income distribution and economic growth", in *Cambridge Journal of Economics*, Vol. 13, No. 3, pp. 395–412.

Bluhm, R. Forthcoming. *Private pensions in Chile: Costs of the financial crisis, long-run performance and public alternatives*, Issues in Social Protection Discussion Paper No. 20, Social Security Department (Geneva, ILO).

Blundell-Wignall, A.; Wehinger, G.; Slovik, P. 2009. "The elephant in the room: The need to deal with what banks do", in *OECD Journal: Financial Market Trends* (Paris), Vol. 2009/2, No. 97, pp. 11–35.

Bonnet, F.; Ehmke, E.; Hagemejer, K. 2010. "Social security in times of crisis", in *International Social Security Review*, Vol. 63, No. 2, pp. 47–70.

Borchert, I.; Mattoo, A. 2009. "Services trade: The collapse that wasn't", in R. Baldwin (ed.): *The great trade collapse: Causes, consequences and prospects* (London: Centre for Economic Policy Research (CEPR)).

Bourgon, J. 2010. "Programme review: The Government of Canada's experience eliminating the deficit, 1944–99: A Canadian study", in OECD: *Restoring fiscal sustainability: Lessons for the public sector* (Paris).

Bowles, S.; Boyer, R. 1995. "Wages, aggregate demand, and employment in an open economy: An empirical investigation", in G. A. Epstein; H. M. Gintis: *Macroeconomic policy after the conservative era: Studies in investment, saving and finance* (Cambridge, Cambridge University Press).

Brackfield, D.; Oliveira Martins, J. 2009. *Productivity and the crisis: Revisiting the fundamentals*. Available at http://www.voxeu.org (accessed 2 Aug. 2010).

Bureau of Labor Statistics (BLS). 2010. *The employment situation: November 2010*, BLS News Release No. USDL-10-1662 (Washington, DC, US Department of Labor).

Burtless, G. 2000. *Social security privatization and financial market risk: Lessons from U.S. financial history*, Center on Social and Economic Dynamics Working Paper No. 10 (Washington, DC, Brookings Institution).

—. 2009. *Lessons of the financial crisis for the design of national pension systems*, CESifo Working Paper Series No. 2735 (Munich, Ludwig-Maximilians-Universitaet and Ifo Institute for Economic Research (CESifo)).

Cambodia Institute of Development Study (CIDS). 2010. *Tracking study of Cambodian garment sector workers affected by the global economic crisis*, Benchmarking survey report (final) (Phnom Penh).

Cameron, B. 2010. "Concerns over life products for low earners are justified", in *Saturday Star*, Johannesburg, 15 May.

Campbell, D.; Slany, A.; Khare, S. Forthcoming. *Employment-led growth in Nepal*, Phase I report (Geneva, ILO).

Cazes, S.; Verick, S.; Heuer, C. 2009. *Labour market policies in times of crisis*, Employment Working Paper No. 35, Economic and Labour Market Analysis Department, Employment Sector (Geneva, ILO).

—; —; Al Hussami, F. Forthcoming. *Diverging patterns in US and European unemployment dynamics: Evidence from Okun's law, the Great Recession and longer term trends*, Employment Working Paper, Economic and Labour Market Analysis Department, Employment Sector (Geneva, ILO).

Centre for the Analysis of Regional Integration at Sussex (CARIS). 2010. *Mid-term Evaluation of the EU's Generalised System of Preferences* (Brighton).

Cerra, V.; Panizza, U.; Saxena, S. C. 2009. *International evidence on recovery from recessions*, IMF Working Paper No. 183 (Washington, DC, IMF).

Charpe, M.; Chiarella, C.; Flaschel, P.; Semmler, W. Forthcoming. *Financial assets, debt and liquidity crises: A Keynesian Approach* (Cambridge, Cambridge University Press).

Ciutacu, C.; Chivu, L. 2007. *Quality of work and employment in Romania* (Dublin, European Foundation for the Improvement of Living and Working Conditions).

—; —. 2010. *Anticipating and managing restructuring: Romania*, ARENAS National Background Papers, prepared for the European Commission Directorate-General for Employment, Social Affairs and Equal Opportunities and the ILO International Training Centre, Turin.

Collier, P. 2008. The bottom billion: *Why the poorest countries are failing and what can be done about it* (Oxford, Oxford University Press).

Commission on Growth and Development. 2008. *The growth report: Strategies for sustained growth and inclusive development* (Washington, DC, International Bank for Reconstruction and Development/World Bank).

Constitutional court of the Republic of Latvia. 2009. Judgement on behalf of the Republic of Latvia, Riga, 21 December 2009, case No. 2009-43-01. Available at http://www.satv.tiesa.gov.lv/upload/judg__2009_43_01.

Curkina, I. 2010. "Social partners criticise harsh budget for 2010", European Industrial Relations Observatory on-line, 15 Mar. (Dublin, European Foundation for the Improvement of Living and Working Conditions).

da Costa, A.C.R.; da Rocha, E.R.P. 2009. *Panorama da cadeia produtiva têxtil e de confecções e a questão de inovação*, Setor Têxtil e Confecções [Textiles and Clothing Sector] (Rio de Janeiro, National Economic and Social Development Bank (BNDES)).

Das, J.; Do, Q. T.; Ozler B. 2004. *Conditional cash transfers and the equity–efficiency debate*, Policy Research Working Paper Series, No. 3280 (Washington, DC, World Bank).

Demirgüç-Kunt, A.; Levine, R. (eds). 2001. *Financial structure and economic growth: A cross-country comparison of banks, markets, and development* (Cambridge, MA, MIT Press).

Devarajan, S.; Miller, M.; Swanson, E. 2002. *Goals for development: History, prospects, and costs*, World Bank Policy Research Working Paper No. 2819 (Washington, DC, World Bank).

Diop, A. 2008. *Pension reforms in Central and Eastern Europe in a global perspective: Lessons learned*, address presented at the Wissenschaftliches Kolloquium, "Internationale Entwicklungen in der Rentenpolitik", Berlin, 2 Apr.

Drouin, A.; Cichon, M. 2009. *Optimal financing and self-adjusting mechanisms for sustainable retirement systems: The social stabilisation of pensions in times of crises and beyond: A critical review of three decades of pension reform and their outcomes*, paper presented at the International Conference of Social Security Actuaries and Statisticians, Ottawa, 16–18 Sep.

Durevall, D.; Mussa, R. 2010. *Employment diagnostic: Analysis on Malawi,* prepared for the Government of Malawi with assistance from the ILO (Geneva, ILO).

Dusa, Mircea. 2011. Interview, Realitatea TV, as quoted in http://www.ziare.com/politica/legea-salarizarii/pnl-si-psd-au-contestat-la-ccr-salarizarea-profesorilor-si-codul-de-dialog-social-1089787.

Ebert, F. C.; Posthuma, A. 2010. *Labour provisions in trade arrangements: Current trends and perspectives*, Discussion Paper No. 205 (Geneva, International Institute for Labour Studies, ILO).

Economic Commission for Latin America and the Caribbean (ECLAC). 2009a. "The employment situation in Latin America and the Caribbean: Crisis in the labour markets and countercyclical responses", *ECLAC/ILO Bulletin* (Santiago), No. 2, Sep.

—. 2009b. *Economic Survey of Latin America and the Caribbean 2008–2009: Policies for creating quality jobs* (Santiago).

—. 2010. *Preliminary overview of the economies of Latin America and the Caribbean 2010* (Santiago).

Economist Intelligence Unit. 2011. *Country report: Romania* (Jan.)

Elbadawi, I. A.; Kaltani, L.; Soto, R. 2009. *Aid, real exchange rate misalignment and economic performance in sub-Saharan Africa*, Working Paper 368, Instituto de Economia (Santiago, Pontifica Universidad Católica de Chile).

Elsby, M.; Hobijn, B.; Sahin, A. 2008. *Unemployment dynamics in the OECD*, Working Paper No. 14617 (Cambridge, MA, National Bureau of Economic Research (NBER)).

European Commission (EC). 2007. "The labour income share in the European Union", in *Employment in Europe 2007*, Directorate-General for Employment, Social Affairs and Equal Opportunities (Brussels).

European Foundation for the Improvement of Living and Working Conditions. 2009. *Working time developments 2009* (Dublin).

European Industrial Relations Observatory (EIRO). 2010. On-line EIRO updates, RO1008019I (23 Sept.)

—. 2011. On-line EIRO updates, RO1012019I (2 Mar.) 2011.

European Parliament, 2010. *The role of the social protection as economic stabiliser: Lessons from the current crisis*, Directorate-General for Internal Policies, Policy Department A: Economic and Scientific Policy, Employment and Social Affairs (Strasbourg).

Ffrench-Davis, R. 2010. *Macroeconomía para el empleo decente en América Latina y el Caribe* (Santiago, ILO Country Office).

Fiszbein, A.; Schady, N. (eds). 2009. *Conditional cash transfers: Reducing present and future poverty* (Washington, DC, World Bank).

Fitoussi, J.; Stiglitz, J. 2009. *The ways out of the crisis and the building of a more cohesive world*, Working Paper No. 17 (Paris, Observatoire Française des Conjonctures Économiques (OFCE)).

Food and Agricultural Organization (FAO). 2009. *The State of Food Insecurity in the World 2009: Economic crises – impacts and lessons learned* (Rome).

Fraile, L. 2009. "Lessons from Latin America's neo-liberal experiment: An overview of labour and social policies since the 1980s", in *International Labour Review*, Vol. 148, No. 3, pp. 215–233.

Freyssinet, J. 2010. *Tripartite responses to the economic crisis in the principal Western European countries*, DIALOGUE Working Paper No. 12, Industrial and Employment Relations Department (Geneva, ILO).

Friedman, J.; Schady, N. 2009. *How many more infants are likely to die in Africa because of the global financial crisis?*, Policy Research Working Paper No. 5023 (Washington, DC, World Bank).

Garibaldi, P. 1998. "Job flow dynamics and firing restrictions", in *European Economic Review*, Vol. 42, No. 2, pp. 245–275.

Ghellab, Y. 2009. *Recovering from the crisis through social dialogue*, Dialogue in Brief No. 1, Industrial and Employment Relations Department (Geneva, ILO).

Ghose, A.; Majid, N.; Ernst, C. 2008. *The global employment challenge* (Geneva, ILO).

Ghosh, J. 2010. "Global crisis and beyond: Sustainable growth trajectories for the developing world", in *International Labour Review*, Vol. 149, No. 2, pp. 209–225.

Gillion, C. et al. 2000. *Social security pensions: Development and reform* (Geneva, ILO).

Glassner, V. 2010. *The public sector in the crisis*, Working Paper No. 7 (Brussels, European Trade Union Institute (ETUI)).

—; Keune, M. 2010. *Negotiating the crisis? Collective bargaining in Europe during the economic downturn*, DIALOGUE Working Paper No. 10, Industrial and Employment Relations Department (Geneva, ILO).

Godley, W.; Lavoie, M. 2007. *Monetary economics: An integrated approach to credit, money, income, production and wealth* (Basingstoke, Palgrave Macmillan).

Gooch, L. 2010. "Malaysia outlines new growth strategy", in *The New York Times*, 30 Mar.

The Group of Twenty (G20). 2009. *Leaders' statement: The Pittsburgh Summit*, statement presented at the G-20 Summit, Pittsburgh, Pennsylvania, 24–25 Sep.

Hagemejer, K. 2009. "Rights-based approach to social security coverage expansion", in R. Holzmann; D. A. Robalino; N. Takayama (eds): *Closing the coverage gap: Role of social pensions and other retirement income transfers* (Washington, DC, World Bank), pp. 57–72.

Hall, M. 2010. "New government moves to cap redundancy payments for civil servants", European Industrial Relations Observatory on-line, 10 Aug.

Haq, T.; Rosas, G.; Schmidt, D. Forthcoming. *Regional and international experience with youth employment*, ILO Cairo Working Paper Series (Cairo, ILO).

Harding, D.; Pagan. A. 2002. “Dissecting the cycle: A methodological investigation”, in *Journal of Monetary Economics*, Vol. 49, No. 2, pp. 365–381.

Harris, R.; Silverstone, B. 2001. “Testing for asymmetry in Okun’s law: A cross-country comparison”, in *Economics Bulletin*, Vol. 5, No. 2, pp. 1–13.

Hartono, D. 2010. *A research study to assess the effectiveness of policies designed to mitigate the impact of the global financial crisis in Indonesia*, Discussion Paper Series No. 208 (Geneva, International Institute of Labour Studies, ILO).

Hein, E. 2010. *Distribution, “financialization” and the financial and economic crisis: Implications for post-crisis economic policies*, unpublished document.

—; Vogel, L. 2008, “Distribution and growth reconsidered: Empirical results for six OECD countries”, in *Cambridge Journal of Economics*, Vol. 32, No. 3, pp. 479–511.

Höpner, M. 2008. *Viking-Laval-Rüffert: Economic freedoms versus fundamental social rights – where does the balance lie?*, paper presented at the debate organized by Notre Europe and the EuropeanTrade Union Institute (ETUI), “Political Answers to Judicial Problems? Europe After Viking, Laval and Rüffert”, Brussels, Jul.

Horn, G. et al. 2009. *From the financial crisis to the world economic crisis: The role of inequality*, Macroeconomic Policy Institute (IMK) Policy Brief, Oct. (Düsseldorf, Hans Böckler Stiftung).

Howell, D. R. 2010. *Institutions, aggregate demand and cross-country employment performance: Alternative theoretical perspectives and the evidence*, Working Paper No. 228, Political Economy Research Institute (PERI) (Amherst, MA, University of Massachusetts).

Huynh, P. et al. 2010. *Impacts of current global economic crisis on Asia’s labor market*, ADBI Working Paper No. 243 (Tokyo, Asian Development Bank Institute).

India, Government of. 2010. *Report on effect of economic slowdown on employment*, quarterly reports from Q4 2008 to Q1 2010, Ministry of Labour and Employment (Chandigarh).

Institute of International Finance (IIF). 2010. *Interim report on the cumulative impact on the global economy of proposed changes in the banking regulatory framework* (Washington, DC).

Instituto de Pesquisa Econômica Aplicada (IPEA). 2009. *Impactos da redução do imposto sobre produtos industrializados (IPI) de automóveis*, Nota Técnica No. 15, Diretoria de Estudos Macroeconômicos (Brasilia).

—. 2010. “Efeitos Econômicos do Gasto Social no Brasil”, in *Perspectivas da Política Social no Brasil*, Vol. 8, Projeto Perspectivas do Desenvolvimento Brasileiro (Brasilia).

International Institute for Labour Studies (IILS). 2008. *World of Work Report 2008: Income inequalities in the age of financial globalization* (Geneva, ILO).

—. 2009a. *The financial and economic crisis: A decent work response* (Geneva, ILO).

—. 2009b. *World of Work Report 2009: The global jobs crisis and beyond* (Geneva, ILO).

—. 2010. *World of Work Report 2010: From one crisis to the next?* (Geneva, ILO).

—. 2011a. *Indonesia: Reinforcing demand in times of crisis*. Studies on Growth with Equity Series (Geneva, ILO).

—. 2011b. *Brazil: An innovative income-led strategy.* Studies on Growth with Equity Series (Geneva, ILO).

International Labour Office/Organization (ILO). 1944. *Declaration concerning the aims and purposes of the International Labour Organisation*, International Labour Conference, 26th Session, Philadelphia, 1944.

—. 1994. *The social dimensions of the liberalization of world trade*, Governing Body, 261st Session, Geneva, 1994, Working Party on the Social Dimensions of the Liberalization of International Trade, GB.261/WP/SDL/1.

—. 2002. *Conclusions concerning decent work and the informal economy in Record of Proceedings*, Vol. II, pp. 25–53, International Labour Conference, 90th Session, Geneva, 2002.

—. 2006. *Freedom of Association: Digest of decisions and principles of the Freedom of Association Committee of the Governing Body of the ILO*, Fifth (revised) edition (Geneva).

—. 2007. *Strengthening the ILO's capacity to assist its Members' efforts to reach its objectives in the context of globalization*, Report V, International Labour Conference, 96th Session, Geneva, 2007.

—. 2008. *Global Wage Report 2008/09: Minimum wages and collective bargaining – towards policy coherence* (Geneva, ILO).

—. 2009a. *Uruguay: Recent reforms to unemployment insurance*, ILO Notes on the Crisis Series (Santiago).

—. 2009b. *Chile: Fiscal policy and employment: The contingency programme against unemployment*, ILO Notes on the Crisis Series (Santiago).

—. 2009c. *Protecting people, promoting jobs: A survey of country employment and social protection policy responses to the global economic crisis*, Report prepared for the G20 Leaders' Summit, Pittsburgh, 24–25 September 2009 (Geneva).

—. 2009d. *Recovering from the crisis: A Global Jobs Pact*, adopted by the International Labour Conference at its Ninety-eighth Session, Geneva.

—. 2009e. *Report of the Committee of Experts on the Application of Conventions and Recommendations: General Report and observations concerning particular countries*, Report III (Part 1A), International Labour Conference, 98th Session, Geneva, 2009.

—. 2009f. *Improvements in the standard-related activities of the ILO: Towards a final plan of action for the implementation of the standards strategy*, Governing Body, 306th Session, Geneva, Nov. 2009, Committee on Legal Issues and International Labour Standards, GB.306/LILS/4(Rev.).

—. 2009g. *Report of the Committee on the Application of Standards: Observations and information concerning particular countries*, Provisional Record No. 16, Part II, International Labour Conference, 98th Session, Geneva, 2009.

—. 2010a. *Employment policies for social justice and a fair globalization*, Report VI, International Labour Conference, 99th Session, Geneva, 2010.

—. 2010b. *Public works and the creation of jobs*, ILO Notes on the Crisis Series (Santiago).

—. 2010c. *Social protection policies to face the crisis and for growth*, ILO Notes on the Crisis Series (Santiago).

—. 2010d. *Global Wage Report 2010/11: Wage policies in times of crisis* (Geneva).

—. 2010e. *Are domestic markets the answer to the global financial crisis?: Comments based on the experience of Latin America*, ILO Notes on the Crisis Series (Santiago).

—. 2010f. *World Social Security Report 2010/2011: Providing coverage in times of crisis and beyond* (Geneva).

—. 2010g. *Recovery patterns, growth and employment potential, with specific reference to the Global Jobs Pact integrated approach countries*, Governing Body, 309th Session, Geneva, Nov. 2010 , Committee on Employment and Social Policy, GB.309/ESP/1/2.

—. 2010h. *Trends econometric models* (Geneva).

—. 2010i. *Accelerating a job-rich recovery in G20 countries: Building on experience*, an ILO report with substantive contributions from OECD, presented at the Meeting of G20 Labour and Employment Ministers, Washington, DC, 20–21 Apr.

—. 2010j. *The sectoral dimension of the ILO's work: Update of sectoral aspects regarding the global economic downturn: Public administration*, Governing Body, 309th Session, Geneva, Nov. 2010, Committee on Sectoral and Technical Meetings and Related Issues, GB.309/STM/1/1.

—. 2010k. *Global Employment Trends 2010: January* (Geneva).

—. 2010l. *Global Jobs Pact scan: Indonesia* (Geneva and Jakarta).

—. 2010m. *Employment and social protection policies from crisis to recovery and beyond: A review of experience*, an ILO report presented at the Meeting of G20 Labour and Employment Ministers, Washington, DC, 20–21 Apr.

—. 2010n. *Extending social security to all: A guide through challenges and options* (Geneva).

—. 2010o. *Germany's response to the crisis*, G20 Country Brief Series, prepared for the G20 Meeting of Labour and Employment Ministers, Washington, DC, 20–21 Apr. (Geneva).

—. 2010p. *Effects of non-contributory social transfers in developing countries: A compendium*, Social Security Department Working Paper (Geneva).

—. 2010q. *Yaoundé Tripartite Declaration on the Implementation of the Social Protection Floor*, adopted at the ILO Second African Decent Work Symposium, "Building a Social Protection Floor with the Global Jobs Pact", Yaoundé, 6–8 Oct.

—. 2010r. *Accelerating action against child labour: Global report under the follow-up to the ILO Declaration on Fundamental Principles and Rights at Work* (Geneva).

—. 2010s. *Report of the Committee of Experts on the Application of Conventions and Recommendations: General Survey concerning employment instruments in light of the 2008 Declaration on Social Justice for a Fair Globalization*, Report III (Part 1B), International Labour Conference, 99th Session, Geneva, 2010.

—. 2010t. *Report of the Committee of Experts on the Application of Conventions and Recommendations: General Report and observations concerning particular countries*, Report III (Part 1A), International Labour Conference, 99th Session, Geneva, 2010.

–. 2010u. *Extending the scope of application of labour laws to the informal economy: Digest of comments of the ILO's supervisory bodies related to the informal economy* (Geneva).

—. 2011a. *Panorama Laboral 2011: Latin America and the Caribbean* (Lima).

—. 2011b. *Building a sustainable future with decent work in Asia and the Pacific*, Report of the Director-General, 15th Asia and the Pacific Regional Meeting, Kyoto, Japan, April 2011.

—. 2011c. *Report of the Committee of Experts on the Application of Conventions and Recommendations: General Report and observations concerning particular countries*, Report III (Part 1A), International Labour Conference, 100th Session, Geneva, 2011.

—. 2011d. *Memorandum of technical comments on the draft Labour Code and the draft Law on Social Dialogue of Romania*, Jan.

—. 2011e. *Recovering from global crisis: Social dialogue and adjustment in Romania: Progress report on ILO cooperation with constituents and the International Monetary Fund*, Governing Body, 310th Session, Geneva, Mar. 2011, Working Party on the Social Dimensions of Globalization, GB.310/WP/SDG/2/2).

—. 2011f. *Global Employment Trends 2011: The challenge of a jobs recovery* (Geneva).

—. 2011g. *Social security for social justice and a fair globalization*, Report VI, International Labour Conference, 100th Session, Geneva, 2011.

—. 2011h. *Report of the Committee of Experts on the Application of Conventions and Recommendation: Social security and the rule of law: General Survey concerning social security instruments in light of the 2008 Declaration on Social Justice for a Fair Globalization*, Report III (Part 1B), International Labour Conference, 100th Session, Geneva, 2011.

—; International Monetary Fund (IMF). 2010. *The challenges of growth, employment and social cohesion*, paper presented at the Joint ILO–IMF Conference in cooperation with the Office of the Prime Minister of Norway, Oslo, 13 Sep.

—; World Trade Organization (WTO). 2009. *Globalization and informal jobs in developing countries*, a joint study of the International Labour Office and the Secretariat of the World Trade Organization (Geneva).

International Monetary Fund (IMF). 2003. *Romania: Staff Report for the 2002 Article IV Consultation, December 2002*, IMF Country Report No. 03/11 (Washington, DC).

—. 2004. *Romania: Staff Report for the 2004 Article IV Consultation*, IMF Country Report No. 04/221 (Washington, DC).

—. 2007a. *The IMF and aid to sub-Saharan Africa*, Independent Evaluation Office of the IMF (Washington, DC).

—. 2007b. "Africa's better policies are paying off", interview with Abdoulaye Bio-Tchane, *IMF Survey Magazine* (28 Jun.).

—. 2007c. *Romania: Staff Report for the 2007 Article IV Consultation, June 2007*, IMF Country Report No. 07/219 (Washington, DC).

—. 2007d. "The globalization of labor", in *World Economic Outlook, April 2007: Spillovers and cycles in the global economy* (Washington, DC).

—. 2007e. *World Economic Outlook, October 2007: Globalization and inequality* (Washington, DC).

—. 2008a. *World Economic Outlook: Financial stress, downturns, and recoveries* (Washington, DC).

—. 2008b. *Romania: Staff Report for the 2008 Article IV Consultation, June 2008*, IMF Country Report No. 08/208 (Washington, DC).

—. 2009a. *World Economic Outlook: Sustaining the recovery* (Washington, DC).

—.2009b. *Romania: Request for Stand-by Arrangement, 24 April 2009*, IMF Country Report No. 09/183 (Washington, DC).

—. 2009c. "From recession to recovery: How soon and how strong?", in *World Economic Outlook, April 2009: Crisis and recovery* (Washington, DC).

—. 2010a. *World Economic Outlook, April 2010: Rebalancing growth* (Washington, DC).

—. 2010b. *Fiscal Monitor: Navigating the fiscal challenges ahead* (Washington, DC).

—. 2010c. *Balance of Payments Statistics Yearbook* (Washington, DC).

—. 2010d. *Regional Economic Outlook: Middle East and Central Asia*, World Economic and Financial Surveys Series (Washington, DC).

—. 2010e. *Reaching the MDGs: Macroeconomic prospects and challenges in low-income countries*, background note by IMF Staff for the United Nations MDG Summit (Washington, DC).

—. 2010f. *Romania: Staff Report for the 2010 Article IV Consultation and Fourth Review under the Stand-By Arrangement, July 2010*, IMF Country Report No. 10/227 (Washington, DC).

—. 2010g. "Unemployment dynamics during recessions and recoveries: Okun's Law and beyond", in *World Economic Outlook*, *April 2010: Rebalancing growth* (Washington, DC).

—. 2010h. "Fiscal exit: From strategy to implementation", in *Fiscal Monitor*, Nov. (Washington, DC).

—. 2011. *World Economic Outlook Update: An update of key WEO projections*, 25 Jan. (Washington, DC).

Islam, R.; Mujeri, M.K.; Ali, Z. Forthcoming. *Fiscal and policy space for crisis response with a focus on employment and labour market: A study of Bangladesh*, Employment Policy Department Working Paper (Geneva, ILO).

Jaccoud, L. 2009. *Pobres, pobreza e cidadania: Os desafios recentes da proteção social*, Texto para Discussão No. 1372 (Rio de Janeiro, Instituto de Pesquisa Econômica Aplicada (IPEA)).

Jansen, M.; von Uexkull, E. 2010. *Trade and employment in the global crisis* (Geneva, ILO and New Delhi, Academic Foundation).

Jara, A.; Moreno, R.; Tovar, C. E. 2009. "The global crisis and Latin America: Financial impact and policy responses", in *BIS Quarterly Review* (Basel), Jun.

Kapsos, S. 2004. *Estimating growth requirements for reducing working poverty: Can the world halve working poverty by 2015?*, Employment Strategy Paper No. 14, Employment Strategy Department (Geneva, ILO).

—. 2005. *The employment intensity of growth: Trends and macroeconomic determinants*, Employment Strategy Paper No. 12, Employment Strategy Department (Geneva, ILO).

Kashyap, A.K.; Stein, J.C.; Hanson, S. 2010. *An analysis of the impact of "substantially heightened" capital requirements on large financial institutions* (Chicago, University of Chicago).

Knotek, E. S. 2007. "How useful is Okun's law?", in *Economic Review* (Kansas City, Federal Reserve Bank of Kansas City), No. 4, pp. 73–103.

Kolyako, N. 2009. "Social partners in Latvia reach agreement on Reform Task Force's principles", in *The Baltic Course*, 4 Aug.

Krugman, P. 2010. "Myths of austerity" in *The New York Times*, 1 Jul.

Kucera, D.; Roncolato, L. 2011. "Trade liberalization, employment and inequality in India and South Africa", in *International Labour Review*, Vol. 150, No. 1–2.

—; —; von Uexkull, E. 2010. *Trade contraction in the global crisis: Employment and inequality effects in India and South Africa*, Employment Sector Working Paper No. 54 (Geneva, ILO).

Kumar, R.; Alex, D. 2009. "The great recession and India's trade collapse", in R. Baldwin (ed.): *The great trade collapse: Causes, consequences and prospects* (London, Centre for Economic Policy Research (CEPR)).

Kumhof, M.; Rancière, R. 2010. *Inequality, leverage and crises*, IMF Working Paper WP/10/268 (Washington, DC, IMF).

Kyrili, K.; Martin, M. 2010. *The impact of the global economic crisis on the budgets of low-income countries*, research report commissioned by Oxfam from Development Finance International (Oxford, Oxfam International).

La Marca, M. 2010. "Real exchange rate, distribution and macro fluctuations in export-oriented economies" in *Metroeconomica*, Vol. 61, No. 1, pp. 124–151.

Landesmann, P. 2008. *Productivity and employment growth in the EU since the early 1990s*, paper prepared for the ILO, unpublished document.

Lapavitsas, C. 2009. "Financialised capitalism: Crisis and financial expropriation", in *Historical Materialism*, Vol. 17, No. 2, pp. 114–148.

Layard, R.; Nickell, S.; Jackman, H. 2005. *Unemployment, macroeconomic performance and the labour market*, 2nd ed. (Oxford, Oxford University Press).

League of Arab States (LAS) and United Nations Development Programme (UNDP). 2009. *Development challenges for the Arab Region: A human development approach* (Cairo and New York).

Lee, J. 2000. "The robustness of Okun's law: Evidence from OECD countries", in *Journal of Macroeconomics*, Vol. 22, No. 2, pp. 331–356.

Leung, R.; Stampini, M; Vencatachellum, D. 2009. *Does human capital protect workers against exogenous shocks? South Africa in the 2008–2009 crisis*, IZA Discussion Paper No. 4608 (Bonn, Institute for the Study of Labor (IZA)).

Lübker, M. 2007. *Labour shares*, Technical Brief No. 1, Policy Integration Department (Geneva, ILO).

Malaysia, Government of. 2009. *Retrenchment by state, citizenship and gender: January, February, March 2009.* Labour Department Peninsular Malaysia, Labour Department Sabah and Labour Department Sarawak (Kuala Lumpur, Ministry of Human Resources).

Marais, H. 2009. *The impact of the global recession on South Africa*, Working Paper No. 114 (Madrid, Real Instituto Elcano).

Markandya, A. et al. 2010. *The costs of achieving the Millennium Development Goals through adopting organic agriculture*, Asian Development Bank Institute Working Paper No. 193 (Tokyo, ADBI).

Maupain, F. 1997. "Trade and core labour standards", in *Wirtschaftspolitische Blätter*, Vol. 44, No. 6, pp. 582–588.

McCord, A. 2010 "The impact of the global financial crisis on social protection in developing countries", in *International Social Security Review*, Vol. 63, No. 2, pp. 31–45.

Millard, S.P.; Mortensen, D.T. 1994. *The unemployment and welfare effects of labor market policies: A case for a hiring subsidy*, unpublished document (Evanston and Chicago, IL, Northwestern University).

Montenegro, C.; Hirn, L. 2008. *A new disaggregated set of labour market indicators using standardized household surveys from around the world, background paper for the World Bank's World Development Report 2009: Reshaping economic geography* (Washington, DC, World Bank).

Mortensen, D.; Pissarides, C. 1994. "Job creation and job destruction in the theory of equilibrium unemployment", in *Review of Economic Studies*, Vol. 61, No. 3, pp. 397–415.

Mostafa, J. 2010. *Economic effects of government social expenditures, unpublished mimeo* (Brasilia, Instituto de Pesquisa Econômica Aplicada (IPEA)).

Mylenko, N. 2011. "Facilitating access to finance for small and medium sized enterprises in East Asia", in *An eye on East Asia and Pacific*, No. 3 (Washington, DC, World Bank).

Naastepad, C.W.M.; Storm, S. 2006–7. “OECD demand regimes (1960-2000)”, in *Journal of Post Keynesian Economics*, Vol. 29, No. 2, pp. 211–246.

Neftci, S.N. 1984. "Are economic time series asymmetric over the business cycle?”, in *The Journal of Political Economy*, Vol. 92, No. 2, pp. 307–328.

Nesporova, A.; Popova, N. 2010. *Employment, skills and migration trends and policies*, ILO memorandum, unpublished.

Nickell, S. 1997. “Unemployment and labor market rigidities: Europe versus North America”, in *Journal of Economic Perspectives*, Vol. 11, No. 3, pp. 55–74.

Nine O’Clock RO. 2011a. “Social dialogue and teachers’ salary laws challenged in Constitutional Court”, 21 Apr.

—.2011b. “Government takes responsibility on social code and teachers unified wages law”, 18 Apr.

—.2011c. “The growing … decrease of living standards”, 5 May.

Ocampo, J.A. 2010. *How well has Latin America fared during the global financial crisis?*, Lecture Series No. 56 (Buenos Aires, Iniciativa para la Transparencia Financiera).

Okun, A.M. 1962. “Potential GNP: Its measurement and significance”, in *Proceedings of the Business and Economics Section of American Statistical Association*, pp. 98–104.

Onaran, Ö.; Stockhammer, E. 2005. “Two different export-oriented growth strategies: Accumulation and distribution a la Turca and a la South Korea”, in *Emerging Markets Finance and Trade*, Vol. 41, No. 1, pp. 65–89.

Organisation for Economic Co-operation and Development (OECD). 2006. *OECD Employment Outlook: Moving beyond the jobs crisis* (Paris).

—.2009a. *Is informal normal? Towards more and better jobs in developing countries* (Paris).

—. 2009b. *Employment Outlook 2009: Tackling the jobs crisis* (Paris).

—. 2009c. *Pensions and the crisis: How should retirement-income systems respond to financial and economic pressures?* (Paris).

—. 2010a. *Pensions markets in focus* (Paris), Iss. 7, Jul.

—. 2010b. *Preparing fiscal consolidation* (Paris).

Ortiz, I. et al. 2010. *Prioritizing expenditures for a recovery for all: A rapid review of public expenditures in 126 developing countries*, Social and Economic Policy Working Paper (New York, UNICEF).

Orton, I. 2010. “The impacts of the crisis on social security administrations: A review of the findings of an ISSA survey”, in *International Social Security Review*, Vol. 63, No. 2, pp. 87–101.

Ostry, J. D. et al. 2010. *Capital inflows: The role of controls*, IMF Staff Position Note SPN/10/04 (Washington, DC, IMF).

Pagano, M.; Volpin, P.F. 2005. “Managers, workers, and corporate control”, in *The Journal of Finance*, Vol. 60, No. 2, pp. 841–868.

Papadakis, K. 2010. *Restructuring enterprises through social dialogue: Socially responsible practices in times of crisis*, DIALOGUE Working Paper No. 19, Industrial and Employment Relations Department (Geneva, ILO).

—. Forthcoming. *The EU–IMF–ECB structural adjustment programme in Greece and its impact on industrial and employment relations: A preliminary overview and assessment*, Working Paper, Industrial and Employment Relations Department (Geneva, ILO).

Patras, E. 2010. *The impact of the financial crisis in Greece on industrial relations/human* *resource management*, paper presented at the International Industrial Relations Association Regional Conference, Copenhagen, 9 July.

Phelps, E. 1998. *Structural slumps: The modern equilibrium theory of unemployment, interest, and assets* (Cambridge, MA, Harvard University Press).

Pino, A.; Yermo, J. 2010. "The impact of the 2007–2009 crisis on social security and private pension funds: A threat to their financial soundness?", in *International Social Security Review*, Vol. 63, No. 2, pp. 5–30.

Prasad, N.; Gerecke, M. 2009. *Employment-oriented crisis responses: Lessons from Argentina and the Republic of Korea*, Policy Brief (Geneva, International Institute for Labour Studies, ILO).

Pyatt, G.; Round, J. 1979. "Accounting and fixed price multipliers in a Social Accounting Matrix framework", in *Economic Journal*, Vol. 89, No. 356, pp. 850–873.

Rajan, R.G. 2010. *Fault lines: How hidden fractures still threaten the world economy* (Princeton, NJ, Princeton University Press).

Ravallion, M. 2008. *Bailing out the world's poorest*, Policy Research Working Paper No. 4763 (Washington, DC, World Bank).

Reich, R. 2010. *Aftershock: The next economy and America's future* (New York, Knopf).

Reinhart, C.; Rogoff, K. 2009. *This time is different: Eight centuries of financial folly* (Princeton, NJ, Princeton University Press).

Reuters. 2010. "Bangladesh doubles credit for small enterprises", Dhaka, 7 Nov.

Rodrik, D. 2008. *The real exchange rate and economic growth*, Brookings Papers on Economic Activity, No. 2 (Washington, DC, Brookings Institution).

Romania, Government of. 2010a. Letter of Intent from the Government of Romania to the IMF, 16 June 2010, in IMF (2010f), p. 92.

—. 2010b. Letter of Intent from the Government of Romania to the IMF, 22 December 2010, in International Monetary Fund (2011): *Romania: Sixth review under the Stand-By Arrangement, IMF Country Report 11/20* (Washington, DC).

—. 2011. Explanation Statement for Law to modify and complete Law No53/2003, 28 Feb. 2011.

Ronnas, P.; Kwong, M. 2009. *Deriving targets for productive employment from poverty target*, Employment Department, unpublished working paper (Geneva, ILO).

Roy, R. 2010. *Fiscal space: A human development framework*, presentation at the Employment Policy Department Retreat, Geneva, 14–16 September 2010.

Rubery, J. (ed.). 1988. *Women and recession* (London, Routledge).

Rychly, L. 2009. *Social dialogue in times of crisis: Finding better solutions*, DIALOGUE Working Paper No. 1, Industrial and Employment Relations Department (Geneva, ILO).

Saboia, J. 2007. *Salário mínimo e distribuição de renda no Brasil no período 1995/2005: Fatos e simulações*, paper presented at the seminar "Análise dos Resultados das Pesquisas Nacionais por Amostra de Domicílios", CGEE/IPEA/MEC/MTE, Brasília, Mar.

Sahoo, P. 2010. "Increasing FDI in India: Does the budget go far enough?" in East Asia Forum (blog), 25 Mar., East Asian Bureau of Economic Research (EABER) (Canberra, Australian National University).

Sakthivel, S.; Joddar, P. 2006. "Unorganized sector workforce in India: Trends, patterns and social security coverage", in *Economic and Political Weekly*, Vol. 41, No. 21, pp. 2107–2114.

Saluja, M.R.; Yadav, B. 2006. *Social accounting matrix for India 2003–04* (Haryan, India Development Foundation).

Schettini, B.P. et al. 2010. *Novas evidências empíricas sobre a dinâmica trimestral do consumo agregado das famílias brasileiras no período 1995–2009* (Brasilia, Instituto de Pesquisa Econômica Aplicada (IPEA)).

Schneider, F. 2007. *Shadow economies and corruption all over the world: What do we really know?*, Economics Discussion Papers No. 2007–9. Available at http://www.economics-ejournal.org.

Singapore, Government of. 2010. *Budget statement for the financial year 2010: Towards an advanced economy: Superior skills, quality jobs and higher income*, speech presented by Mr. Tharman Shanmugaratnam, Minister for Finance, 22 Feb.

Spanu, A. 2010. "90,000 new jobs if labour market is more flexible, FIC insists", in *Nine O'Clock RO*, 8 Dec.

Stanculescu, M. S. 2006. *Informal economy and unregistered work in Romania*, paper presented at the EU–ILO Project on Social Dialogue as a Tool to Address Unregistered Work, Ankara, Turkey, November 2006.

Statistics Indonesia (BPS). 2010. *Labor force situation in Indonesia on August 2009* (Jakarta).

Statistics South Africa. 2010. *Quarterly Labour Force Survey*, Quarter 1, 2009 to Quarter 1, 2010 (Pretoria).

Stiglitz, J. 2002. *Globalization and its discontents* (New York, W.W. Norton).

—. 2009. "The global crisis, social protection and jobs", in *International Labour Review*, Vol. 148, No. 1–2, pp. 1–13 .

Stockhammer, E. 2009. *Determinants of functional income distribution in OECD countries*, Macroeconomic Policy Institute (IMK) Studies No. 5, (Düsseldorf, Hans Böckler Stiftung).

—; Onaran, Ö.; Ederer, S. 2009. "Functional income distribution and aggregate demand in the Euro area", in *Cambridge Journal of Economics*, Vol. 33, No. 1, pp. 139–159.

Storm, S.; Naastepad, C.W.M. Forthcoming. *Macroeconomics beyond the NAIRU* (Cambridge, MA, Harvard University Press).

Sumner, A. 2010. *Global poverty and the new bottom billion: What if three-quarters of the world's poor live in middle-income countries?*, IDS Working Paper (Brighton, Institute for Development Studies).

Supiot, A. 2010. "A legal perspective on the economic crisis of 2008", in *International Labour Review*, Vol. 149, No. 2. pp. 151–162.

Thurlow, J. 2005. *South African social accounting matrices for 1993 and 2000* (Washington, DC, International Food Policy Research Institute).

Torres, R. 2010a. "Incomplete crisis responses: Socio-economic costs and policy implications", in *International Labour Review*, Vol. 149, No. 2, pp. 227–237.

—. 2010b. "Recovering from the jobs crisis", in Carnegie Council: *Policy innovations for a fairer globalization* (New York).

Trebilcock, A. 2004. "International labour standards and the informal economy", in J-C. Javillier; B. Gernigon: *Les normes internationales du travail : Un patrimoine pour l'avenir – Mélange en l'honneur de Nicolas Valticos* (Geneva, ILO).

Tzannatos, Z. 2008. *The policy environment for job creation in the Arab economies*, World Bank, Middle East and North Africa Region and Mohammed Bin Rashid Al Maktoum Foundation, Dubai (Washington, DC, World Bank).

—. 2009. *The global financial, economic and social crisis and the Arab countries: A review of the evidence and policies for employment creation and social protection*, paper presented at the ILO and the Arab Labour Organization (ALO) Arab Employment Forum, Beirut, 19–21 Oct.

United Nations (UN). 2009. *Recovering from the crisis: A global jobs pact*, Economic and Social Council, E/2009/L.24, Substantive session of 2009, Geneva, 6–31 July.

—. 2010. *The Millennium Development Goals Report 2010* (New York).

United Nations Conference on Trade and Development (UNCTAD). 2010a. *The Least Developed Countries Report 2010: Towards a new international development architecture for LDCs* (Geneva).

—. 2010b. *World Investment Report 2010: Investing in a low-carbon economy* (Geneva).

—. 2010c. *Trade and Development Report 2010: Employment, globalization and development* (Geneva).

United Nations Development Programme (UNDP). 2010a. *MDG progress reports for Egypt, Tunisia and Morocco* (New York).

—. 2010b. *Beyond the midpoint: Achieving the Millennium Development Goals* (New York).

United Nations Research Institute for Social Development (UNRISD). 2010. *Combating poverty and inequality: Structural change, social policy and politics* (Geneva).

United Nations System Chief Executives Board for Coordination (UN–CEB). 2009. "Initiative VI: A social protection floor", in *Global financial and economic crisis: UN system joint crisis initiatives* (New York).

van Treeck, T. 2010. *Liquidity constraints versus loss aversion in household consumption: A simple reconciliation*, Macroeconomic Policy Institute (IMK) Working Paper No. 13 (Düsseldorf, Hans Böckler Stiftung).

Vega Ruiz, M.L. 2010. *Strengthening labour inspection in Romania*, ILO memorandum, unpublished (Geneva, ILO).

Verick, S. 2010. *Unravelling the impact of the global financial crisis on the South African labour market*, Employment Sector Working Paper No. 48 (Geneva, ILO).

von Arnim, R. 2009. "Recession and rebalancing: How the housing and credit crises will impact US real activity", in Journal of Policy Modelling, Vol. 31, pp. 309–324.

Weeks, J.; McKinley, T. 2006. *Does debt relief increase fiscal space in Zambia? The MDG implications*, Country Study No. 5 (Brasilia, UNDP International Poverty Centre).

Wijaya, M. 2010. "In Singapore, productivity at all costs", in *Asia Times Online* (Hong Kong), 23 Mar.

Williamson, J. 2004. *A short history of the Washington Consensus*, paper presented at the CIDOB Foundation Conference, "From the Washington Consensus towards a New Global Governance", Barcelona, 24–25 September.

World Bank. 1994. *Averting the old age crisis: Policies to protect the old and promote growth* (Washington, DC).

—. 2006. *Pension reform and the development of pension systems: An evaluation of World Bank assistance*, Independent Evaluation Group (Washington, DC).

—. 2009. *World Development Indicators* (Washington, DC).

—. 2010a. *Indonesia jobs report: Towards better jobs and security for all* (Jakarta).

—. 2010b. *Global Economic Prospects: Crisis, finance and growth* (Washington, DC).

—. 2011. *Food Price Watch* (Feb.), World Bank Poverty Reduction and Equity Group.

Available at http://www.worldbank.org/foodcrisis/food_price_watch_report_feb2011.html.

World Commission on the Social Dimension of Globalization (WCSDG). 2004. *A fair globalization: Creating opportunities for all* (Geneva, ILO).

World Trade Organization (WTO). 2010. *Trade value growth slows in the third quarter of 2010*, Press release, 1 Dec. (Geneva).

Zhang, Y.; Thelen, N.; Rao, A. 2010. *Social protection in fiscal stimulus packages: Some evidence*, United Nations Development Programme, Office of Development Studies (UNDP/ODS) Working Paper (New York, UNDP).

# DATABASES


European Commission. The European System of Integrated Social Protection Statistics (Eurostat/ESSPROS) database. Available at http://epp.eurostat.ec.europa.eu/portal/page/portal/social_protection/introduction.

European Union. Eurostat. Available at http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes.

India, Government of. 2006. National Sample Survey Organisation (NSSO). National Sample Survey: Employment–Unemployment NSS, 61st Round, July 2004–June 2005 (New Delhi). Available on CD.

International Labour Office (ILO). Global Wage database. Available at http://www.ilo.org/travail.

—. Key Indicators of the Labour market database. Available at http://www.ilo.org/empelm/what/lang--en/WCMS_114240.

—. NATLEX database. Available at http://www.ilo.org/dyn/natlex/natlex_browse.home?p_lang=en.

—. Social Security Inquiry database. Available at http://www.ilo.org/dyn/ilossi/ssimain.home?p_lang=en.

International Monetary Fund (IMF). Government Finance Statistics (GFS) database. Public social protection (excluding health) expenditure in percentage of GDP. Available on CD.

Organisation for Economic Co-operation and Development (OECD). Social Expenditure database (SOCX). Available at http://www.oecd.org/document/9/0,3343,en_2649_34637_38141385_1_1_1_1,00.html.

Statistics South Africa (Stats SA). Labour Force Survey. Available at http://www.statssa.gov.za/keyindicators/lfs.asp.

US International Trade Commission (USITC). Monthly import data from India and South Africa at the Harmonized System (HS) eight-digit level, United States. Available at http://www.census.gov/foreign-trade/index.html.

World Bank. World Development Indicators database. Available at http://databank.worldbank.org/ddp/home.do.

—. World Economic Outlook database, Apr. and Oct. Available at http://www.imf.org/external/pubs/ft/weo/2010/01/weodata/index.aspx.

World Health Organization (WHO). WHO Statistical Information System (WHOSIS), now replaced by the Global Health Observatory (GHO). Available at http://www.who.int/gho/en/.