1. European social revival and the great recession

Introduction

Though some signs of recovery are already apparent, the 2009 collapse in economic activity will continue to create perverse effects. While unemployment in Europe and the euro area is expected to spiral up to record highs of 11 or 12% by the end of 2010, public deficits and public debt are hitting 6 to 7% and 100% of GDP respectively, levels that are well outside the range tolerated by the Maastricht criteria.

In the face of these dismal trends in unemployment and public finances, policymakers in Europe are anxious to get back to 'business as usual'. Fiscal 'exit' strategies and cutting public expenditure should, in these policymakers' view, become the new priorities, while the return of mass unemployment will, they believe, require a stepping up of labour market supply-side policies such as 'activating' the unemployed and 'making work pay'.

This article issues a strong warning against any such return to the conventional wisdom of the past. It argues that neither should the crisis be regarded as an 'unfortunate accident', nor can analysis of its causes stop at a diagnosis of financial market failure. Instead, it is the entire Washington-Brussels-Frankfurt consensus that must be called into question. It is the systematic bias in favour of unregulated markets and business profits resulting in high and rising inequalities that is the root cause of this crisis. The second part of the article thus goes on to describe how the Washington – Brussels – Frankfurt consensus should be replaced by an alternative set of economic and social policies designed to achieve a rebalancing of the interests of labour and capital and of the market and the state.

Themes

1.1 From social recession to casino capitalism

1.2 European social revival as the way out of the great recession

1.3 Conclusions: 'Labour is not a commodity'

1.1 From social recession to casino capitalism

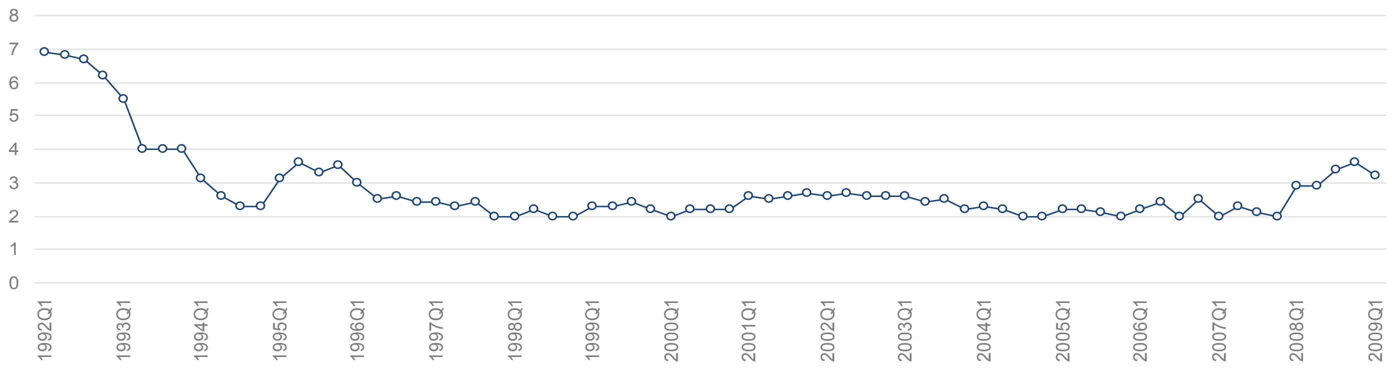
Business-friendly supply-side reform as the basis of the great recession

Over the past decade or two, workers and trade unions in Europe have been subjected to constant exhortation. They were lectured about the need to accept greater inequalities since, by rewarding the most talented, the economy would become more innovative, and the benefits of this would, in one way or another, trickle down to the rest of society. Workers were also urged to become more active, more flexible and more moderate in their claims. In order to boost business competitiveness, they were to become less dependent on social benefits, ready to accept any offer of any job at any wage and in any place, easier to fire, more restrained and flexible in their wage demands. In short, a deliberate choice had been made in favour of a supply-side policy agenda that placed the whole burden of adjustment on the shoulders of the labour force, while ‘pampering’ the business side of the equation.

This business-friendly supply-side agenda has indeed been delivered. Reforms of temporary job protection systems have opened the back door on regular job protection, providing business with the ‘easy’ firing which it so cherishes. Meanwhile, unemployment benefit systems have also been downgraded as numerous member states, inspired by the ‘making work pay’ slogan, have reduced benefit levels and benefit duration while also making it more difficult to access unemployment benefit systems (an overview of these developments can be found in Lefresne 2008). On top of this, wage formation systems have been reformed with the focus of collective bargaining being shifted to the company level (company-level opening clauses in sectoral agreements, for example).

The effect of all these ‘reforms’ has been to severely weaken the bargaining position of organised labour. Figure 1.1, describing the average development of collectively agreed wages in the euro area, illustrates the extent to which this process has taken place. Whereas collectively agreed wages were still reactive to business cycle upturns at the beginning of the nineties (for example an 8% wage increase in 1991 – 1992 under the influence of German reunification), the whole collective bargaining process subsequently lost much of its momentum. From the mid-nineties on, the annual growth rate of collectively agreed wages fell to around 2%. Even during the few years in which the business cycle reached a peak (2000, 2007), euro-area trade unions were able to obtain wage deals of no more than around 3%. Since trend inflation was running somewhat below 2%, this meant a decade of stagnating purchasing power for euro-area collective bargaining.

Figure 1.1 Collectively agreed wages in the euro area



Source: ECB.

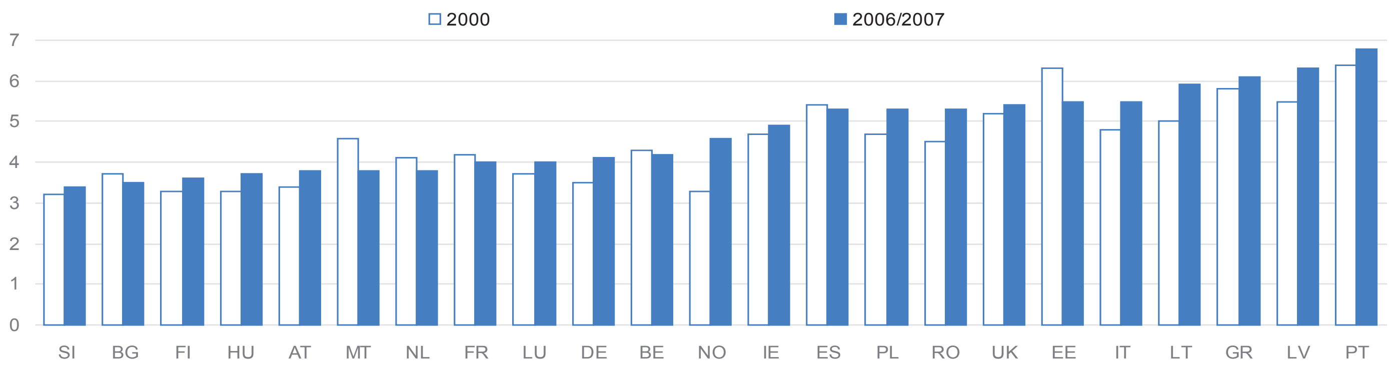
1.1 From social recession to casino capitalism

Business-friendly supply-side reform as the basis of the great recession

Whereas moderation and flexibility became the governing principles on the side of organised labour, the contrary applied on the side of business actors. The economic rents created by flexibility, precarious work practices and wage restraint were easily captured by the real insiders, so that the shareholders, along with a certain elite of CEOs, managers, supervisors, etc., profited enormously. Super dividend pay-outs, share buy-backs, bonuses and stock options boomed alongside weak wage dynamics.

The end result is that economies have become more unequal. Inequalities have certainly soared in the Anglo-Saxon world and one stunning statistic here is that inequalities in the US and the UK have now almost returned to the levels pre-dating the Great Recession of the 1930s, such that the richest one percent of the population capture some 15% of the total national income of the economy. However, many countries in continental Europe have also been confronted with high or rising inequalities (OECD 2008). For example, as can be seen from the right-hand side of Figure 1.2, in several continental European countries the top 20% of incomes are currently five to six times as high as the lowest 20% of incomes.

Figure 1.2 Inequality of income distribution (80/20 income quintile share ratio), 2000-2006/07



Data source: Eurostat but taken from ETUC and ETUI (2008) *Benchmarking Working Europe*.

1.1 From social recession to casino capitalism

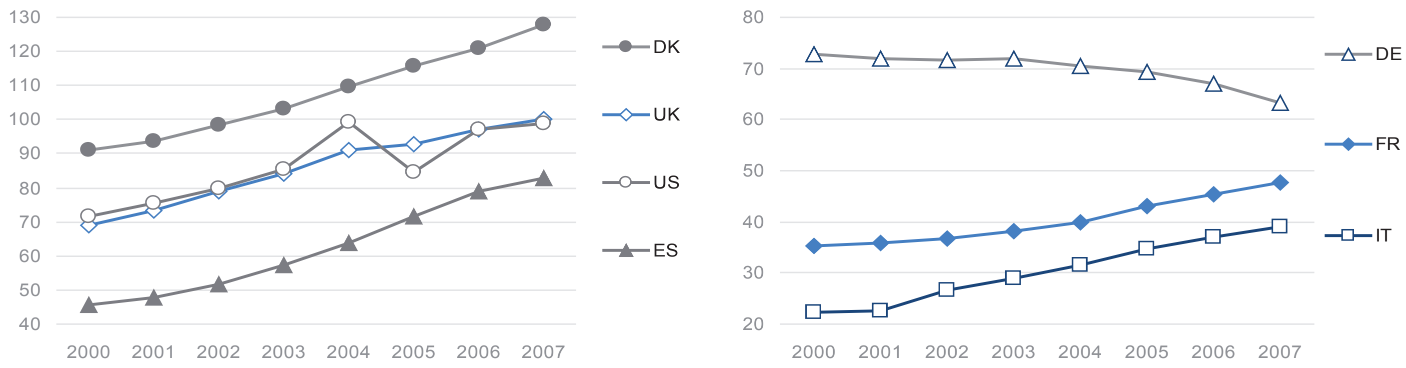
‘Bubble’-driven growth reaching its limits

These inequality trends deriving from the previously described business-friendly policy agenda give rise to a major problem. When a small elite captures up to 15 or even as much as 30% of a country’s total income, the balance between aggregate demand and aggregate supply is disturbed. In other words, since the super rich do not spend their entire income, much of this is being saved, while the lower incomes, on the other hand, have a high propensity to consume and are financially constrained to do so.

It is here that ‘financial innovation’, or more accurately, ‘casino capitalism’ comes in. To compensate for the loss of demand dynamics resulting from the fact that many workers lose out on their fair share of economic progress, policy has relied on financial markets to step in and fill the missing gap. In the absence of progress in real wages and with good jobs being turned into unstable contracts, demand and economic growth needed to rely increasingly on households taking on excessive debt loads and on the creation of ‘asset price bubbles’.

The magnitude acquired by this low-wage/high-debt economy in several countries in recent years is truly astonishing. From 2000/2001, there was a virtual explosion in the level of household debts in a number of countries including, in particular, the US, the UK, Spain, and Denmark (see Figure 1.3). This fact also sheds a totally different light on the so-called ‘economic miracle’ that befell several of these economies. It was claimed until very recently that the economic successes of countries like the UK, the US or Ireland (and Denmark for that matter) were attributable to their highly flexible labour markets. It is now apparent that many of these countries were simply living on borrowed money and unsustainable asset booms.

Figure 1.3 Household debt load as % of GDP



Data source: OECD (2008).

1.1 From social recession to casino capitalism

'Bubble'-driven growth reaching its limits

The policy of financial market deregulation needs to be seen from this perspective. Lending standards, practices and formulae were relaxed and predatory lending was allowed not only because it was believed this would lead to greater 'market efficiency' but also because household spending could in this way be kept up. Banks were allowed to expand credit way beyond their means and the capital at their disposal by hiding masses of credits in offshore vehicles and allowing new and complicated but untested internal valuation models to artificially lower the risk evaluation of assets while ignoring the possibility of 'systematic' risk.

As such, the financial crisis – with banks on the verge of bankruptcy, with thousands of billions of toxic assets hidden in banks' balance sheets, with its exotic names and complicated products – is actually a sort of 'red herring'. Bankers and fund managers did not develop risky practices, such as sub prime lending, credit default swaps and offshore structured investment vehicles, solely because of their own individual greed. They were actually allowed, indeed encouraged, to do so because, otherwise, the economic system – with its deep and strong policy bias against labour and in favour of inequalities – was unmanageable. This makes today's recession not just a crisis of financial markets but also a crisis of the economic model of inequality.

At the same time, it is important to establish a proper understanding of the fact that the limits have been reached. In those countries that used to rely on speculative bubbles to drive demand dynamics, debt loads and asset prices have now become excessively high and the speculative boom has turned into a speculative bust. Private sector agents now want to drive their debt burdens down and asset prices too are caught in a downward spiral.

1.1 From social recession to casino capitalism

'Free riders' of casino capitalism

Not all countries have resorted to excessive borrowing to speculate in asset booms. Germany, with its extreme tradition of monetary stability, and Japan, still digesting the consequences of the pricking of the asset bubble at the beginning of the nineties, are two of the most notable exceptions. These countries have instead sought to repeat their traditional recipe of an export-led recovery. In trying to improve their competitive positions, both Germany and Japan have gone further than others in promoting the interests of business at the expense of those of labour. Germany maximised the model of wage moderation and competitive disinflation, while in Japan the labour side of the production equation has been systematically undermined by the spread of precarious, atypical work.

Both countries have poor results to show. They may indeed be export champions but this success has come at the expense of weak domestic demand, while overall growth performance has been unconvincing. What is more, the financial crisis highlights an additional and serious flaw in this model of export-led growth. Export-led strategies make sense only if demand dynamics are flourishing in the countries to which exports are sent. Germany and Japan have been 'free riding' on the US, UK's and Spanish asset booms which were powerful enough to drive forward their own domestic demand as well as export demand. Now that these asset booms have disappeared, Germany and Japan no longer have their typical export-demand motor to drive their economies forward, with the result that both these countries, alongside many others, fell into recession. While the collapse in economic activity was even more pronounced in Germany, unemployment did not rise to the same extent as it did in other countries, this being thanks to government-sponsored schemes for reducing and sharing working hours.

1.1 From social recession to casino capitalism

A return to 'business as usual' is not an option

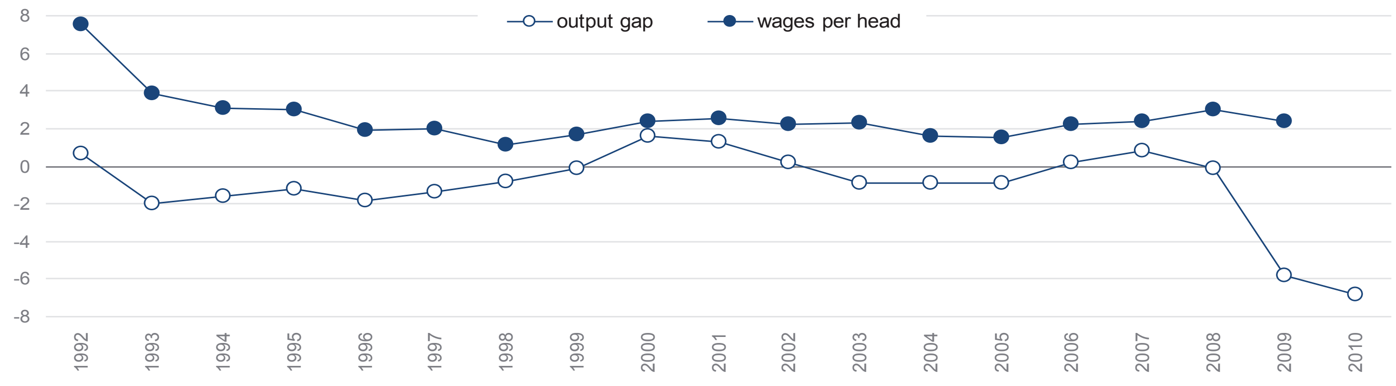
Old habits do not die easily. Many economists still preserve in their mind this model of promoting the interest of business at the expense of labour while counting on financial market innovation to take care of the deficit in aggregate demand.

However, as argued above, this model of excessive borrowing for purposes of speculation has now reached its limits. Approaches based on 'exit' strategies to drive public deficits down, labour market deregulation to boost labour supply, wage moderation to hike business profits and dividends, can no longer count on aggressive demand management disguised as financial market innovation to stabilise the economy. Any attempt to continue to pursue these traditional policies, while the private sector continues to drive down its debt positions, is bound to produce economic and social disaster.

Figure 1.4 provides one illustration in the area of wage moderation. The graph traces the past behaviour of wages in relation to economic downturns. It appears that there is a certain relationship between the output gap (i.e. the gap between actual and potential economic activity) and wage dynamics. Each time economic activity slumps and slack in the economy develops (early 1990s, around 2001), wage dynamics also suffer: a 1% negative output gap can be linked with a deceleration of wage growth of around 1%. At times of previous crisis, this brought the growth of per capita wages down to a minimal rate of 1.5 to 2%.

Application of this 'rule of thumb' to the coming years triggers a strong warning signal. Indeed, the intensity of this financial crisis is much more pronounced than in the two previous cases. The economy is now estimated to have slumped some 6 to 8% below its potential, making for a huge output gap. If this enormous slack in economic activity indeed develops, it will inevitably have an effect on wages. And since wage dynamics are already starting from a weak rate of growth, the risk of their collapse is very high. If that were allowed to happen, the crisis would then move into another phase whereby cuts in wages would trigger deflationary wage price spirals, real interest rates would rise and we would find ourselves in a situation of 'debt deflation' and the talk would be no longer of a 'Great Recession' but of a 'New Great Depression' to be compared with what happened in the 1930s.

Figure 1.4 Wage dynamics and output gaps in euro area



Source: OECD (2008).

1.2 European social revival as the way out of the great recession

Stronger workers' rights in the internal market

Workers' rights are not part of the problem; they are part of the solution. Stronger workers' rights are not only urgent to stop the perverse distribution and the rise in inequalities and precarious labour market practices that has been gaining impetus over many years. Stronger workers' rights also make good 'economic' sense for, by rebalancing the interests of business and labour, economic upturns can be made self-sustaining with the economy driven by the creation of good and stable jobs paying decent wages instead of having to rely on speculative bubbles and risky lending practices.

Here are some of the most important points of such a policy programme:

First of all, the recent decisions of the European Court of Justice need to be addressed. In court cases such as 'Laval', the ECJ has in practice subordinated the fundamental right to strike to the fundamental freedom to trade in the internal market. Trade unions wanting to undertake collective action in cases involving cross-border services now have to think twice and consider whether their action meets the various criteria related to the internal market philosophy of free trade (proportionality, justified objective and having exhausted all other and less distorting options). In this regard, the European political dimension needs to bring the European Court of Justice back into line and into the basic spirit of European integration by drawing up a Social Progress Protocol in which fundamental social rights are given precedence over the economic freedoms of the single market. Such fundamental social rights include the collective right to organise, to undertake collective action and to strike. The resulting Social Progress Protocol should be attached to the European Treaty.

Closely related to this case is the revision of the Posting of Workers' directive which the ECJ has (ab)used to turn European minimum standards into national maximum standards. Countries are free to set minimum standards also for workers posted from abroad but higher wages resulting from collective bargaining cannot be enforced upon the employer. In this way, the ECJ is promoting 'unequal pay for equal work'. If the policy aim is to safeguard the legitimacy of workers' mobility in the internal market and prevent employers from using cross-border posted workers to undercut other workers, then a revision of the Posted Workers' directive is essential.

The third issue of relevance here is the widespread use of precarious labour and unstable employment contracts. In this respect, it should be recognized that the principles of the European social *acquis* are too weak and, in any case, are not really respected. European social directives, as well as European social agreements, do stipulate that non-regular contracts should remain the exception and not become the rule. The social *acquis* also requires member states to call a halt to the practice of endless chains of fixed-term contracts in which the same worker is performing the same work over many years through a succession of short-term contracts. In practice, however, the national-level implementation of these European principles leaves much to be desired. To give a single example, several member states allow chains of fixed-term contracts for as long as three or even six years, thereby allowing business to transform what are basically stable and productive jobs into insecure contracts. Accordingly, a third proposal to strengthen workers' rights is to reappraise the role of the European social *acquis* by identifying existing gaps (for example, a directive on agency work is missing) and by a stronger and systematic follow-up of its implementation at national level.

1.2 European social revival as the way out of the great recession

Better pay: common European principles for stronger collective bargaining

To counter the risk of the crisis triggering wage undercutting which will then spill over into deflation and prolonged depression, collective bargaining and wage formation institutions require substantial strengthening. Instead of wage freezes and nominal wage cuts, policy needs to promote real (and nominal) wage increases. The aim is to turn wages, in these times of looming deflation, into an anchor of price stability.

This can be done by developing a European framework for 'fair and decent' wages against the background of the European Employment Strategy. This European framework would encourage member states, in close association with the national social partners, to conduct policies and establish collective bargaining practices so that strong downwards floors in wage dynamics are put in place. This implies setting wage floors for the lowest wages to make sure there is a bottom in the labour market under which wages cannot fall.

However, it is not enough to address low wage or poverty wage situations. If we want to avoid deflation traps, then more needs to be done and the entire structure of collectively agreed wages needs to be sheltered from the downward pressure coming from this crisis. This implies enforcing respect for and promoting 'going' wage rates and wage increases as agreed to in collective agreements. Several instruments to do so exist and can be used by member states and national social dialogue (legal extension of collective bargaining, developing 'Ghent' systems of unemployment benefits in which trade unions administer the systems and are in this way able to organise the workforce, general policies to promote trade union membership, and so forth).

1.2 European social revival as the way out of the great recession

More and better jobs: invest in an expanded European recovery plan

Stronger workers' rights and better pay can make an economic recovery self-sustaining. However, a strong recovery will not come on its own. With excessive debt loads of households, banks and business, private sector spending and investing is likely to be depressed for several years to come. To prevent this doomsday scenario and to ensure a strong recovery instead, Europe needs to create a new driving force for growth and jobs. Investment to fight climate change and achieve a green and sustainable future for Europe can provide the necessary steam, driving growth and creating millions of new jobs.

More practically, a large-scale investment plan totalling an annual 1% of GDP effort for the next three years needs to be drawn up. Investment possibilities at the European level exist in the areas of renewable energies, clean technologies, energy savings, physical and social infrastructure and networks, while materials of the future, modern cars and clean transportation systems need to be identified. To avoid an overburdening of member states' public finances and to overcome the fact that several member states are themselves cut off from access to affordable finance, this investment effort requires support at the European level itself. The European budget needs to be topped up with the European Investment Bank's power to borrow on international capital markets and the initiative as a whole needs to be backed up by European central banks buying these debt bonds.

If these investments start to kick in from the beginning of next year, we can hope to avoid much of the increase in unemployment that is expected to take place during 2010. Moreover, these investments will have a multiplier effect. They will continue to provide further support for economic activity and employment over the next years, thereby gradually bringing high unemployment rates down.

1.3 Conclusions

‘Labour is not a commodity’

The policy programme geared to European social revival, as it has been described above, should not be seen as a concern only for workers and trade unions. It should be regarded, over the long term, as of relevance also to the interest of business. Business as a whole has no objective interest in the spread of precarious work practices, unstable jobs, or long working hours. By treating labour as a commodity, these work practices undermine the motivation and commitment of workers, thereby damaging productivity and innovation. Nor does business have any true interest in growth and demand being driven by speculation and asset bubbles. Speculative bubbles burst sooner or later and the consequences of this for the real economy, for both labour and capital, are disastrous.

Accordingly, Europe urgently needs to rediscover workers’ rights as a force for productivity and as a way of building a new model of economic progress in which fair wages and working conditions constitute the basis of growth and employment dynamics. We need to turn away from the logic which claims that Social Europe is just a cost and bring in a new social deal according to which workers’ rights act as a beneficial constraint, given that individual businesses may indeed be tempted to take the easy way out and resort to unsustainable practices such as unstable work relationships, low wages and long working hours. The best way to resist this temptation is to introduce strong and robust labour standards, developed in conjunction with strong and representative trade unions, with Europe backing up these labour standards by establishing a level playing field for competition in the internal market.