

World of Work Report 2009

World of Work Report 2009

The Global Jobs Crisis and Beyond

INTERNATIONAL LABOUR ORGANIZATION
INTERNATIONAL INSTITUTE FOR LABOUR STUDIES

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The **International Institute for Labour Studies** was established by the International Labour Organization in 1960 as an autonomous centre for advanced studies in the social and labour field.

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Editorial

Raymond Torres

Director

International Institute for Labour Studies

The world economy is rebounding from the financial crisis, aided by stimulus measures...

The world economy is exhibiting encouraging signs of a recovery. The IMF now predicts over 3 per cent economic growth for 2010, with Brazil, China and India leading the economic rebound. In addition, this Report shows that job losses have been less than would have been predicted on the basis of earlier crises. Indeed, another Great Depression has probably been avoided, aided by stimulus measures implemented by governments since the onset of the crisis.

...but the jobs crisis is far from over...

Despite these major achievements, the global jobs crisis is not over and it could even worsen unless adequate action is taken.

First, the jobs crisis is much larger in size than unemployment figures suggest. As shown in Chapter 1, in the 51 countries for which data are available, at least 20 million jobs have been lost since October 2008 when the financial crisis started. But unemployment is only one dimension of the jobs crisis: about 5 million workers are at risk of losing jobs now. Though demand and output fell steeply, enterprises have kept millions of workers, often through the support of governments. These workers are currently on shorter hours, partial unemployment or involuntarily part time. They are at risk of losing their job if firms become unviable, governments withdraw their support, or the economic rebound is not strong enough.

Given job retention and usual lags in hiring decisions, the initial stages of the economic rebound will entail little job creation. Employment in high GDP per capita countries will not return to pre-crisis levels before 2013. In emerging and developing countries, employment levels could start recovering from 2010, but will not reach pre-crisis levels before 2011.

Second, and more fundamentally, there is a significant risk that the jobs crisis will have long-lasting negative social and economic implications. The Report estimates that almost 43 million workers are at-risk of exclusion from the labour market – because, if the right programmes are not put in place or existing ones are phased out, individuals could shift to long-term joblessness or drop out of the labour market entirely. Experience from earlier crises suggests that this risk is especially acute for the low-skilled, migrant and older workers. New entrants, including youth and women, will face major difficulties obtaining employment. There are already some indications that the proportion of people of working age who do not participate in the labour market has started to increase. In developing countries, high-quality jobs have been lost and affected workers are likely to move to the informal economy.

For the workers concerned and their families, hardship is aggravated by gaps in the social protection system. Two-thirds of the countries for which data are available do not have unemployment benefits. Only one third of developing countries provide some form of social protection to informal sector workers and the self-employed. Everywhere, perceptions of job precariousness are on the rise.

...threatening economic recovery.

The prospect of greater long-term joblessness also undermines confidence, thereby affecting consumption and investment decisions. It therefore represents a major threat to economic recovery itself. Also, perceptions of job precariousness will exert further downward pressure on wages, aggravating the risk of depressed aggregate demand.

In short, economic recovery will remain both fragile and incomplete as long as the jobs crisis continues.

So a premature exit from stimulus measures would be counterproductive and expensive for budgets in the long run...

It is therefore crucial to avoid premature or ill-conceived exit strategies. Public debts have increased significantly – reflecting both the bail out of the financial system and fiscal stimulus measures. So governments and social partners face the twin challenge of addressing the jobs crisis while avoiding an unsustainable aggravation of fiscal goals. However, the Report shows that badly shaped spending cuts now would hit many existing jobs which were saved thanks to earlier stimulus measures but are still at risk. Such an early exit would also postpone employment recovery and would aggravate the risk of long-term joblessness, labour market exclusion and employment informality.

Importantly, bringing outsiders back into productive employment has proven very difficult and exorbitantly costly for the public purse in past crises. Taking preventive action now would therefore be cost-effective in the long run. Public deficits would be temporarily impacted by the expenditure outlays required to reinforce employment-related measures. But such policies would effectively address the needs of firms and workers – the real economy. Indeed, the boost in economic activity resulting from the job gains would auger well for a return to pre-crisis debt levels in the medium-term.

...underlining the need for, first, continued job-centred stimulus to promote economic recovery as stressed in the Global Jobs Pact...

The Report shows that a continuation of fiscal stimulus measures, if better focused on jobs as recommended in the ILO Global Jobs Pact, would raise employment by 7 per cent compared to an early exit situation. Moreover, while this would raise public expenditures in the short run, the potential gains in terms of employment and output would allow public debt to return to its pre-crisis level in the medium-term.

There is evidence that measures focused around the principles of the ILO Global Jobs Pact are effective. For example, Australia, Brazil, Germany, Jordan and the Republic of Korea have successfully implemented measures consistent with the Global Jobs Pact, by (i) focusing crisis responses on employment, social protection and skills; (ii) avoiding counterproductive measures such as downward spiral of wages or downgrading labour standards; and, (iii) exploiting the potential for social dialogue in order to improve the design of crisis responses and their social acceptance. Importantly, most of these countries have acted quickly and in a targeted manner, explaining why the measures have been so cost-effective.

...and, second, reforms of the financial system to make recovery sustainable

The effectiveness of job-centered crisis responses will be constrained as long as the root causes of the crisis are not addressed. Rescue packages to financial institutions have reached unprecedented levels in countries where the crisis originated. The bill will be expensive for taxpayers and job losers. It is therefore essential to ensure that an end is put to those financial practices and irresponsible risk-taking that preceded the crisis.

This is a challenging task. The financial sector has developed beyond reasonable boundaries and its practices have spread through the non-financial economy (Chapter 2). It has long been claimed that today's profits would be tomorrow's investments and more jobs later on. But reality has not kept to the promise:

A large share of the increase in profits has accrued to the financial sector – the financial sector's share of total corporate profit reached 42 per cent before the crisis, up from about 25 per cent in the early 1980s. And the profits of non-financial firms serve more to pay dividends rather than invest in the real economy. During the 2000s, less than 40 per cent of profits of non-financial firms in developed countries were used to invest in physical capacity, which is 8 percentage points lower than during the early 1980s.

Ever growing pressures for more and better financial returns have adversely affected wages and job stability in the real economy. The global decline of wages as a per cent of GDP has been more pronounced in countries where risky financial practices were more pervasive.

Regrettably, as documented in the Report, financial reforms have been slow to materialize. True, the financial industry has undertaken steps to modify its practices through the adoption of codes of conduct and other non-binding initiatives. In some countries, there is concern that new regulations will push the financial industry to other locations. The overall impression is that, unless action is taken soon, business-as-usual will prevail. In such an unreformed context, the practices that provoked the financial crisis will resume soon after economic recovery starts. This would aggravate weakness already present in the world of work, while raising the risk of future crises.

The crisis should be used as an opportunity to make globalization fairer...

The Global Jobs Pact goes far beyond designing policies to encourage a speedy recovery. It sets a framework for shaping a fair and sustainable globalization. As last year's *World of Work Report* showed, income inequalities grew in two thirds of the countries for which data exist. This has been a key facilitating factor for the financial crisis: faced with the prospect of stagnating relative incomes, and in the face of irresponsible lending practices, low-income households had growing recourse to debt in order to fund their investment plans.

As a first step into the analysis, the Report examines how existing international trade agreements address social issues (Chapter 3). The finding is that over 30 per cent of bilateral or regional trade agreements concluded since 2005 embody labour provisions, compared with only 4 such agreements in 1995. Further research is needed to assess whether such provisions are effective vis-à-vis the goal of making globalization fairer.

...and more sustainable for the environment

Investing in the environment is a potential source of new jobs. If a price on CO₂ emissions was imposed – at a level close to what is internationally suggested – and if the resulting revenues were used to cut labour taxes, then employment would rise by 0.5 per cent by 2014. This is equivalent to over 14.3 million net new jobs for the world economy as a whole (Chapter 4). These jobs will not come automatically, however. Indeed almost 38 per cent of all jobs are located in high-carbon intensive sectors. Therefore, programmes that support labour market transitions and skills are needed to make new jobs a reality. Green policies need to be implemented hand-in-hand with decent work policies.

Taking action to address the broader issues underlying the crisis will contribute to realizing the vision of a sustainable and fairer global economy.

Table of Contents

Editorial	vii
1. The global jobs crisis: Patterns and medium-term scenarios	1
Main findings	1
Introduction	3
A. Immediate labour and social impacts	3
B. Risk of long term under-employment and limited social protection	12
C. The way forward	18
Appendix A. The impact of crises on labour markets: Past experience	34
Appendix B. The impact of financial crises on employment: An empirical analysis	38
Bibliography	41
2. Making finance work for the real economy: Challenges for policy	45
Main findings	45
Introduction	46
A. Financial sector growth vis-à-vis the non-financial sector	47
B. Financialization of the non-financial economy: Trends and social impacts	50
C. Financialization as a source of instability for enterprises and jobs: The case of leveraged buyouts	53
Conclusion	59
Bibliography	59

3. Rebalancing globalization: The role of labour provisions in existing international trade arrangements and development finance policies	63
Main findings	63
Introduction	64
A. Labour provisions in trade arrangements: Current situation and trends	65
B. International development finance	82
Conclusion	91
Bibliography	92
4. Green policies and jobs: A double dividend?	97
Main findings	97
Introduction	98
A. The employment challenge: Assessing employment in high carbon intensive sectors	99
B. The employment potential: Estimating the effects of green policies on jobs	100
Conclusion	106
Appendix A. Estimating the size of the high carbon intensive sector	108
Appendix B. Selected empirical results of the distributional effects of green policies	110
Appendix C. Assessing the employment effects of green policies in nine countries: A vector autoregression approach	111
Bibliography	112
Recent publications	115

List of tables, figures and boxes by chapter

Figures

Chapter 1

Figure 1.1	Job losses since the onset of the crisis in select countries (in millions, by country grouping)	4
Figure 1.2	Change in the average number of hours worked per employed person (in percentages, Q2 2009 – Q2 2008)	5
Figure 1.3	Change in the incidence of part-time employment in total employment, select countries (in percentage points, Q2 2009 – Q2 2008)	5
Figure 1.4	Impact of current and previous crises on employment and GDP (in percentages)	6
Figure 1.5	Levels and change in long-term unemployment during previous recessions, EU-15 and rest of OECD (percentages as a share of total unemployment)	8
Figure 1.6	Percentage point change in labour force participation rates, select OECD countries, Q3 2009 – Q4 2008	9
Figure 1.7	Discouraged workers in select countries, Q2 2008 – Q2 2009	9
Figure 1.8	Recovery to pre-crisis employment levels by country groupings, 2007-14	12
Figure 1.9	Employment projections in select high GDP per-capita countries, 2000–14	15
Figure 1.10	Employment projections in select medium GDP per-capita countries, 2007–13	15
Figure 1.11	Percentage of unemployed workers not receiving unemployment benefits, various years	16
Figure 1.12	Percentage of countries that have provisions for social security schemes for informal wage workers and self-employed workers, by regions, as of 2009	17
Figure 1.13	Fiscal positions (deficit and debt) in select countries, 2010	20
Figure 1.14	Employment effects of various public spending scenarios compared to the baseline (no intervention), percentages	20
Figure 1.15	Labour market recovery in Australia	24
Figure 1.16	Economic and labour market recovery in Brazil, 2007-09	27
Figure 1.17	Workers without a working permit, as percentage of total employed, 2008–09	27
Figure 1.18	Employment losses and <i>Kurzarbeit</i> beneficiaries, Germany, January 2008 to June 2009	29
Figure 1.19	Quarterly unemployment rates in Jordan, 2008-09	30
Figure 1.20	Labour market recovery in the Republic of Korea, 2008-09	31
Figure 1.21	Income inequalities have been on the rise worldwide	33
Figure A1.1	Labour market recovery time needed after a crisis	35
Figure A1.2	Time needed for wages to recover to pre-crisis levels in select countries, by crisis episode	37

Chapter 2

Figure 2.1	The rising incidence of profits of the financial sector in advanced economies, 1990-2008	48
Figure 2.2	Real wage gap between financial and non-financial firms in the United States, 1987-2007	48
Figure 2.3	Career choice of top business school graduates in 2008	49
Figure 2.4	Decline in investment as a percentage of GDP in advanced economies (from 1980 to 2006)	52
Figure 2.5	Financialization and wage share in advanced economies (percentage change in wage share, 1989-2005	54
Figure 2.6	Financialization and unionization in advanced economies	54
Figure 2.7	Magnitude and growth of LBO activity world wide (total volume = \$3.6 trillion)	54
Figure 2.8	LBOs in developing and emerging economies (1970-2007)	54
Figure 2.9	Making profits and running away (average holding period of investors in controlled companies, in months, 1970-2007)	55

Chapter 3

Figure 3.1	The rising trend in the number of trade agreements with labour provisions	76
Figure 3.2	Share of trade agreements with labour provisions compared to the total number of trade agreements entered into force from 1995-2009	76

Chapter 4

Figure 4.1	World trends of GDP and CO ₂ emissions (percentage growth from 1990)	100
Figure 4.2	Well-designed green policies will boost employment	104

Tables

Chapter 1

Table 1.1	Labour force participation rates during the Asian crisis and years to recovery	10
Table 1.2	Increase in levels of informality during times of crisis, select countries	11
Table 1.3	Social security coverage for Latin America and the Caribbean (only urban wage-based)	18
Table B1.1	Definitions and sources of variables used in the regression analysis	39
Table B1.2	Regression results	39
Table B1.3	Alternative estimators	40

Chapter 2

Table 2.1	Investment as a percentage of operating surplus (1980s to 2000s)	52
Table 2.2	Current state of financial sector reform in advanced economies	58

Chapter 3

Table 3.1	Evolution of labour provisions in the EU GSP, from 1995 to 2002	68
Table 3.2	Evolution of labour provisions in US trade agreements from 1994 to 2009	69
Table 3.3	Evolution of labour provisions in Canadian trade agreements (other than NAALC/NAFTA) from 1997 to 2009	70
Table 3.4	Labour provisions in African trade agreements	71
Table 3.5	Labour provisions in trade agreements concluded by Asian countries and areas	72
Table 3.6	Different types of labour provisions in EU trade agreements	73
Table 3.7	Labour provisions in Latin American and Caribbean regional trade agreements	74
Table 3.8	Labour provisions in bilateral trade agreements concluded by Latin American countries and areas	75
Table 3.9	Incidence of trade arrangements with labour provisions	76
Table 3.10	Imports covered by labour provisions as a percentage of total imports from beneficiary countries, 2008	77
Table 3.11	Petitions under the labour provisions of the US GSP, 1985 to 2007	79
Table 3.12	Overview of labour provisions in the IFC Performance Standard 2	85
Table 3.13	Labour provisions in operational policies of major DFIs	86
Table 3.14	Submissions regarding breaches of the Performance Standards filed with the IFC by trade unions between July 2006 and August 2009	90

Chapter 4

Table 4.1	Employment in high carbon intensive industries (2005)	100
Table 4.2	Estimated impacts of green policies on employment in nine countries	104
Table 4.3	Employment effects of green policies with employment subsidies: Outcomes from different studies	105
Table A4.1	Classification of industries by CO ₂ -output intensity	109

Boxes

Chapter 1

Box 1.1	Employment projections: Methodological considerations	13
---------	---	----

Chapter 2

Box 2.1	Dividend recapitalizations – A risky practice for the real economy and jobs	57
---------	---	----

Chapter 3

Box 3.1	The US–Cambodia Textile Agreement: An experience with positive incentives	81
Box 3.2	Implementation of labour provisions in indirect DFI investments	88

Chapter 4

Box 4.1	Carbon taxes and cap-and-trade schemes	101
Box 4.2	Employment effects of green policies combined with lower labour taxes: Results from three studies	106

The global jobs crisis: Patterns and medium- term scenarios*



Main findings

- Recent rebounds in world GDP and equity markets should not mask the fact that the crisis for the world of work is not yet over. Over 20 million jobs have been lost since the onset of the global crisis. But the real size of the crisis is even larger than these numbers suggest.
- First, there are millions of jobs at-risk. Many enterprises and workers operate on short-time working schedules, which so far have helped cushion the impact of the crisis to a significant extent. It is unclear, however, whether these reduced working-time practices can be sustained for much longer. Based on GDP-employment relationships in previous crises, it is estimated that at least 5 million additional jobs could be lost if these practices, often supported by governments, were discontinued.
- Second, unless adequate action is taken, nearly 43 million job losers and new entrants could drop out of the labour market or enter long-term unemployment, aggravating social hardship and reducing future growth potential:
 - In developing countries, earlier experiences suggest that higher levels of informal employment tend to persist well beyond crises.
 - In developed countries, long-term unemployment spells usually continue to rise even after unemployment rates begin to decline. In the EU-15 during the early 1990s, the incidence of long-term unemployment among prime-age workers rose over 8 percentage points and remained stubbornly high for many years.
 - Many jobseekers who experience increasing difficulties obtaining employment will leave the labour market entirely. There are already some early indications that overall labour force participation rates have declined in

* Excellent research assistance by Dawn Gearhart and Nadeeka Wataliyadda is gratefully acknowledged.

many high GDP per-capita countries since the beginning of 2009. After the Asian crisis, the decline in participation rates among working-age men never recovered to pre-crisis levels.

- Third, social protection systems – crucial to support incomes of the innocent victims of the crisis – have significant gaps. Two-thirds of the countries for which data are available do not have unemployment benefits. Even in those countries with such schemes, coverage for jobseekers is often limited. In addition, provisions for social security benefits apply only to formal wage workers in most countries: only one-third of developing countries have provisions pertaining to informal sector workers or self-employed workers. Actual social security coverage is even lower: for example, although legal provisions for informal wage workers exist in Latin America, only 20 per cent of the workers are effectively covered.
- Altogether, experience from earlier crises suggests that employment in high GDP per-capita countries will not return to pre-crisis levels before 2013 and employment rates (employment to working-age population ratios) not before 2014. In emerging and developing countries, employment levels could start recovering from the end of 2010, but employment rates might not recover in the near term. These trends would exert further downward pressure on wages, aggravating the risk of depressed consumption and making recovery fragile. However, if governments move ahead with implementation of the Global Jobs Pact, employment will recover faster and the risks of long-term joblessness and informality will be reduced. The chapter shows that a continuation of fiscal stimulus, if better focused on jobs, would reduce employment losses by 7 per cent compared to an early exit situation. Fiscal spending will temporarily increase public debt but in the medium term debt will return to pre-crisis levels as growth, supported by job creation, resumes.
- Already, the principles of the Global Jobs Pact – notably, prioritizing employment and building social protection – have helped to guide government action. Some examples along these lines, which have helped to lessen the depth of the jobs and social crisis and accelerate the recovery process include:
 - Limiting job losses by recourse to job-sharing (e.g. Republic of Korea) and enhancements to existing schemes to facilitate reduced working hours, work-sharing and partial unemployment benefits (e.g. Germany).
 - Increased social assistance to targeted groups (e.g. Australia) and improvements in social assistance programmes such as unemployment benefits and conditional cash transfers, as well as higher minimum wages (e.g. Brazil) to help maintain household expenditures and boost domestic private consumption.
 - Sustained commitment to universal social protection in addition to increased support for poor families and vulnerable groups among the unemployed (e.g. Jordan).
- While important, these measures alone will not be sufficient to ensure a sustainable recovery. Indeed, the principles and objectives of the Global Jobs Pact go well beyond policies designed to encourage a speedy recovery. Addressing the root causes of the crisis is needed as well – an issue examined in the next three chapters.

Introduction

The economic crisis which befell the global economy in 2009 – the worst since the Great Depression of the 1930s – has had a profound impact on the world of work. The global policy response to stabilize financial markets and revive global growth has been unprecedented and there are encouraging signs of a rebound in economic growth. Recovery, however, will not be achieved until the employment situation improves in a sustainable manner.

Experience from past crises shows that the labour market tends to recover long after economic growth resumes. The impact of the crisis on the quality of employment is often more profound. In the aftermath of previous crises, wages were depressed over a sustained period, the incidence of informality increased and many small enterprises went out of business. These trends suggest that the career prospects of many workers will be hit, in some cases on a permanent basis. In addition, post-crises labour markets are often characterized by a high incidence of long-term unemployment and labour market detachment. These trends will not only affect the well-being of many workers and their families but will also depress long-term growth prospects. Immediate action to mitigate these pervasive labour market and social effects is therefore crucial.

The purpose of this chapter is to: (i) shed light on the nature and depth of the jobs crisis (section A); (ii) assess the prospects for employment recovery over the next few years including an analysis of the adequacy of existing social security measures (section B); and (iii) examine how policies inspired by the Global Jobs Pact could help improve the employment outlook (section C). The last section also introduces Chapters 2 to 4, which discuss how to pave the way for a more sustainable world economy.

A. Immediate labour and social impacts

This section analyses the depth and intensity of the current economic crisis in the world of work. It examines changes in the labour market since the onset of the crisis in terms of job losses, changing employment patterns and labour market attachment.

Over 20 million jobs have been lost since the onset of the crisis...

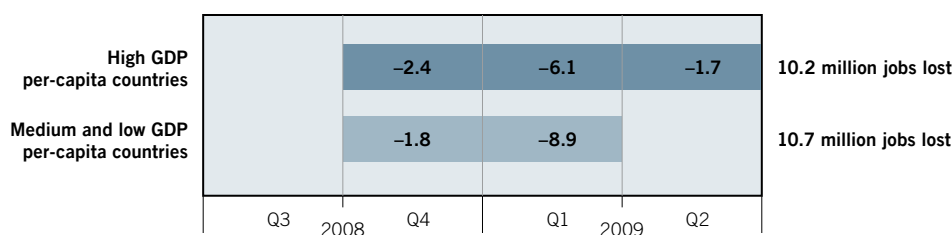
In 2007, the rapid employment growth that preceded the crisis began to slow and, by 2008, all regions of the world experienced a deceleration of employment growth. Eventually, the situation worsened and translated into significant employment losses. In high GDP per-capita countries, over 10 million jobs have been lost since the fourth quarter of 2008 (figure 1.1).¹ Job losses began even earlier in a number of countries including the United Kingdom and the United States (with financial sector jobs being the first casualty).²

Emerging and developing economies (medium and low GDP per-capita) are facing many of the same challenges, but the nature of the country-level impacts also varies considerably. In the countries for which information is available, employment losses are estimated to total more than 10 million to date – nearly 9 million

1. See note of figure 1.1 regarding country groupings according to the level of per-capita GDP.

2. See V. Escudero: *Effects of the crisis on the financial sector: Trends and policy issues* (Geneva, ILO, 2009).

**Figure 1.1 Job losses since the onset of the crisis in select countries
(in millions, by country grouping)**



Note: Job losses in this figure are net job creation, i.e. they indicate net changes in employment. High GDP per-capita countries include Australia, Canada, Japan, the Republic of Korea, the United States and the EU-15. Medium and low GDP per-capita countries include Argentina, Brazil, Chile, China, Colombia, Ecuador, Egypt, Jamaica, Mauritius, Mexico, Morocco, other EU, Peru, the Philippines, the Russian Federation, South Africa, Sri Lanka, Thailand, Turkey and Venezuela.

Sources: ILS estimates based on OECD, 2009c; ILO Laborsta database, LFS or other sources (Argentina, Brazil, China, Mexico, Turkey and other medium and low GDP per-capita countries); and IMF, IFS database (the Russian Federation).

in the first quarter of 2009 (of which Brazil, China, the Russian Federation and South Africa accounted for over half). But Turkey, where employment declined by more than 2 million between the third quarter of 2008 and the first quarter of 2009 has also been dramatically affected as the reduction of private capital inflows had a substantial effect on countries with large current account deficits and limited ability to borrow from abroad. For the second quarter of 2009, employment losses are slowing for this group with some countries showing a return to positive employment growth while others continue to experience jobs losses.

...but job losses have been limited thanks to labour retention in enterprises...

Job losses, however, provide only a partial and incomplete picture of the global jobs crisis. To a certain degree, job losses have been mitigated by working-time reductions and other employment retention practices. Such practices reduce the social costs typically associated with job losses but also allow firms to avoid the excessive costs involved in firing and re-hiring.

Indeed, most developed countries (for which data are available) have experienced significant falls in working hours since the start of the crisis – 2.2 per cent on average (figure 1.2). All 37 countries analyzed (except one) have experienced declines over this period. This is in stark contrast to the increases (25 of 36 countries) experienced in hours worked between 2007 and 2008.

This has translated into an increased incidence of part-time employment in many countries since the onset of the crisis (figure 1.3). For example, in Estonia, part-time employment rose over 5 percentage points to reach 12 per cent in 2009. The increasing incidence of part-time employment has helped, to varying degrees, offset job losses and, therefore, to provide a stimulus to aggregate demand. In Canada, for example, 43 thousand part-time jobs were created in the first and second quarters of 2009 (compared to more than 105 thousand full-time jobs lost). Yet it is important to note that working hour reductions may not have necessarily translated into increases in part-time employment, e.g. workers could be working 33 hours instead of 37 or 23 hours instead of 25 with no change, necessarily, in employment status.

In some countries, working-time reductions have been supported by governments through subsidizing partial unemployment policies.³ This policy has been

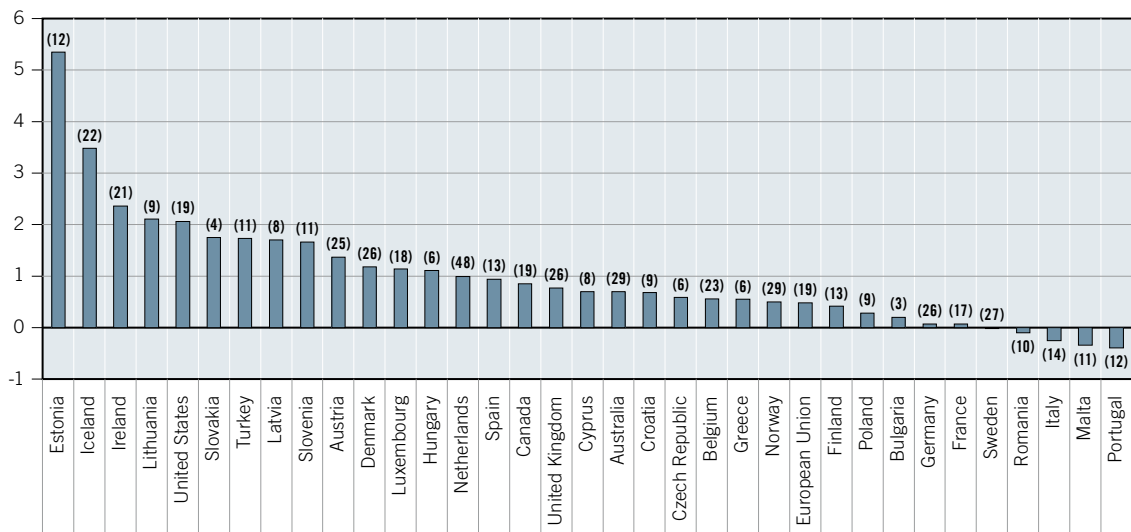
4 See section C for a discussion of some country cases where wage moderation and subsidies to part-time employment were undertaken in an attempt to limit employment losses.

Figure 1.2 Change in the average number of hours worked per employed person (in percentages, Q2 2009 – Q2 2008)



Note: Data for Australia, Canada, Germany, Spain and the United States refer to Q3 2009 and Q3 2008, respectively.
Source: IILS estimates based on national statistical departments; Eurostat database and OECD, 2009c.

Figure 1.3 Change in the incidence of part-time employment in total employment, select countries (in percentage points, Q2 2009 – Q2 2008)



Note: Figures in parentheses show incidence of part-time employment in Q2 2009
Source: IILS estimates based on national statistical departments and Eurostat database.

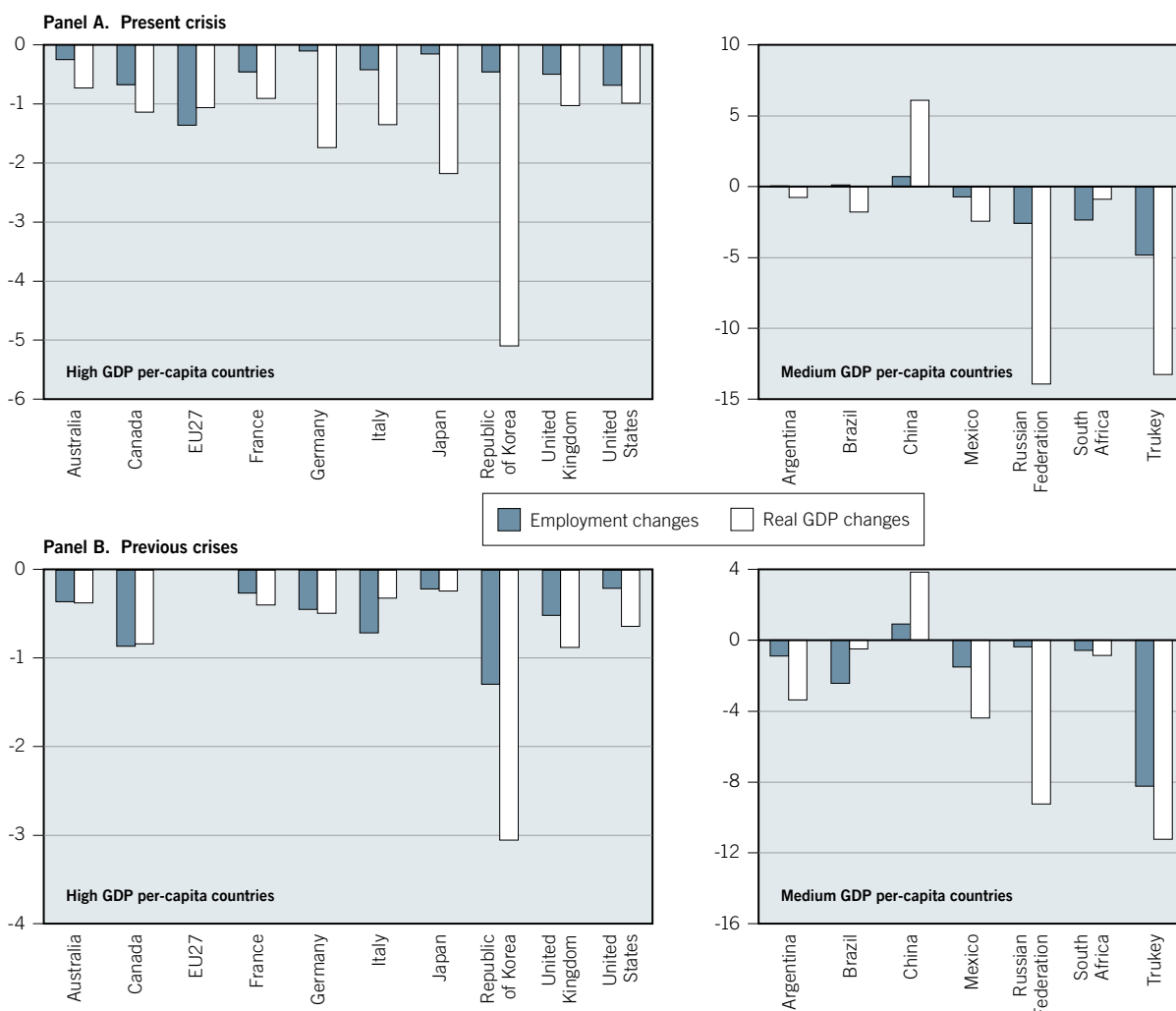
adopted, for example, in France, Germany and the Netherlands to protect against additional job destruction in the short run with the expectation that the economy will resume growth in the near future. Others include wage moderation, e.g. in the case in the Republic of Korea (see section C and Appendix A). Of course, another important consideration is the capacity of existing labour market institutions to absorb economic shocks and to mitigate immediate negative labour market impacts, e.g. a steep rise in unemployment (a forthcoming joint IILS-IZA discussion paper will examine this issue).

...which is why employment generally fell much less than GDP.

In many countries, both advanced and developing, the extent of the employment losses due to the current crisis is (for the time being) dramatically lower compared to reductions in output (with the exception of South Africa and the EU27 as a group, see figure 1.4). In fact, in examining GDP and employment changes during past crises, a number of important observations emerge in comparison to the present situation:

- The gap between declines in output and employment was smaller during the previous crises (with the exception of Argentina, Mexico and the United States); and,
- There were cases in which deteriorations in employment exceeded those of output (such as in Brazil, Canada and Italy).

Figure 1.4 Impact of current and previous crises on employment and GDP (in percentages)



Note: Previous crises refer to the most recent past crises of all countries based on Laeven and Valencia (2008). Changes in GDP and employment are compound quarterly changes measured from peak to trough (where a trough has not yet been attained for the present crisis, the latest available information is used). For Argentina, Brazil and China, the current crisis corresponds to year-on-year changes from the quarterly trough in GDP and employment in order to facilitate comparison to the past crises in these countries for which only annual data is available (and as such should not be compared to other countries). Information on past crises for EU 27 is not available given that, as a group, it did not experience a previous crisis.

But labour retention also means that millions of jobs are at-risk...

While employment falling less than GDP has helped cushion the current jobs crisis, the issue arises of whether job retention can continue for much longer. With a weak economic recovery expected, there is a risk that currently retained workers will join the ranks of the unemployed and, thus, the global jobs crisis may worsen in the short term.⁴ In fact, if employment were to exhibit a similar relationship to GDP as was the case during earlier crises (as demonstrated above), the number of jobs currently at risk is in the order of 5 million. The risk is high as firms' and government budgets are increasingly constrained and the policy of partial benefits and similar measures are phased out or retracted. This could prolong what is already expected to be a slower labour market recovery compared to previous downturns (see section B for forecasts of employment levels and rates).

The above analysis also suggests that labour market recovery depends critically on the speed with which firms will begin their hiring processes. If firms tap into existing resources first, i.e. increase the working hours of existing employees, and thus delay the hiring process, this would worsen employment prospects of disadvantaged groups, including new entrants and the unemployed.

...and that, for jobseekers, durations of job search are likely to rise.

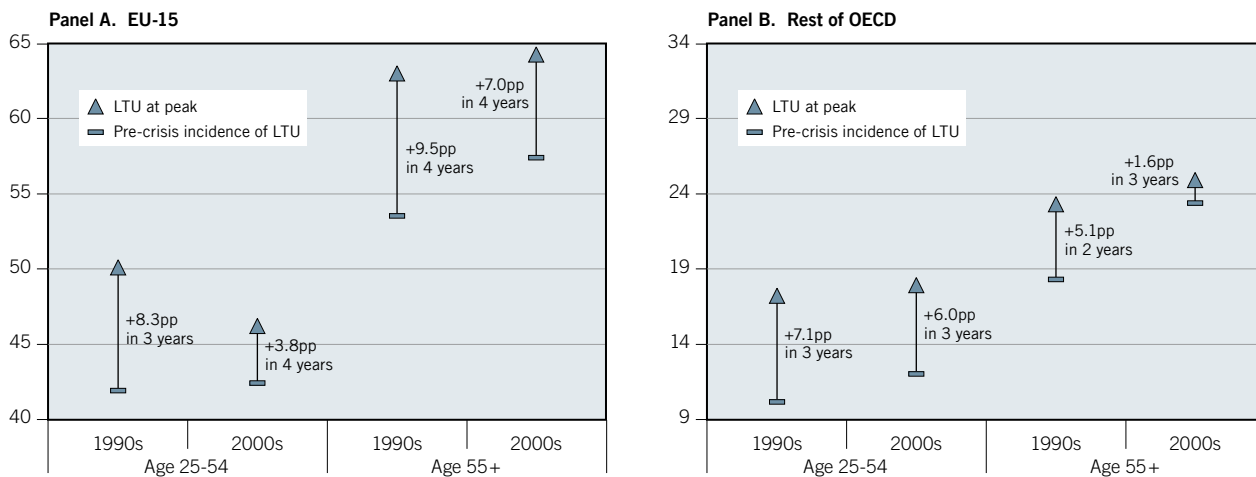
Even as employment opportunities decline, some individuals have little choice but to continue their job search. Consequently, as the crisis prolongs, there is an increased risk of long-term unemployment. This was the case in previous recessions where the share of unemployed workers still looking for a job after a year or more continued to rise – and in most cases never returned to pre-crisis levels (figure 1.5). In the EU-15, during the early 1990s, the incidence of long-term unemployment among prime-age workers (25-54) rose over 8 percentage points to reach over 50 per cent. During the recession of 2001, the rate had not yet fallen back to its 1991 level before it began to increase again, although less dramatically and for a shorter period. For older workers (55 and over) in the EU-15, similar trends are apparent except the increases were more dramatic, persisted for a longer period of time and at much higher rates. For the rest of the OECD similar trends emerge, i.e. increases were more dramatic in the 1990s compared to 2001, the impact was more severe for older workers in terms of intensity and duration, and for both age groups the incidence of long-term unemployment has yet to recover to the levels of the early 1990s. And, if the rise in long-term unemployment during this crisis resembles that of the 1990s, long-term unemployment could increase by nearly 6 million by 2012.

Social hardship is already intensifying as many jobseekers have dropped out of the labour market or have become discouraged...

As jobseekers experience increasing difficulties in finding employment, the likelihood that they leave the labour market entirely increases. In some countries, there are already signs of declining overall labour force participation rates. Available data suggests that since the beginning of 2009, labour force participation rates have decreased in most OECD countries, with the exception of Australia, France,

4. In Canada part-time work dropped by 60 thousand in October 2009 alone, erasing the gains from the previous two months.

Figure 1.5 Levels and change in long-term unemployment during previous recessions, EU-15 and rest of OECD (percentages as a share of total unemployment)



Note: Long-term unemployment is considered to be the share of total unemployment lasting one year or longer. Rest of OECD includes Australia, Canada, Japan, Republic of Korea, New Zealand, Norway and the United States.

Source: ILS estimates based on OECD Labour Force Statistics.

Italy, Japan, and Luxembourg (figure 1.6). In other countries such as Canada, Ireland, Sweden and the United States, overall participation rates began to decline even earlier, i.e. in early to mid-2008. If participation rates fall as little as 0.4 percentage points among high GDP per-capita counties over the period 2009-2012, the number of inactive persons could rise by over 12 million.

Such trends often have pervasive effects on vulnerable groups such as older workers and youth.⁵ For youth, there are already early signs of declining labour market activity in the United Kingdom and the United States, where participation rates for youth workers have declined over 2008 and 2009 by around 2 and 4 percentage points respectively. Unless these drops in participation rates are matched by increased school enrolment, a sustained period out of the labour force can permanently compromise future employment prospects for youth workers and risk a mismatch between labour demand and supply once economic activity picks up.

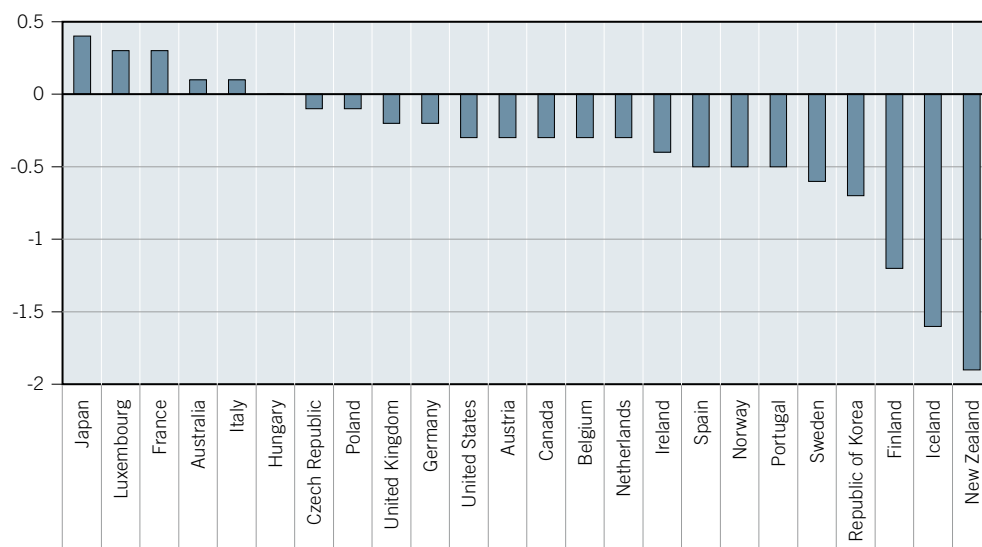
In many cases, the desire to work is still there but many have become discouraged.⁶ In the United States where the trend in job losses began as early as December 2007, there are clear signs of discouragement: in October 2009, 800 thousand US workers were considered to be discouraged.⁷ This is nearly double the level found a year earlier and approximately one-quarter of a million more discouraged workers than during the peak after the most recent recession at the

5. During the 1991-92 recession, the pervasive effects of inactivity among men aged 55-64 were dramatic. From the onset of the recession, the participation rate of male older workers started to decline, and the ensuing trough lasted for more than a decade in OECD countries.

6. "Discouraged" workers are defined as persons not in the labour force who believe that there is no work available due to various reasons and who desire to work (ILO, 2003).

7. These persons are characterized by the last time they searched for work in the weeks and months before the Current Population Survey (CPS) was taken. Discouraged workers have looked for work in the 12 months preceding the survey, but they have not looked in the past four weeks. Labour force characteristics, glossary, updated 2009 <http://www.bls.gov/cps/lfcharacteristics.htm#discouraged>

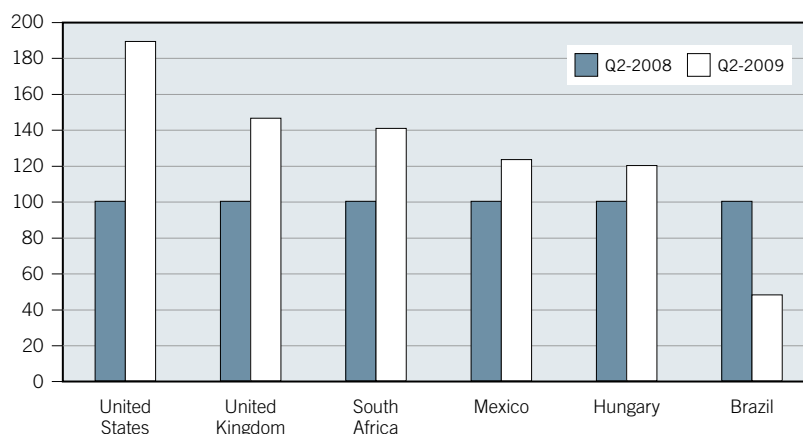
Figure 1.6 Percentage point change in labour force participation rates, select OECD countries, Q3 2009 – Q4 2008



Note: The labour force participation rate is defined as the labour force (15 and over) divided by the total working-age population (16-64). 2009 Q3 figures are forecasts as of June 2009.

Source: Based on OECD, 2009b.

Figure 1.7 Discouraged workers in select countries, Q2 2008 – Q2 2009 (Q2 2008 = 100)



Note: Figures for Hungary and the United States are not seasonally adjusted. This graph is not intended for cross-country comparisons as countries use different definitions.

Sources: ILS estimates based on national statistical departments.

end of 2000 (i.e. 530 thousand discouraged workers in 2004). The concern is that the level of discouraged workers will continue to rise, as it did for four consecutive years in the United States following the 2001 slowdown. Other countries, with similar available data (e.g. Mexico, Hungary, South Africa and the United Kingdom) exhibit similar upward trends (figure 1.7).

For developing countries, current data on participation rates is rather limited but similar trends occurred in countries affected by the Asian crisis. For working-age (15-64) men the trend decline in participation rates lasted between two years (Indonesia) and, in some cases, has yet to recover (table 1.1). Looking forward, for medium and low GDP per-capita countries, if participation rates among men fall

Table 1.1 Labour force participation rates during the Asian crisis and years to recovery

Country	Working age (15-64), males		
	LFP rate at the beginning of the crisis	Decrease from peak to trough (percentage points)	Years to recovery
Malaysia	83.4	0.7	Not yet
Republic of Korea	77.5	1.8	Not yet
Indonesia	85.0	2.2	2 years
Viet Nam	83.6	2.8	Not yet
Philippines	85.0	3.9	Not yet

Note: The crisis date is 1997 for all countries except the Philippines, where the impact of the crisis on the labour force participation (LFP) rate was not observed until 1998. Countries are ranked in ascending order according to the decrease in labour force participation rate incurred.

Source: Key Indicators of the Labour Market (KILM), 5th edition.

by only 0.7 percentage points (smallest decline in table 1.1), the number of men exiting the labour market could rise by over 24 million by 2012. Taken together, almost 43 million persons over the period 2009-2012 could enter inactivity or long-term unemployment.

...while for others informal employment is the only option.

In many developing countries, when formal jobs are scarce, rather than long-term unemployment or discouragement the concern is that jobless workers tend to move into the informal sector due to the lack of social security provisions.⁸ Although data on informality are scarce and definitions vary, analyses of previous crises seem to support these predictions. In addition, evidence from previous crises illustrates that, once individuals move to the informal sector, it is difficult for them to return to regular employment.^{9,10} Indeed, looking at six recent financial crises for which data are available, the following observations emerge:

- Informality tends to increase immediately post-crisis, though the extent of the increase varies; and,
- In some countries, informality returns to pre-crisis levels after two to three years, while others experience increased informality levels persisting even after five years (table 1.2).

These trends have severe consequences for employment recovery prospects.

These risks (including rising long-term unemployment, more prevalent inactivity, and increases in informality) are particularly unwelcome developments and as past

8. Only 20 per cent of the world's population is covered by social security, leaving 5.5 billion people at risk (see also section B).

9. See, for example, *East Asian labour markets and the economic crisis: Impacts, responses and lessons*, G. Betcherman and R. Islam (eds.) (Washington, The World Bank and Geneva, ILO, 2001).

10. Indeed, evidence on transition probabilities across segments of employment (formal, informal and without a job) shows that status persistence within different segments is high, including the group that does not have a job (Bacchetta, Ernst and Bustamante, 2009).

Table 1.2 Increase in levels of informality during times of crisis, select countries

Country and crisis year	Informality during crisis	Increase to peak (percentage points)	Time needed to recover pre-crisis levels	Sample used
Ecuador, 1998	57.6	0.3	2 years	Urban
Uruguay, 2002	40.8	0.6	2 years	National
Venezuela, 2002	56.3	1.9	2 years	National
Paraguay, 2002	75.1	1.2	3 years	National
Argentina, 2001	38.6	4.8	not yet at 5 years (2006)	Buenos Aires
Colombia, 1998	55.4	5.6	not yet at 6 years (2004)	7 main cities
Indonesia, 1997	62.8	8.0	not yet at 6 years (2003)	Urban

Note: Data are sorted in ascending order according to the increase in the incidence of informality to peak.
Source: ILS based on Bacchetta, Ernst and Bustamante, 2009.

experiences show, they are very difficult to reverse and can have profound impacts on recovery potential in a number of ways.

First, the stigma associated with an extended period out of the labour force can hinder efforts to find a new job once a recovery is under way, often giving rise to a permanent mismatch of skills between those offered and those demanded. Indeed, workers who remain without a job for a long period of time experience a loss of skills and deterioration of their general human capital. In this respect, if labour demand recovers, measures aimed at encouraging a return to the labour market could prove quite expensive.

Second, increased recourse to informal employment may increase the vulnerability of a country to shocks.¹¹ Estimates show that countries with above average sized informal economies are more than three times as likely to suffer adverse effects of a crisis (higher cyclical volatility) than those with lower rates of informality (Bacchetta, Ernst and Bustamante, 2009). In addition, previous crises have shown that, as the informal economy expands it may generate substantial further downward pressure on informal-economy wages – which, before the current crisis were already declining. Also, to the extent that most informal employees are underemployed, a fall in hourly wages may push informal employees to take up two or more informal jobs or to extend their working hours (if they are self-employed). This will affect their future re-employment chances in the formal economy.

Finally, there is the risk that perceptions of unfairness and mistrust linked to the crisis will rise and potentially lead to social unrest. Already, in spring of 2009 the Edelman Trust Barometer reported that 60 per cent of respondents felt that their level of trust in corporations has dropped since 2007.¹² And only 28 per cent of respondents in the United States believe that, even after a US\$800 billion stimulus package, the Government has made real progress in fixing the issues caused by the crisis.

Consequently, even though the International Monetary Fund (IMF) now predicts that global economic growth will return to positive territory (3.1 per cent)

11. This is partly related to the particular place occupied by such countries within global production chains, and partly to the limited capacity of states with large rates of informality to command sufficient resources to insure people adequately against external shocks. But, even more important, is the fact that informal employment reduces the effectiveness of automatic stabilizers and requires additional discretionary fiscal and monetary policy interventions in countries that lack the necessary fiscal and policy space (Bacchetta, Ernst, and Bustamante, 2009).

12. Edelman Trust Barometer, http://www.edelman.com/trust/2009/docs/Trust_Book_Final_2.pdf

in 2010, the recovery is rather fragile especially as regards the labour market.^{13,14} In fact, as this section demonstrates, the crisis in the labour market is far from over. Indeed, the negative employment effects of crises, especially financial crises, tend to persist long after the start of an economic recovery.¹⁵

B. Risk of long term under-employment and limited social protection

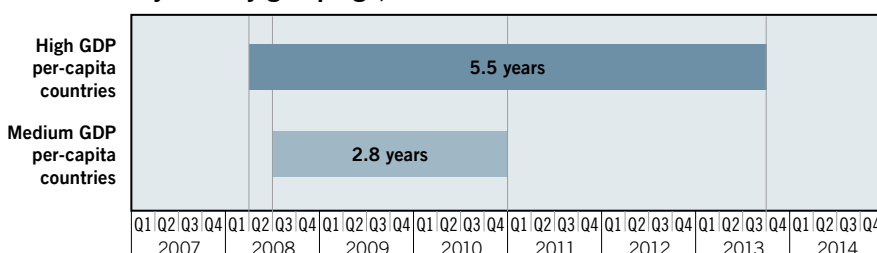
The purpose of this section is to gauge the extent of the expected negative effects of the current crisis on the labour market. This is important given the likelihood that the global jobs crisis is prolonged. It is also important to remember that a labour market recession (with profound implications for individual welfare) is also likely to dampen economic recovery (through lower wage growth and reduced potential output) and, in turn, potentially jeopardize efforts to restore fiscal sustainability.

Employment growth will be sluggish and inadequate...

The projections presented here draw on output-employment elasticities which have been estimated by way of an econometric analysis of the impact of growth on employment during past financial crises (using GDP projections from the IMF: see Appendix B and box 1.1 for methodological considerations).¹⁶ In this respect, the duration and depth of the employment recession is clearly dependent on the ability to gauge correctly the evolution of the economic recovery that is under way.

In this respect, it is important to keep in mind the uncertainty surrounding economic prospects, especially during turning points: the IMF has revised its

Figure 1.8 Recovery to pre-crisis employment levels by country groupings, 2007-14



Note: See box 1.1 for country groupings. Countries within each group differ slightly when compared to section A given that this section is restricted to countries that experienced a crisis in the past and for which there is sufficient historical time series data.

Source: ILS estimates based on IMF, 2009b; OECD, 2009c; and ILO, Laborsta database.

13. Real GDP growth rate is based upon purchasing power parity (PPP) weights, IMF (2009b).

14. Is it important to note that other projections exist. For example, the UN (2009b) projects a growth rate of GDP (PPP weighted) of 3.8 per cent in 2010.

15. See Appendix A. Additionally, a recent study on the history of banking crises by Reinhart and Rogoff (2008) shows that, on average, a crisis is associated with a 7 percentage point increase in the unemployment rate, which takes, on average, 4.8 years to return to the pre-crisis level. In this study, the authors focus on systemic financial crises, including the “big five” developed economy crises (Spain 1977, Norway 1987, Finland 1991, Sweden 1991 and Japan 1992), plus a number of famous emerging market episodes (the 1997–98 Asian crisis, 1998 Colombian crisis and the 2001 Argentinean crisis).

16. The econometrical analysis follows the methodology developed in Escudero (2009).

Box 1.1. Employment projections: Methodological considerations

The projections presented in this section draw on the relationship between changes in real GDP and changes in employment during past crises. The elasticities used for the employment projections have been estimated using Okun-law panel regressions for four separate groups of countries based upon previous country level crises episodes (see Appendix B for more details on calculations, crises periods, sizes of elasticities and timings of the crises taken into account):

- *High GDP per-capita* based upon two groups: Group 1: past eight crises for Canada, Germany, France, Italy, United States and United Kingdom) and Group 2: one crisis episode per country for Australia, Spain and the Republic of Korea;
- *Medium GDP per-capita* based upon two groups: Group 1: nine past crises episodes for Argentina, Indonesia, Mexico and Turkey and Group 2: six previous crises for Brazil, the Russian Federation and South Africa.

The employment projections were constructed by applying the employment elasticity to the GDP growth projections from the IMF (by country, from 2009 onwards) and aggregated accordingly.¹ The employment rate projections were calculated using the employment projections and dividing them by the working-age population (individuals aged 15 to 64) estimations of Laborsta.

Other ILO efforts to measure the extent of the job crisis

In September 2009 the ILO report to the G20 Leaders' Summit (ILO, 2009e): *Protecting people, promoting jobs: A survey of country employment and social protection policy responses to the global economic crisis* included four possible trajectories for global employment growth for the period up to 2015 (the horizon set for the Millennium Development Goals). These trajectories, or scenarios, illustrated different assumptions about the pace of output recovery and the ratio of employment growth to output growth. The four scenarios were as follows:

- Scenario 1: the best-case scenario with strong recovery (above 4 per cent world economic growth as of 2011) and strong employment content of growth (elasticity of 0.6 per cent).
- Scenario 4: the worst-case scenario characterized by a weak economic recovery (world economic growth between 2 and 4 per cent to 2014) and a relatively low employment to growth elasticity (of 0.4 per cent).
- Scenarios 2 and 3 presented intermediate trajectories. Scenario 2 retained the fast economic recovery assumption of scenario 1 but with a slightly weaker employment elasticity of 0.5 per cent. Scenario 3 assumed a weak recovery with the same employment elasticity (0.5 per cent) as scenario 2.

¹ For the group of high GDP per capita countries the elasticity-based employment growth rate was applied according to availability of quarterly employment information of each country. In this sense, the latest historical point used is Q3 2009 for Australia, Canada, Germany, Spain and the United States and Q2 2009 for the remaining countries. Projections start from the following quarter on.

global economic growth forecasts at least six times since October 2008 (IMF, 2008). Indeed, there remains the possibility that the economic recession could be prolonged further, especially if the vicious cycle of declining consumer confidence coupled with the prospect of a weak labour market recovery persists.

Against the backdrop of these recent forecasts, the main conclusion that emerges from the analysis of employment elasticities is that the total duration of the labour market recession – in terms of employment levels – will last for up to two and a half years for medium GDP per-capita countries and up to five and a half years for high GDP per-capita countries (figure 1.8). In other words, employment in high GDP per-capita countries is likely to return to pre-crisis levels only in late 2013, with a return in medium GDP per-capita countries forecast much sooner (end of 2010).

These estimates, however, refer only to employment levels; they do not take into account the fact that the working-age population will continue to grow over the coming years. Thus, examining employment rates (employment to working-age population ratios) provides a better indication of the expected under-employment or “joblessness”.¹⁷ Given the expected rise in the working-age population, not surprisingly, employment rates are expected to recover much later, *i.e.* in late 2014 for high GDP per-capita countries. For medium GDP per-capita countries, given the strong growth in the working-age population, there is no recovery expected in employment rates foreseen before 2014. This is not the first time that employment rates have demonstrated such behaviour: a similar trend occurred in Asian countries in 1994 when the employment rate began to trend downward and, 13 years later, has yet to recover (see Appendix A).

More details on the scenarios by group indicate:

- *High GDP per-capita countries*: job losses are likely to continue until the second quarter of 2010, at which point employment growth is expected to be moderate and a full recovery is not expected until *late 2013* (figure 1.9). The employment rate is expected to follow a similar trajectory for the next few quarters but the recovery will take more than a year longer, *i.e.* not until the latter half of 2014.
- *Medium GDP per-capita countries*: job destruction is only likely for the group as a whole for 2009. The recovery profile is expected to be rather V-shaped in nature with employment returning to pre-crisis level by the end of 2010 (figure 1.10). However, as mentioned above given the substantial increases expected in the numbers of those entering the working-age population, the employment rate recovery does not seem viable in the near term.

...many unemployed and self-employed workers do not have access to benefits...

As new employment opportunities become scarce, the immediate challenge for workers will be to continue to seek ways of replacing lost income to reduce the likelihood of a social crisis. But many workers, both formal and informal, do not have access to appropriate support mechanisms.

In some countries, the first order response to mitigating income loss is via temporary support in the form of unemployment benefits or assistance. Unemployment benefit systems – if well-designed – can play a critical role in alleviating the initial impacts of income loss by providing income support and other measures of assistance (e.g. job search assistance and training).¹⁸

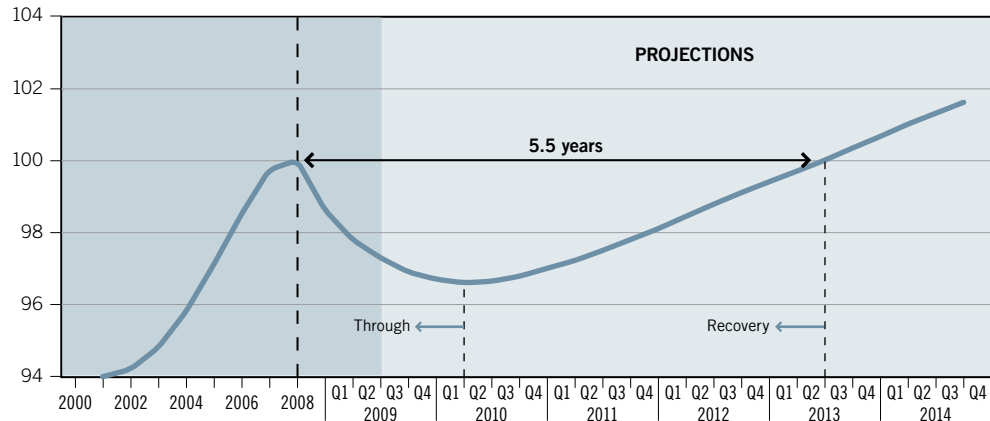
However, the coverage (amount and extent) of benefits and support measures available to individuals varies significantly across countries and regions. Two-thirds of countries for which data are currently available do not have unemployment insurance schemes in place to help jobseekers bridge the income gap.¹⁹ Of equal concern is the fact that even within countries with support systems in place, their effective reach is often very limited, which means that, on a global scale, there is

17. Working-age population is defined in this analysis as individuals aged 15 to 64.

18. In addition to replacing lost income, social security can also act as a counter-cyclical force and automatic stabilizer by boosting demand and promoting consumer confidence.

19. Approximately 56 out of 167 countries analysed in a recent ILO study. Of course, the countries without unemployment insurance schemes may have a range of other assistance measures in place, such as social assistance, public works and other similar programmes; but, these programmes have proved to have very limited coverage in global terms (ILO, 2009f, forthcoming).

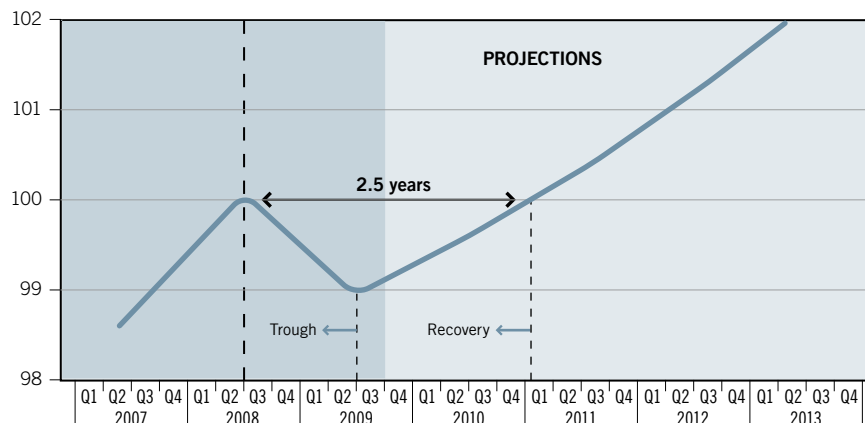
Figure 1.9 Employment projections in select high GDP per-capita countries, 2000–14 (Pre-crisis level = 100)



Note: See box 1.1 for country groupings. Countries within each group differ slightly when compared to section A given that this section is restricted to countries that experienced a crisis and for which there is sufficient historical time series data.

Source: ILS estimates based on IMF, 2009b; OECD, 2009c.

Figure 1.10 Employment projections in select medium GDP per-capita countries, 2007–13 (Pre-crisis level = 100)



Note: See box 1.1 for country groupings. Countries within each group differ slightly when compared to section A given that this section is restricted to countries that experienced a crisis in the past and for which there is sufficient historical time series data.

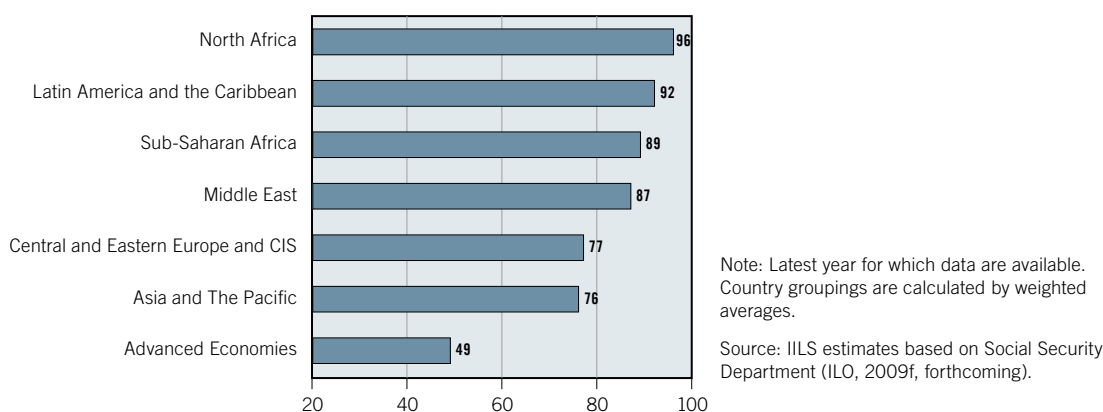
Source: ILS estimates; IMF, 2009b; ILO, Laborsta database.

a significant gap in income support coverage for unemployed workers. Figure 1.11 shows the variation between regions in terms of the share of the unemployed who are not receiving unemployment benefits. For example, in Advanced Economies, the share of unemployed persons not receiving benefits is just under 50 per cent.²⁰ This rises to over 70 per cent in Asia and Central and Eastern European countries, and over 80 per cent in other emerging and developing regions.

In light of the crisis, some countries have extended their unemployment benefit systems, by increasing entitlement amounts, making eligibility criteria less strict or extending the length of time over which unemployed workers can receive benefits. However, government initiatives are confined to the instruments already

20. See also OECD: *Employment Outlook*, 2009d; Stone, Greenstein and Coven, 2007; and OECD Database on Benefits and Wages.

Figure 1.11 Percentage of unemployed workers not receiving unemployment benefits, various years



available in their countries, which as figure 1.11 illustrates, are often quite restrictive in terms of coverage.²¹

...and broader social protection is limited to the formal workforce.²²

In most developing countries, the provision of social security measures, including unemployment benefits, is confined to a small section of formal sector workers (i.e. coverage and eligibility are typically limited to those who participate in the labour market within legally recognized employment relationships).²³

However, in developing countries between 40 and 93 per cent of the workforce are in the informal sector and as section A illustrated increased recourse to informality is likely (Rani, 2008). And although, in some countries, social security provisions also apply to informal wage and self-employed workers, such coverage is rather limited.²⁴

- *Informal sector workers:* with respect to health provisions (i.e. disability, work injury or sickness and maternity), less than 10 per cent of Middle Eastern countries have measures in place to cover informal wage workers (figure 1.12, panel A). In Asian and Latin American countries, less than 40 per cent of countries have provisions in place for these workers. Similarly, few countries have old-age and widow/survivor pension schemes in place for informal wage workers; the totals range from 18 per cent of countries in the Middle East to 37 per cent in Africa. Even fewer countries have provisions for unemployment benefits or family allowances for informal wage workers.

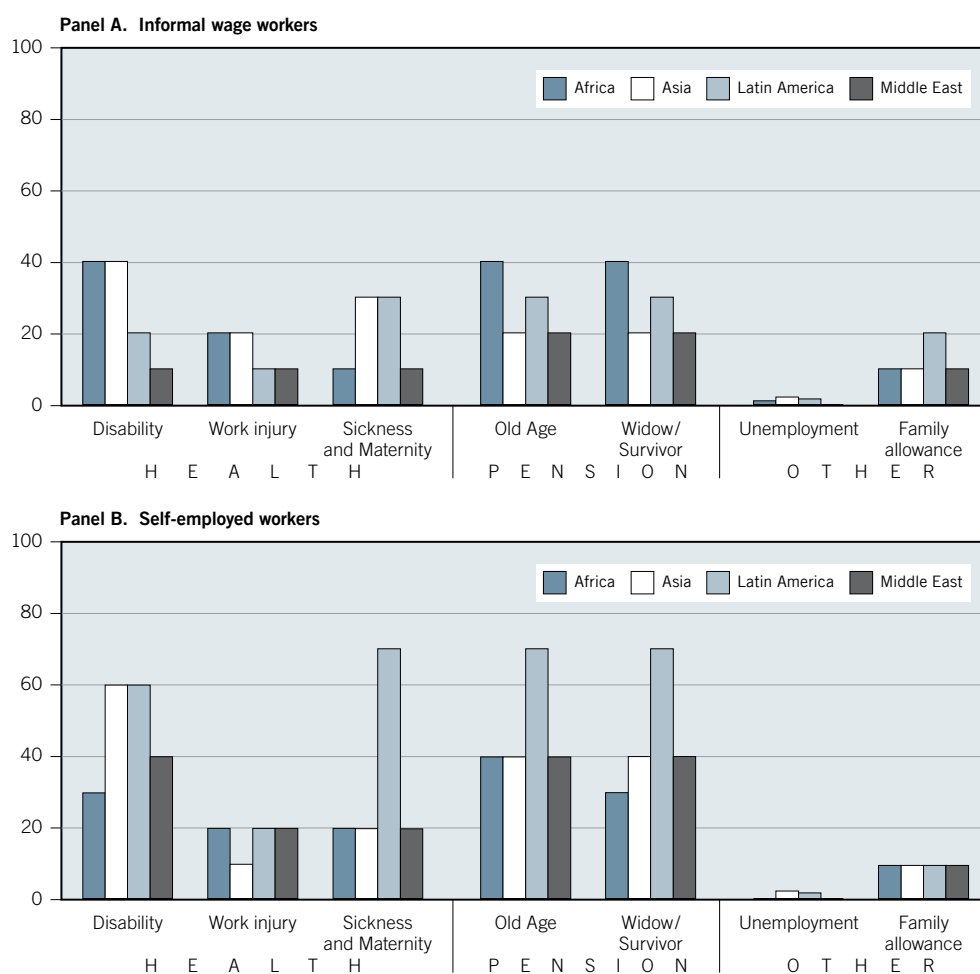
21. For more detailed information on countries' responses in terms of income support to the unemployed by income level please see ILO (2009b), *Thematic assessment on protection of unemployed workers* (Geneva).

22. This sub-section has been prepared by Uma Rani.

23. 'Formal wage' workers comprise of those employed in public and private sector; and those with salaried employment.

24. "Informal wage" workers comprise temporary, part-time and seasonal workers; casual labour (those with daily and weekly earnings) in all economic sectors; domestic servants/workers; wage workers in small enterprises (with less than five, ten or 20 workers, depending on the country); homeworkers and unpaid family labour. The self-employed workers who were covered on a voluntary basis included self-employed taxi drivers, artists, traders, employers of small enterprises, craftsmen and fishermen.

Figure 1.12 Percentage of countries that have provisions for social security schemes for informal wage workers and self-employed workers, by regions, as of 2009



Source: ILS estimates based on legislative documents available at ISSA (2009).

- Self-employed workers*: for these workers, there appears to be a greater number of schemes in place, especially with regard to disability and pensions, where one-third or more of countries have provisions of this nature (figure 1.12, panel B). This is particularly the case in Latin America, where the incidence rises to two-thirds of countries or more. However, there remain important gaps: Latin America aside, less than 25 per cent of countries have provisions for work injury, unemployment or family allowances for self-employed workers. Similarly, more than half of the countries do not have pension provisions for self-employed workers (the exception, once again, is Latin America).

It is important to emphasize that, even in countries where social security schemes exist there is often a significant gap between the *provision* of social protection and the numbers of individuals who are *effectively* covered – as was the case above with respect to unemployment benefit systems. Data for a selection of countries in Africa, Asia and Latin America indicate such gaps between provision and coverage. For example, in Kenya, up to 25 per cent of the population have formal health protection coverage, whereas in Côte d’Ivoire the figure is only 5 per cent. In Panama, it is estimated that nearly 65 per cent of the population have health coverage, but in Paraguay the figure is just under 16 per cent (ILO, 2009d).

Table 1.3 Social security coverage for Latin America and the Caribbean (only urban wage-based)

	Wage workers		
	Total	Formal sector	Informal sector
Argentina (2005)	62.5	74.4	23.0
Bolivia (2004)	28.3	45.8	4.5
Brazil (2004)	71.5	76.2	35.3
Chile (2003)	82.9	88.5	54.7
Costa Rica (2005)	80.4	90.4	40.4
Dominican Republic (2005)	58.7	70.0	7.2
Ecuador (2005)	46.4	60.8	14.8
El Salvador (2004)	58.9	78.2	6.8
Guatemala (2004)	48.7	66.0	7.6
Mexico (2005)	62.5	76.2	20.1
Nicaragua (2001)	41.0	58.4	6.4
Panama (2005)	76.3	86.3	25.9
Paraguay (2005)	32.3	52.1	4.1
Peru (2003)	35.2	38.5	2.4
Uruguay (2005)	77.3	88.9	44.9
Venezuela (2005)	61.7	73.4	15.8
Simple average	57.8	70.3	19.6

Note: "Informal sector" refers to employment in informal micro enterprises (fewer than five workers) and domestic workers; and "formal sector" refers to those employed in large private enterprises and in the public sector.

Source: Titelman (2007) based on ECLAC database (2007).

In this respect, the gap between formal and informal sector workers widens when examining the case of urban wage workers. For example, even in countries where social security coverage is relatively high for formal wage workers (e.g. more than 80 per cent in Chile, Costa Rica and Uruguay), it is less than half for informal wage workers (table 1.3). In most other Latin American countries, coverage is typically lower – ranging from 38.5 per cent to 78 per cent for formal wage workers – compared to less than 20 per cent for informal wage earners.

Consequently, given that so many workers lack adequate protection, the severe employment losses precipitated by the current crisis give rise to even greater concern in terms of their social impacts. The reality is that the majority of workers do not have a safety net to rely on in times of need. So, the schism is twofold – not just between employed and unemployed, but dividing those who have access to social protection and those who do not. Given the time it will take for the labour market to recover, this disparity may widen unless appropriate action is taken.

C. The way forward

To date, significant efforts have been made to rescue the financial sector and restore confidence in financial markets – though, as chapter 2 illustrates, very little has been done to address the key failures of the financial system that lie behind the crisis. Fiscal and monetary policies have also been successful in stimulating an economic revival. However, the recent rebound in world output and equity markets should not

mask the fact that, as shown in the previous two sections, the crisis which erupted in October 2008 still grips the world of work and is expected to do so for some time.

According to some, however, governments can no longer afford further fiscal stimulus measures and they should therefore consider exit strategies. The purpose of this section is to: (i) illustrate the importance and feasibility of government intervention in the short term; and (ii) highlight how policy efforts, consistent with the Global Jobs Pact, can promote employment recovery within the limits of fiscal sustainability.

1. The case for further government intervention to overcome the jobs crisis

Case for stimulus measures in the face of rising public debt and deficit.

In addition to financial rescue packages and monetary measures, most countries have intervened to tackle the crisis by introducing fiscal stimulus packages – the sizes of which vary considerably across countries. Globally, the IMF has reported that the average size of discretionary fiscal measures in 2009 is 1.9 per cent of GDP in advanced G20 countries and 2.2 per cent of GDP in emerging and developing G20 countries.²⁵

Given the magnitude of these expenditures, many countries (advanced and major emerging) are expected to incur significant fiscal deficits in 2010 (figure 1.13, panel A). Reflecting budget deficits and measures to bail out some financial institutions, almost all countries (with available data) are likely see increases in their gross public debt as a percentage of GDP (figure 1.13, panel B). Policy-makers are now concerned about how to scale down and limit further interventions in order to rebalance budgets and stabilize public debt.

To shed light on the possible trade-offs between fiscal and employment goals, a macroeconomic model has been used (Ernst and Charpe, 2009). The potential scenarios for public intervention and spending include:^{26,27}

1. No intervention: public spending is kept constant. This case is used as a benchmark to compare the relative performances of alternative fiscal policies;
2. Reduction in public spending with a view to debt stabilization;
3. Public spending in response to changes in employment: fiscal authorities use employment losses (or gains) to determine increases (or decreases) in public spending.

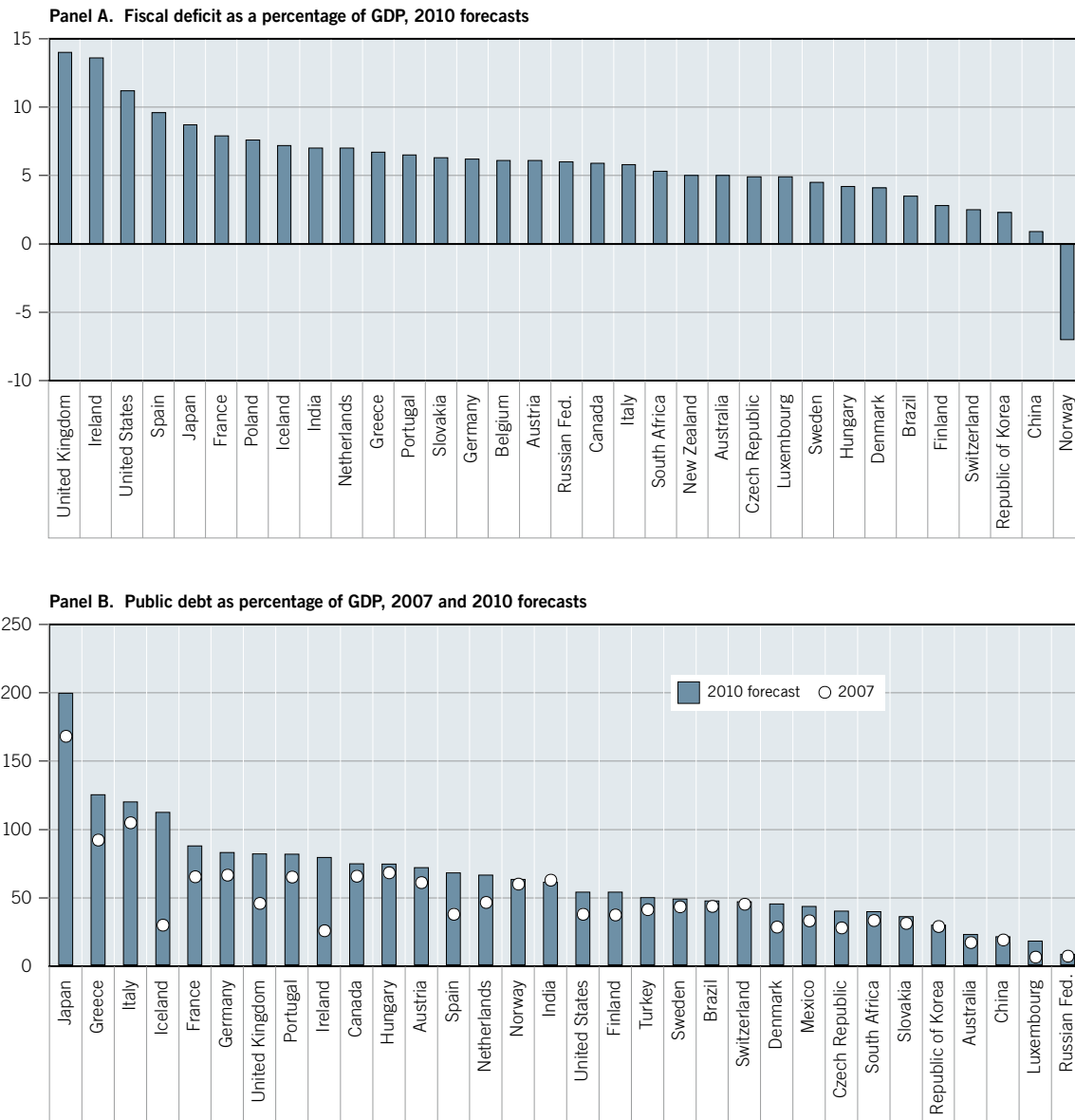
Against the backdrop of the expected continued weakening in the labour market, the main finding illustrates that when fiscal authorities deploy spending in response to the level of employment (increase spending when employment is declining), employment losses would be 7.2 per cent lower compared with no intervention (figure 1.14). Whereas reducing public spending in an attempt to stabilize the

25. M. Horton; K. Manmohan; M. Paolo: “The state of public finances: A cross-country fiscal monitor”, IMF Staff Position Note, July 2009. Quoted in *Protecting people, promoting jobs*.

26. The macroeconomic model developed assumes that unemployment arises due to labour market imperfection and that public spending has an impact on the economy (public intervention financed by debt has a positive impact on consumption through a wealth effect). In the economic literature, the model belongs both to families of matching models and perpetual youth models.

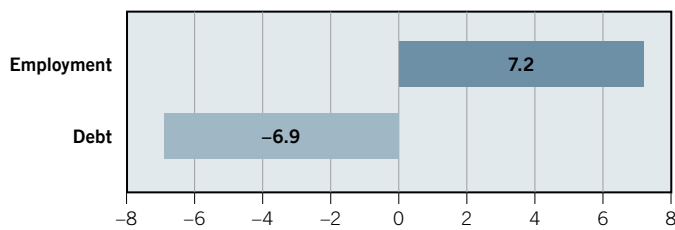
27. The modelling exercise of this section has been prepared by Matthieu Charpe.

Figure 1.13 Fiscal positions (deficit and debt) in select countries, 2010



Source: Fiscal deficits sources are as follows: Reserve Bank of India Survey of Professional Forecasters, November 2009 (India); OECD, 2009c (Brazil, the Russian Federation, China, and South Africa) and OECD, 2009b (all others). Fiscal deficit is defined as government net lending as a percentage of GDP. Public debt source is Economist Intelligence Unit, employing various definitions, making strict country comparisons difficult.

Figure 1.14 Employment effects of various public spending scenarios compared to the baseline (no intervention), percentages



Source: IILS estimates, based on Ernst and Charpe, 2009.

level of public indebtedness could further increase employment losses by 6.9 per cent, prolonging the jobs crisis and potentially dampening recovery prospects. Moreover, while introducing employment-related measures would require expenditure outlays and thus raise public deficits in the short term, the potential gains to employment and output means that the increase in public debt is temporary and in the medium-term returns to its pre-crisis level.²⁸

In addition, supporting the labour market can help mitigate the global jobs crisis and support broader recovery efforts.

Governments must carefully weigh concerns about levels of public debt, while considering that an overly hasty retraction of fiscal measures could generate even greater job losses, delay recovery and put even more pressure on public finances at a later date. Therefore, the challenge for policy-makers is to design short-term policies that address immediate labour market weaknesses and at the same time are consistent with efforts to address underlying issues. Achieving this balance can provide a solid basis for enduring recovery while maintaining reasonable levels of public debt.

The ILO, through its Global Jobs Pact has proposed a range of crisis response measures to address the global jobs crisis while supporting the recovery process more broadly (ILO 2009c; ILO and ILS 2009a; ILO 2009e). Even in countries with shrinking fiscal space, elements of the Global Jobs Pact could prove beneficial in aiding a quicker and more sustainable recovery process – through such avenues as public infrastructure development, social protection, support for vulnerable groups and labour market skills and training programmes. Such policies would go a long way towards addressing labour market imbalances and helping to avoid the re-emergence of another global crisis in the future.

2. Global Jobs Pact: labour market and social measures to support recovery in 5 countries²⁹

Some countries have devised policies in the spirit of the Global Jobs Pact and have not only shown resilient economic growth but are also witnessing early signs of a labour market recovery. The cases of Australia and Brazil – both large commodity exporters with adequate fiscal space – are interesting in this regard:

- Economic growth in Australia was similarly supported by public infrastructure investment but aided by maintenance of household expenditures – of which increased social assistance to targeted groups was a significant catalyst. Labour market retention also helped to prop up employment until economic activity rebounded.
- In Brazil, job creation and a rebound in economic activity were the result of steps taken to increase household income, which boosted domestic private consumption, and improvements in social assistance programmes, such as

28. Initial reviews of stimulus efforts indicate that discretionary fiscal expansion, together with automatic stabilizers, has already created or saved between 7 and 11 million jobs in G20 countries in 2009 (ILO 2009e).

29. This section has been prepared by Marva Corley-Coulibaly and Naren Prasad with excellent research assistance by Megan Gerecke.

unemployment benefits and conditional cash transfers. In addition, Brazil has also managed to maintain the downward trend in informal employment.

In countries where the recovery is more muted, specific labour market and social policies have aided the recovery process and provided critical support to those most in need:

- In Germany, while declines in GDP growth at 3.8 per cent in the first quarter of 2008 have been the steepest in 40 years, job losses were limited by enhancements to existing schemes that support reduced working hours, work-sharing and partial unemployment benefits.
- Cases such as Jordan show that, even with limited fiscal space, countries have been able to design Global Jobs Pact-friendly policies that have had positive impacts. Jordan has successfully increased provisions and support for poor families and vulnerable unemployed, while maintaining its commitment to universal social security.
- The Republic of Korea's economic and labour market recovery has been more tepid but policy has been successful in reducing unemployment through job-sharing and negotiated wage restraint and providing targeted social assistance to the most vulnerable groups, particularly youth and the recently unemployed;

Of course, each country has a different level of policy space, resources and capacity to respond to the crisis. There is no "one size fits all" policy. As section A illustrated, each country has been affected by the crisis in different ways prompting varying policy responses. Some of these measures, however, highlight ways in addressing labour market and social challenges that have helped support a broader recovery.

Australia: labour market resilience in the wake of tentative recovery

Recession avoided

Australia may be the only developed economy to escape a recession in 2009, with growth remaining positive, though moderate, in the first two quarters. Aided by the recovery in commodity exports and strong fiscal stimuli, the economy grew by 0.6 per cent in the second quarter, (quarter-on-quarter), up from 0.3 per cent in the first quarter of 2009. Growth for the year is projected to be around 0.7 per cent. The labour market has also been surprisingly upbeat in Australia, with the trend suggesting that the unemployment rate will peak at fewer than 6 per cent in 2009, a full 2 percentage points below Government projections.

Crisis response

Following the onset of the financial crisis, Australia responded quickly and decisively with monetary and fiscal policy initiatives to support its financial markets, cushion demand, support the most vulnerable in the population and stimulate job creation. The accumulation of savings during the previous commodity boom period allowed the Government adequate fiscal space to assemble a strong counter-cyclical response.

In particular, a series of stimulus packages, in two separate phases, was enacted. The first part, enacted in October 2008, focused on income support,

while the second package in February 2009 consisted of “shovel-ready” infrastructure projects. The totality of the fiscal response (over 2008–10) amounts to around 5.3 per cent of GDP, the third largest among OECD economies (OECD, 2009b). The packages focused on five key areas:

- *Social assistance for targeted groups*: Australia’s initial response to the crisis was through increased social assistance to cash-constrained households, particularly vulnerable groups, such as pensioners and low-income families. The provision of such assistance was not only a means of providing support for those most in need, but also provided an immediate stimulus by putting cash in the hands of those most likely to spend it – thus shoring up household consumption. Pensioners received between A\$1,400 and A\$2,100 (depending on their income level) while low- and middle-income earners received a transfer payment of \$A1,000 per child. Through these and other measures, the package is expected to add A\$19.7 billion to household income (Government of Australia, 2009).
- *Supporting consumption through support for homebuyers*: although not directly related to the labour market, support for homebuyers was a crucial element of the first phase of the stimulus because housing represents 60 per cent of household wealth and is an important driver of consumption and consumer confidence. The First Home Owners Boost stimulated housing activity, and helped to support over 59,000 first time homebuyers (Government of Australia, 2009). Housing prices have since stabilized in Australia and, as of the second quarter of 2009, were down by only 1.2 per cent year-on-year.
- *Infrastructure spending*: by February 2009, a larger stimulus package was announced, which provided additional assistance for targeted groups, but its centrepiece included an element for infrastructure investment – the largest in the country’s history. The Nation Building and Jobs Plan included a A\$29.9 billion publicly funded infrastructure project targeted at local community infrastructure, housing, schools and roads, as well as support for a national broadband network intended to support up to 25,000 local jobs each year for over eight years.
- *Skills, training and job-search assistance*: to address long-term labour market issues and improve job-search assistance, the Government placed a strong emphasis on the provision of training and skills development. A total of A\$187 million was allocated to the Productivity Places Program for 56,000 new training places, bringing the total to nearly three-quarters of a million places over the period 2009-2014. Training is particularly geared towards disadvantaged jobseekers, namely recently retrenched and young workers.
- *Fair Work Act of 2009*: although enacted prior to the crisis (July 2009), the Fair Work Act relates to many areas of employment support, such as retention, training and wages. This overarching Act set the tone for improved industrial activity during the crisis. Among other things, the new industrial relations systems set minimum conditions for all national workers, additional safety nets for most employees, broader access to unfair dismissal complaints and broader rights for unions to enter workplaces.

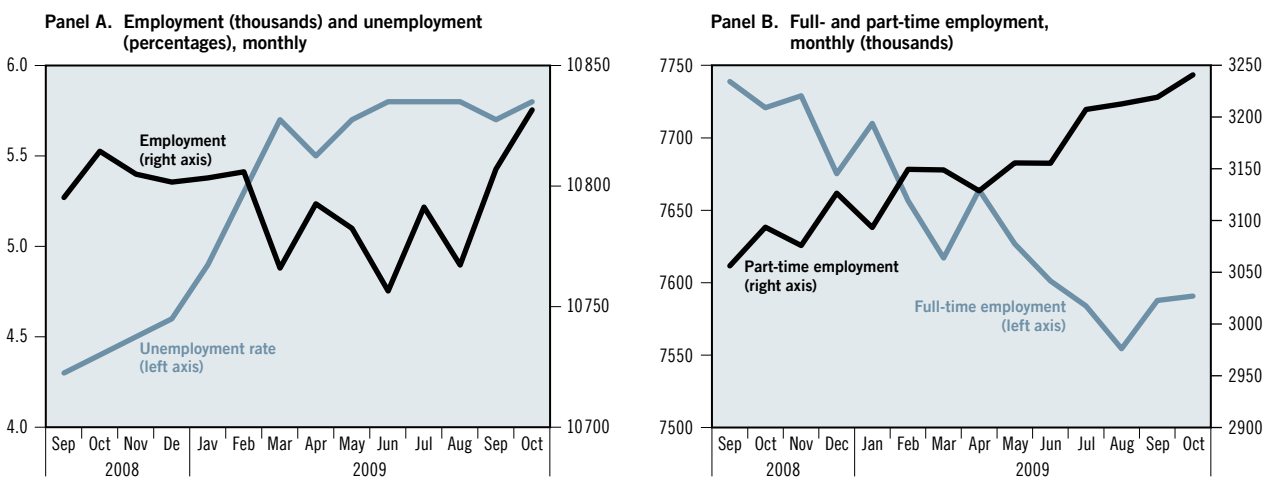
Effectiveness

The OECD has singled out Australia's fiscal stimulus package as being particularly effective in supporting employment. Estimates have shown that, without the implementation of these measures, growth would have contracted by 1.3 per cent between 2008 and 2009 (second quarter, year-on-year) (OECD, 2009d). The main drivers behind the resurgence in growth have been resilient household spending and increased public consumption. Household spending has been supported by the fiscal stimuli, which provided income support in the form of transfer payments for targeted groups, while the public infrastructure component, which came online in 2009, has already increased public investment by 0.8 per cent in the second quarter of 2009 (quarter-on-quarter).

Since October 2008, the unemployment rate has risen from 4.4 per cent to just below 6 per cent in October 2009, but has been hovering around 5.7 per cent since May 2009 (figure 1.15). The number of employed persons has also shown an upward trend since August 2009. Such labour market resilience will serve to shore up demand as well as improve the fiscal outlook as fewer outlays will be needed in terms of unemployment benefits.

An important element in Australia's employment picture is that it has been driven mainly by part-time job creation; full-time employment fell by 1.7 per cent in October 2009 (year-on-year), while part-time employment increased by nearly 5 per cent during the same period (see also section A). Thus, adjustment in the labour market came about mainly through a reduction in working hours, as opposed to increased retrenchment, through a pure market reaction, as firms were reluctant to cut qualified workers from employment rolls. Aggregate hours worked fell by 3 per cent from their peak of 959 million in July 2008 to 930 million in September 2009, while employment remained relatively stable. This has led to a rise in underemployment (those who work part-time but would prefer to work more hours) and, consequently, underutilized labour (a measure of both unemployment and underemployment). After a steady downward trend since May 2001, the quarterly labour force underutilization rate in Australia increased almost 4 percentage points between August 2008 and 2009, from 9.9 per cent to 13.6 per cent, with considerably higher rates for youth workers (23.7 per cent in May 2009).

Figure 1.15 Labour market recovery in Australia



Note: Data for full and part-time employment is seasonally adjusted.

Source: Australian Bureau of Statistics, 2009.

The way forward

Australia's labour market performance has shown resilience in the face of numerous risk factors. Stimulus efforts and the nascent recovery have been underpinned by strong external demand for commodities and increasing domestic consumption in the form of public and household expenditures. However, should the recovery in commodities prove short-lived or commodity prices collapse, domestic demand may not be able to support sustainable growth. As in Brazil, Australian exports are mainly in the form of commodities, which represent around 65 per cent of exports. Though strong demand from China for such commodities has contributed to growth in both countries, Australia's recovery remains susceptible to a fall-off in trade volumes.

Additionally, as discussed in section A, the practice of reducing hours as opposed to cutting jobs (a viable solution for a short-term downturn), may not be fiscally feasible for employers if economic conditions deteriorate in the near term or the global recovery is prolonged. Thus, premature removal of the stimulus package could dampen growth and weaken labour market prospects; most recently, the Australian Treasury has estimated that such premature removal would come at the expense of 100,000 jobs in the economy.

Brazil: recovery through boosting domestic consumption

Short-lived recession

In the wake of the global financial crisis, the Brazilian economy experienced a sharp, but relatively short-lived, recession (-3.4 and -1.0 per cent in Q4 2008 and Q1 2009, respectively). Positive growth returned (1.9 per cent) in the second quarter of 2009 (Banco Central do Brasil, 2009).

Crisis response

The Government's response to the crisis was swift, leveraging existing policy measures to strengthen growth and job creation. The Brazilian stimulus package for the financial crisis was combined with the existing Growth Acceleration Program (PAC) of 2007, which has a large public investment component, especially for public infrastructure. The plan provides assistance to public enterprises, such as Petrobras, enabling them to continue to invest in the economy and assistance to the National Bank for Economic and Social Development. In addition, funding was allocated to the development of the maritime industry. The Government also provided significant stimulus to boost domestic consumption through well-targeted tax incentives for the purchase of automobiles and other durables, as well as assistance to build 1 million houses (400,000 for low-income families and 600,000 for middle-class families) under the programme known as *Minha Casa Minha Vida* – which served to aid struggling sectors such as construction and the automobile industry. Additional assistance was provided to enterprises in the form of loans for export financing to help exporters, and loans providing assistance to SMEs for capital goods purchases and additional investments in agriculture.

To mitigate the social impact of the crisis, the Brazilian Government adopted both universal (e.g. an increase in the minimum wage and extension of unemployment benefits) and targeted responses (e.g. housing for the poor and conditional cash transfers). In particular, the Government raised the minimum wage by 6 per cent in real terms (increasing both directly and indirectly the income of

about 40 per cent of workers). Unemployment insurance was extended to cover workers who were particularly affected by the crisis. In addition, the existing targeted conditional cash transfers delivered via Bolsa Familia were strengthened.

Effectiveness

In Brazil, household consumption is relatively high, representing 61 per cent of GDP in 2008, compared to other emerging economies, such as China where it represented only 36 per cent in 2008. Policies to maintain household income and support domestic private consumption have aided the recovery process: consumption grew by 2.1 per cent in the second quarter of 2009. Tax breaks for automobile and electric appliance purchases appear to have been particularly effective, with consumption of durable goods (such as those produced by the automotive sector) accounting for much of the growth. Consequently, private consumption will contribute 1.5 per cent to real GDP growth in 2009, compared to 3.3 per cent in 2008.

The increase in the minimum wage also contributed to maintaining the purchasing power of households. Additionally, wage increases in the public sector and the automobile industry were maintained in late 2008 and late 2009, respectively, and provided further support to domestic consumption.

Recent data also show that the impact of the crisis on Brazil's labour market was limited as a result of the counter-cyclical and sector-specific policy response (Barcena et al. 2009). During the first half of 2009, employment continued to grow, with the number of formally employed workers in six major metropolitan regions increasing by nearly 400 thousand since January 2009 (figure 1.16). This is reflected in the declining unemployment rate, which dropped from 9 per cent in March 2009 to 7.7 per cent in September 2009.

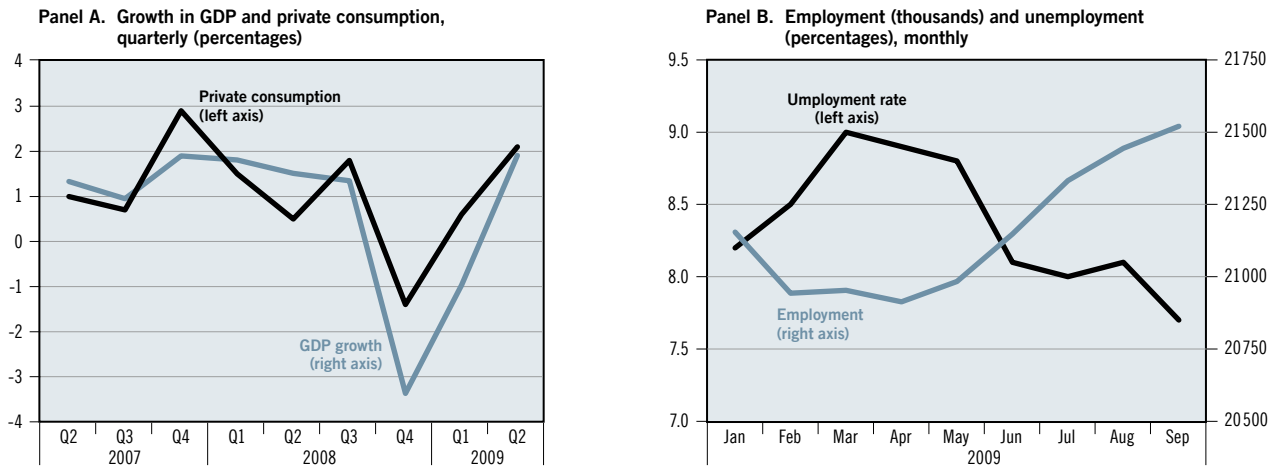
Additionally, jobs in the informal sector continue to decline as a share of total employment. While, in the 1990s, informality represented over 60 per cent of employment in Brazil, by 2006 it represented less than 55 per cent of the employed (Baccheta, Ernst and Bustamante, 2009).³⁰ Similarly, recent data show that workers without a working permit have stayed relatively constant passing from a little over 19 per cent of the total employed in February 2008 to 18.7 per cent in March 2009 and up to 19.2 in September 2009 (figure 1.17). In other words, Brazil's experience shows that an increase in the minimum wage was not accompanied by decreases in the formal workforce. Moreover, the provision of social security has helped to counterbalance risks of increased informal employment.

The way forward

In conclusion, Brazil combined the existing PAC policy measures with its new stimulus package to increase investment in public infrastructure, increase domestic consumption and, eventually, increase growth by maintaining household income, increasing wages and mitigating the impact of the crisis through social assistance programmes (such as unemployment benefits and conditional cash transfers). All these policies helped to increase or maintain employment and sustain the impetus of the country's steps towards formalization of the labour force in a cost-effective

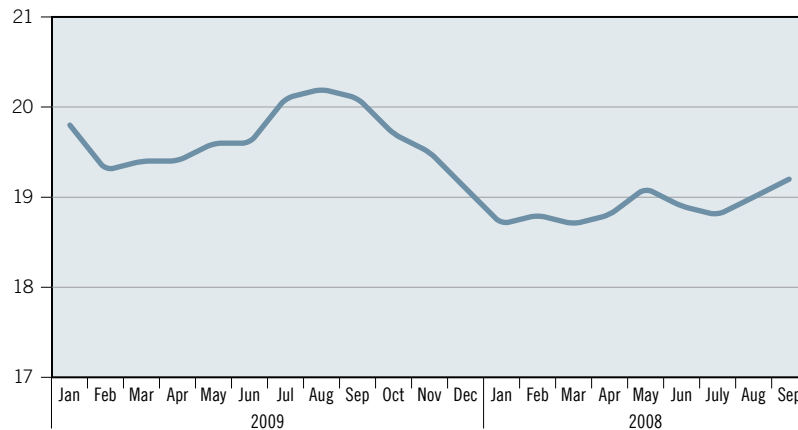
30. The definition of informal sector includes enterprises with fewer than five workers, entrepreneurs, own-account workers or self-employed (excluding professional, managerial and technical workers), contributing family workers (unpaid) and domestic workers.

Figure 1.16 Economic and labour market recovery in Brazil, 2007-09



Source: Banco Central do Brasil, 2009, and Instituto Brasileiro de Geografia e Estatística.

Figure 1.17 Workers without a working permit, as percentage of total employed, 2008–09 (percentages)



Source: Instituto Brasileiro de Geografia e Estatística, 2009.

manner. Brazil's total stimulus package amounted to around 1 to 1.5 per cent of GDP (compared to 13 per cent for China, 5.6 per cent for the United States, 4.7 per cent for Mexico and 3.9 per cent for Argentina).

Additionally, Brazil's well-developed universal welfare system, combined with well-targeted social policies, was instrumental in helping to mitigate the effects of the global crisis on the vulnerable population and aided in the recovery process. With regard to the labour market, further declines in the unemployment rate are likely, but as a result of low enrolment rates in secondary and tertiary education (with 7.3 years of average schooling) skills shortages may persist. The Government will need to pay particular attention to the impact of phasing out the stimulus package, especially in terms of the tax break initiatives.

Germany: labour retention through working hour adjustment

Prior to the crisis, the unemployment rate in Germany had been trending downwards since 2006 and, while negative GDP growth in Germany began in the second quarter of 2008 and continued for four consecutive quarters, the effects were not immediately felt in the labour market. Employment growth only turned negative in November 2008. As illustrated in the previous section, Germany is an example of a country that has experienced a critical growth reduction, but has had low employment losses compared to other countries.

Crisis response

In November 2008, under the German Government's first economic stimulus plan, existing short-time working arrangements (*Kurzarbeit*) were extended in 2008 from six to 18 months. In May 2009, the maximum length was extended again to 24 months. Under this programme, employers can apply for temporary state assistance to top up the wages of employees who are working reduced hours. The assistance is available to establishments which are facing a temporary, unavoidable loss of employment due to economic factors. In situations where diminished activity would lead to a 10 per cent cutback in the gross wages of at least one-third of a company's workforce, that company is entitled to resort to this mechanism, if compliant with the industry's collective bargaining agreement. Granting the short-time allowance to companies is conditional on overtime having been abolished and working time account credits having been exhausted. The Federal Employment Agency covers 67 per cent of the net wage loss suffered by the wage earner (60 per cent for childless workers), and employers are reimbursed 50 per cent of the social security contributions they make on behalf of workers. This can rise to 100 per cent if the downtime (i.e. reduced working hours) is used for training.

Effectiveness

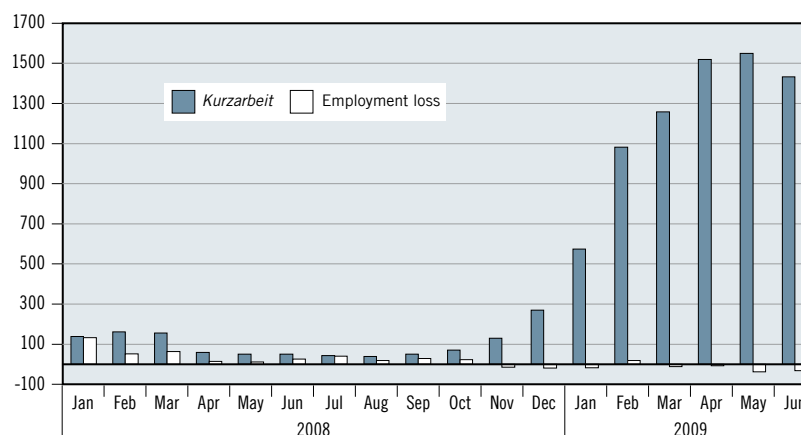
The number of beneficiaries under the shortened working hours scheme has risen dramatically since its introduction: rising from over 130,000 participants in November 2008 to more than 1.4 million workers in June 2009 (figure 1.18).³¹ And, while there is some debate regarding the overall effectiveness of labour hoarding and implications for reduced productivity, employment losses have slowed recently and, as mentioned above, in Germany, economic growth has returned – at least temporarily – to positive territory. In addition, the programme has been credited with increasing consumption by 0.3 percentage points per month and keeping unemployment rates from rising by 1 percentage point (Natixis, 2009).

The way forward

The reduced working hours approach – similar to that adopted in Australia – appears to be successful in the short term. However, the longer term effects have still to be determined. While the scheme has effectively mitigated employment

31. Note that the months of January, February and March typically have more participants due to the special winter-related scheme for the construction sector. However, the number of participants in March 2009 is still nearly ten times higher than in March 2008.

Figure 1.18 Employment losses and *Kurzarbeit* beneficiaries, Germany, January 2008 to June 2009 (thousands)



Source: Federal employment agency of Germany database.

losses, this upside must be weighed against the possibility of forgone productivity increases. One criticism has been that such an approach artificially props up firms and industries which are not competitive. Moreover, there is a risk that, as the labour market recession persists, these “retained” workers will join the ranks of the unemployed and further prolong the crisis. The labour market upswing will be more muted, too. On the positive side, wage growth may resume earlier.

Jordan: limited fiscal space shapes crisis response

Financial crisis impact and limited fiscal space

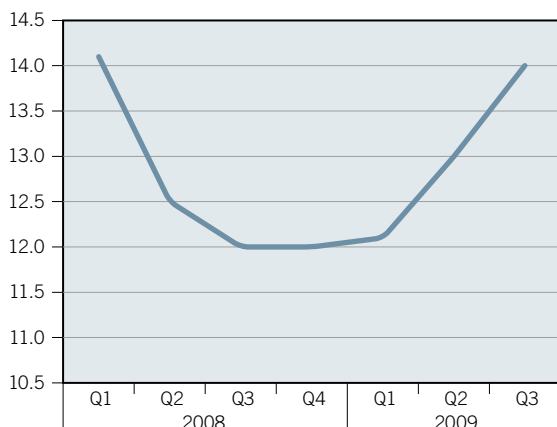
Jordan, in common with other oil-importing countries in the Middle-Eastern region, has been moderate in its fiscal response to the economic crisis, owing to its large public debt and limited financial resources. As a result, the Government had to rescind its previously announced JD183 million (US\$256 million) fiscal stimulus package and has, instead, brought forward planned capital expenditures and extended social services to those most in need.

Economic growth has remained relatively stable at 3 per cent in the first half of 2009 (due to relatively limited access to international financial markets and manufacturing supply chains). Nevertheless, compared to the same period a year ago, GDP growth has fallen nearly 6 percentage points (from 8.9 per cent). In addition, third quarter unemployment is up 2 percentage points compared with the same quarter in 2008 (see figure 1.19).

Crisis response: Targeted support for the most vulnerable groups

In spite of fiscal constraints, the country has taken steps to enhance support for vulnerable groups through a number of channels. Among other measures, it has increased the monthly minimum wage from JD110 (US\$155) to JD150 (US\$211) and improved implementation and expansion of funding to the National Aid Fund (which provides cash assistance and support for poor families) in the amount of JD20 million (US\$28 million). Through this additional allocation, the Fund provided monthly cash assistance to 12,335 new families, extending the total number of families covered in 2009 to 82,694. The Government has also expanded the

Figure 1.19 Quarterly unemployment rates in Jordan, 2008-09 (percentages)



Source: Government of Jordan, 2009a.

eligibility criteria for support under the Special Cases Programme (which includes care for the disabled) from JD200 (US\$282) to JD250 (US\$352) and increased the amount paid under the programme (Government of Jordan, 2009b).

In terms of employment creation, the Government has instituted several programmes, with an emphasis on vulnerable groups. In October 2009, it began accepting applications under the Government Support Programme for the Unemployed and Agriculture Workers, which aims to increase employment opportunities for low-skilled workers (those educated to secondary school level or below) through the provision of social security matching schemes to employers. This programme is especially beneficial to women who are overrepresented in the agricultural sector. The National Vocational and Training Programme has also targeted women in poor and remote areas to provide training to boost female self-employment.

Maintaining social security extension

Although not directly related to the crisis, a crucial element of the Government's social protection initiatives has been the extension of social security to those groups previously not covered. Currently, the Jordanian Social Security Corporation (JSSC) scheme covers approximately 45 per cent of the working population, and mainly excludes the informally employed, employers and self-employed (ISSA, 2009). Coverage had previously been limited to enterprises with more than five employees, but the aim is to extend coverage to 80 per cent of enterprises employing less than five workers by 2011. In this regard, a pilot programme was commenced in November 2008 in the town of Aqaba, with impressive results: about 85 per cent of small enterprises were extended coverage (1,817 out of 2,196 enterprises). In November 2009, the programme's next phase will target workers in an additional 21,000 enterprises.

The way forward

Jordan has managed to provide targeted support to vulnerable groups during the crisis and maintain its commitment to universal social security coverage. Given its limited fiscal space, it increased public investment by bringing forward capital expenditures in the budget and devised targeted support for poor families, agricultural workers and women. Additionally, it has also maintained its phased implementation of universal social protection through a well-planned strategic focus

that gradually targets geographic regions both inside and outside the Kingdom – a strategy which has been recognized by the International Social Security Association for its dynamism and partnership between all major actors involved. This illustrates that such programmes can be feasible, even in low-income countries with limited fiscal space.

Republic of Korea: mitigating social impact through social safety nets

Tepid labour market recovery

The Republic of Korea is slowly recovering from the financial crisis, with economic growth stabilizing in the first quarter of 2009 at 0.1 per cent and expanding further in the third quarter with 2.9 per cent quarter-on-quarter growth.

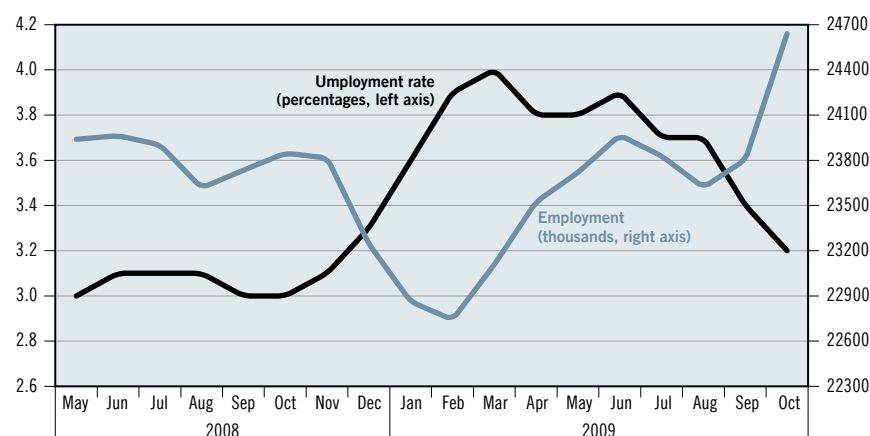
The employment situation has also improved from the previous year's lows. After reaching its lowest level (22.7 million) in February 2009, employment started to recover in March 2009 and, by October 2009, had reached around 24.6 million (figure 1.20). The unemployment rate, which reached a peak of 4 per cent in March 2009 (from a low of 3 per cent during May–October 2008), started its downward descent in July 2009, falling to 3.2 per cent in October 2009. Improvements in the labour market are also reflected in the decrease in the number of people receiving unemployment benefits: the number of recipients has fallen from 445,000 in April 2009 to 389,000 in August of the same year.

Crisis response

The Republic of Korea's fiscal stimulus package represented 6 per cent of GDP (spending and tax cuts) – one of the highest among OECD countries. The policy measures consisted of reinforcing the soundness of banks, restructuring the corporate sector and enhancing social safety nets. The social safety net response can be broken down into:

- *Job-sharing*: providing temporary tax credits and financial incentives for those enterprises that have job-sharing measures in place in order to maintain employment until economic activity recovers;

Figure 1.20 Labour market recovery in the Republic of Korea, 2008-09



Source: Bank of Korea, 2009.

- *Creating jobs in the public sector*: providing youth (one of the groups hardest hit by the crisis) and other unemployed individuals with job opportunities. This step included creating an additional 100,000 jobs for youth through its internship programme in the public sector, 23,000 of which were already under way in 2009, and increasing employment in social services by 126,000 in 2009. Also, the Green New Deal policy for public infrastructure projects was implemented, intended to provide around 1 million additional jobs over a four-year period.
- *Strengthening social safety nets*: providing increased training for the unemployed (150,000 in 2009), incentives to SMEs to retain workers and government guarantees for depreciated housing values. The Republic of Korea has strengthened its unemployment insurance scheme since its 1997 crisis. However, due to strict qualifying conditions, to date there are still only 58 per cent of wage workers covered by the unemployment insurance scheme, which has a maximum duration of six months and a salary replacement rate of around 40 per cent.

Effectiveness

It is argued that this stimulus package – including the job-sharing and wage-restraint aspects introduced through the February 2009 “grand social consensus”³² – was successful in reducing job losses. Estimates have shown that, without the stimulus package, the number of unemployed would be 148–326,000 higher in 2010 (OECD 2009d). However, job retention was given priority over wage increases – as suggested by the fact that wages declined by -3.7 per cent in the second quarter of 2009, on a year-on-year basis. In this respect, wage moderation can be viewed as an essentially temporary measure, designed to support employment levels. If implemented through collective bargaining, it may have mutually beneficial outcomes for employers, workers and governments.³³

The way forward

The Republic of Korea is showing strong signs that it is on the road to recovery with its ambitious stimulus package. Its massive employment creation and job retention programmes are proving successful in terms of reducing unemployment. However, one worrying sign is the declining wage, although the Government emphasizes that this should be a temporary phenomenon.

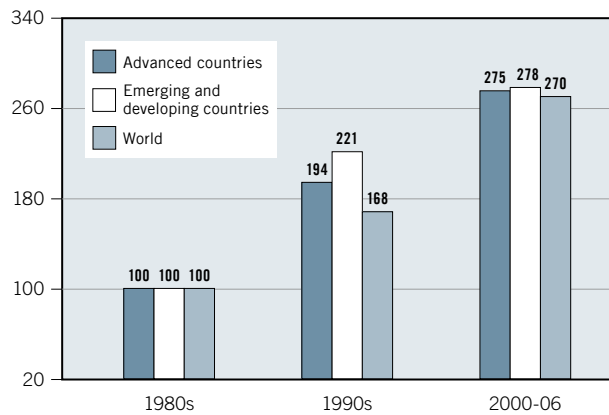
3. Building a sustainable recovery

As the previous section illustrated, several key components of the Global Jobs Pact, namely prioritizing employment and building social protection, have played a central role in the recovery process. Of course, the principles and objectives of the Global Jobs Pact go far beyond designing policies to encourage a speedy recovery. It sets a framework for shaping a fair and sustainable globalization. To accomplish this, however, a number of underlying structural problems – which have been contributing factors in the current crisis – must be addressed.

32. An English version of the agreement can be found at: http://www.molab.go.kr/english/english/Information/news_view.jsp?idx=2888 [16 Nov. 2009].

33. ILO, 2009a.

Figure 1.21 Income inequalities have been on the rise worldwide (Gini coefficient, index: 1980s = 100)



Note: The figure displays the evolution of the (GDP-weighted) Gini coefficients, by level of development, using averages for 1980-89, 1990-99 and 2000-06. The Gini coefficient for the period 1980-89 is equal to 100.

Source: ILS estimates based on World Bank, 2008.

In this respect, the *World of Work Report 2008* (ILO, 2008d) highlighted the rising economic and social imbalances that built up over the past two decades. Notably, since the early 1980s, within-country income inequality grew excessively worldwide (by a factor of almost three) – in both developed and developing countries (figure 1.21).

Of course, a number of other factors are at play, including, financialization of the real economy, unbalanced globalization and employment quality.³⁴ The purpose of this year's *Work of Work Report* is to examine some of these medium term imbalances. In particular, Chapter 2 looks at the financialization of the economy. One central idea is that finance is inextricably linked with the real economy, and its proper functioning is tied to the well-being of workers and employers. Chapter 3 discusses how labour provisions in international trade arrangements and development finance institutions can help make globalization fairer. Chapter 4 provides an assessment of the linkages between policies oriented to greening the economy and job creation.

34. ILO (2008d) gives a detailed account of the factors that led to the crisis.

Appendix A

The impact of crises on labour markets: Past experience

This appendix provides information on past global economic crises and recessions with a view to helping explain the trends of the current crisis. The majority of the data on unemployment and wages from past crises was gathered from the OECD, WDI and ILO-KILM databases.

Unemployment

- During the three crisis events that affected major advanced economies between 1975 and 2007 – which were more localized in nature than the current crisis – the time needed for unemployment levels to recover was between five and eight years (figure A1.1, panel A). However, in two of the three episodes (first two), the unemployment rate did not return to pre-crisis levels.
- Similar trends can be observed during the Asian crisis, where the unemployment rate deteriorated with the economic downturn in 1996: 11 years later it is not even half way back to its pre-crisis level (figure A1.1, panel B).

Employment

- Employment decreased by 1 per cent during previous downturns in major advanced economies, and it took between two and three years to recover (figure A1.1, panel C).
- In some Asian countries, notably Thailand, employment levels fell up to 6 per cent and took up to five years to recover (figure A1.1, panel D). Employment rates in these Asian countries declined significantly even two years before the unemployment rate began to rise – and 13 years later the employment rate has not reversed its downward trend (figure A1.1, panel E).

Wages

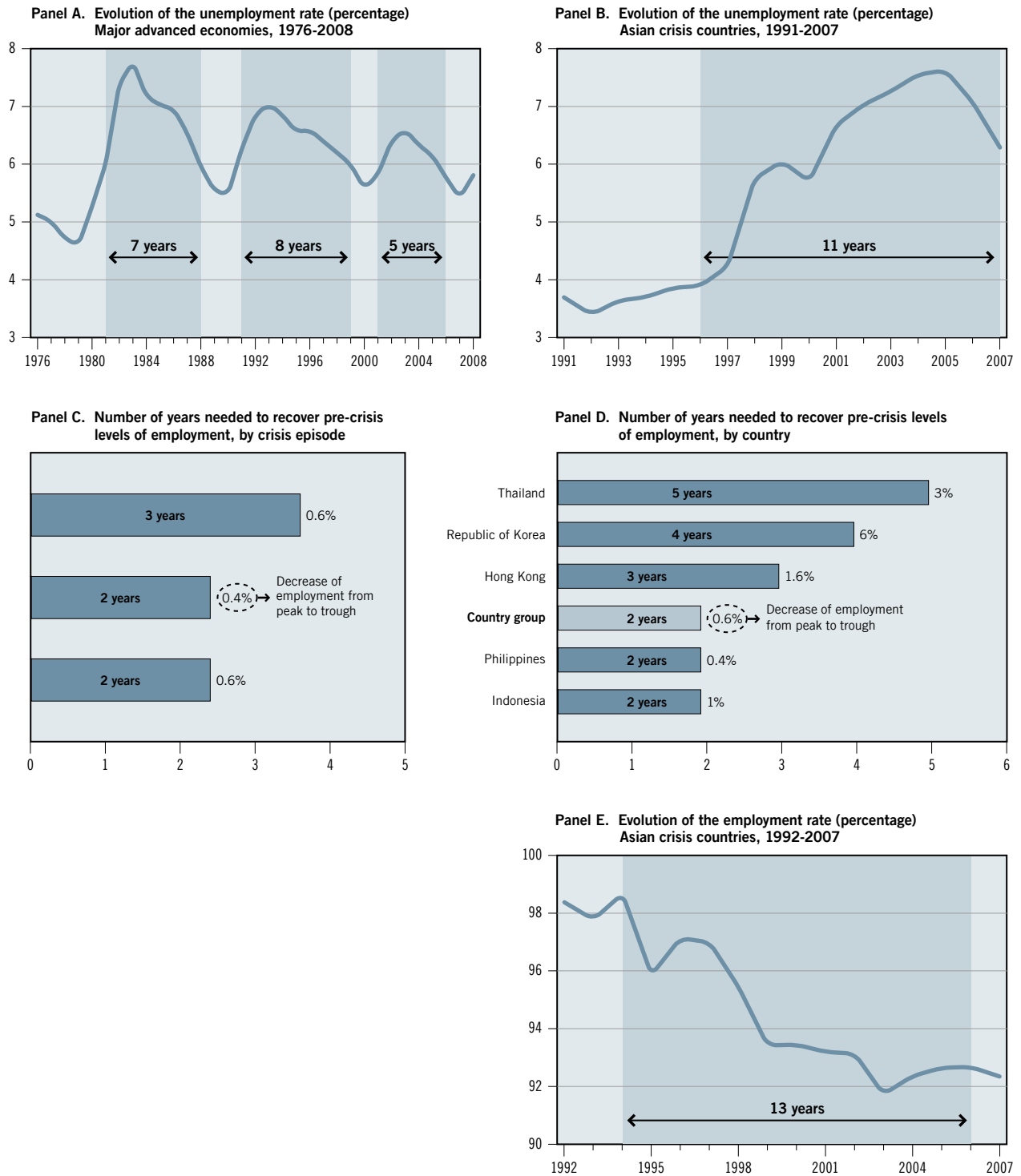
Wage declines during periods of labour market downturn arise for a number of reasons. First, some firms may opt to pay less and maintain employment levels while some workers may be willing to take a cut in salary in order to keep their jobs.³⁵ The impact of this is immediate and, consequently, wage reductions precede – and to some extent limit – employment losses.³⁶ Second, another wave of wage reductions can occur if workers accept a reduced wage on re-employment.³⁷

35. This situation may arise through a collective labour agreement between employers and workers, or may be supported by government policies that aim at protecting jobs in the short run with wage contributions (Krugman, 2009).

36. With long and generalized recessions, wage reductions are unlikely to have a persistent effect on preventing employment levels and have the adverse effect of eroding purchasing power of workers. *Protecting people, promoting jobs*; September 2009e; ILO Report to the G20 Leader's Summit.

37. According to Wachter et al. (2009), when workers displaced from their jobs were compared to similar non-displaced workers, the authors find large immediate losses in annual earnings of 30 per cent. After 15 to 20 years, these losses are still 20 per cent and thus represent a significant setback in workers' lifetime resources.

Figure A1.1 Labour market recovery time needed after a crisis



Note: The onsets of crises periods are defined as the first point of sustained moderation of economic growth. Country-group unemployment rates correspond to weighted averages.

Source: IILS estimates based on OECD, WDI and ILO-KILM.

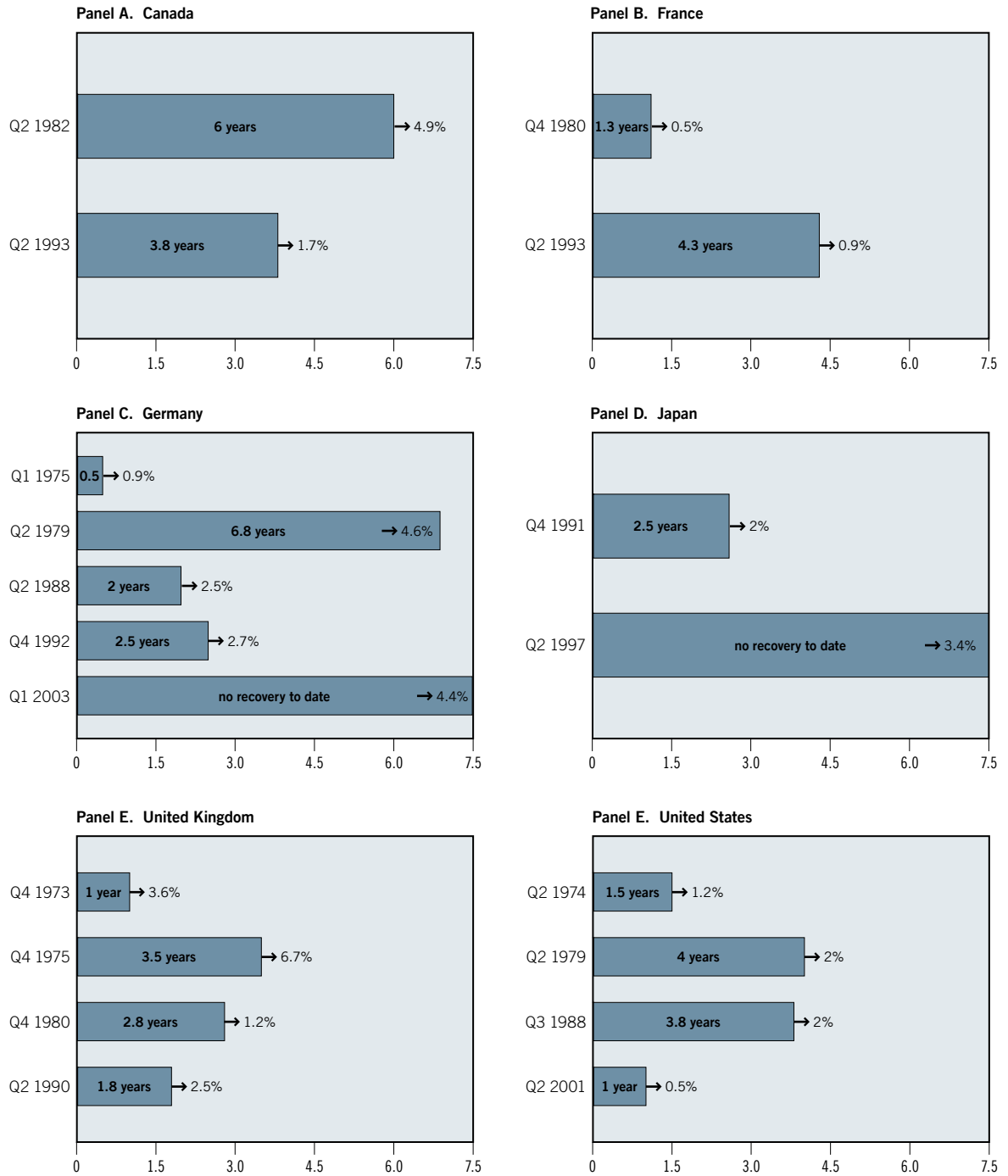
Wage developments during times of crises have varied considerably from country to country. While this is a function of a number of key factors, including existing labour market institutions, social programmes and reform efforts, among a selection of countries with available data during economic downturns reveals some interesting patterns:³⁸

- *Japan and the United States*: wages and employment appear to follow similar trajectories during crisis and non-crisis times, with employment declines slightly preceding those of wages (with varying overall impacts, figure A1.2, panels D and F):
 - In the United States, the decrease in wages from peak to trough was never higher than 2 per cent; in Japan, wage recessions were deeper (2-3 per cent);
 - The time to recovery was longer in United States during the crises of the 1980s and 1990s (in addition, during these crises wages took longer than employment to recover to pre-crisis levels);
 - In Japan, neither wages nor employment has recovered from the 1998 economic downturn.
- *Canada, France and the United Kingdom*: employment reacted faster than wages to past economic shocks: around 1 and 2.5 years earlier for Canada and France during the 1980s crisis, respectively (figure A1.2, panels A, B and E). The intensity (the percentage decrease and the recovery time) of the slump in wages was less severe compared to employment in almost all cases.³⁹
- *Germany*: different patterns emerge with respect to wage developments over past downturns (figure A1.2, panel C):
 - During the 1970s and 1980s, wage levels reacted at a slower pace compared to employment levels (between five and seven years after employment) but fell more profoundly and took longer to recover than employment;
 - Over the past two decades, however, the effects of crises on wages have been more immediate (i.e. within one and a half years), but the intensity of the wage reduction has varied over this period. For example, during the 1992 economic downturn, wage reaction was milder and recovery time shorter than that of employment; after the 2003 economic slump, wages fell more than 4 per cent and have not been able to recover pre-crisis levels.

38. In the case of the United States 1990 recession, the Government instituted mandatory tax increases to pay for future unemployment protection measures. These policies also included higher employer contributions to employees' social security. Employers were thus obliged to pay higher costs attributed to labour and, as a result, fewer workers could be hired or reinstated and fewer still at their original wage rate (Sonmez Atesoglu, 2006).

39. The exceptions are wages in the United Kingdom during the 1974-76 crisis, which fell 7 per cent compared to a 1 per cent decrease in employment; and Canadian wages during the 1983-85 crisis, which took double (six years) the time of employment to achieve a full recovery.

Figure A1.2 Time needed for wages to recover to pre-crisis levels in select countries, by crisis episode



Notes: Wages correspond to real compensation rate of the private sector. The x axis shows the specific time when wages started their decreasing trend. Percentages correspond to the total decrease of wages from peak to trough.

Source: ILS estimates; OECD, 2009c.

Appendix B

The impact of financial crises on employment: An empirical analysis

Section B of this chapter provided employment projections from 2009 to 2014 for two broad groups, based upon 4 underlining groups:

- *High GDP per-capita* based upon two groups: i) Group 1: 372 observations from past eight crises for Canada, Germany, France, Italy, United States and United Kingdom)⁴⁰ and ii) Group 2: 147 observations from one crisis episode for each of Australia, Spain and Republic of Korea;⁴¹
- *Medium GDP per-capita* based upon two groups: i) Group 1: nine past crises episodes (106 observations) for Argentina, Indonesia, Mexico and Turkey⁴² and ii) Group 2: 67 observations for six previous crises (Brazil, Russian Federation and South Africa).^{43,44}

These projections draw on output-employment elasticities, which have been estimated by way of the econometric analysis of the employment impact of past financial crises. The projections are constructed by applying the employment elasticity of each group to the GDP growth projections from the IMF (from 2009 on) at a country level.⁴⁵

The elasticities of employment growth (e_{it}^L) to GDP changes are calculated by means of Okun-law panel regressions (following the methodology developed in Escudero, 2009) for the four groups of countries listed above. The following equation was estimated independently for each of the four country groups:

$$(1) e_{it}^L = \beta_1 Y_{it} + \beta_2 Y_{it-n} + \varepsilon_{it}$$

where, L_{it} corresponds to the annual (or quarterly for country groups 1 and 2) growth rate of employment and ΔY_{it} is the explanatory variable and it is measured by the annual (or quarterly for country high GDP per-capita countries) growth rate of GDP of the countries analysed. One or more lags of the growth rate of GDP are included in the estimations, depending on the group of countries analysed. An overview of the different variables used and their sources and definitions can be found in table B1.1.

40. Canada, 1983-85; France, 1994-95; Germany, late 1970s; Italy, 1990-95; Japan, 1992; the United Kingdom, 1974-76 and 1980s; and the United States, 1988-91. Crises of all groups have been identified on the basis of Laeven and Valencia (2008).

41. Australia, 1989-92; Republic of Korea, 1997-2002; and Spain, 1977-85.

42. Argentina, 1980-82; Argentina, 1989-90; Argentina, 1995; Argentina, 2001 onwards; Indonesia, 1994; Indonesia, 1997-2002; Mexico, 1994-2000; Turkey, 1982-85; Turkey, 2000 onwards. The inclusion of the crisis suffered in Turkey in 1994 was excluded from the analysis because it dampened the model's robustness.

43. Brazil, 1990; Brazil, 1994-99; Russian Federation, 1995; Russian Federation, 1998-99 and South Africa 1989-1995.

44. Note that the high GDP per-capita group contains more observations than the second two because the analysis of the former is based on quarterly information rather than annual information.

45. Country-specific annual forecasts from IMF were converted into quarterly rates using the "effective periodic rate" calculation and then were used to establish future quarterly growth rates of employment.

Table B1.1 Definitions and sources of variables used in the regression analysis

Variable	Definition	Source
GDP annual growth rate	Annual growth rate of GDP, in national currencies and constant prices	World Economic Outlook (WEO) IMF 2009b
GDP quarterly growth rate	Annual forecasts were converted into quarterly rates using the “effective periodic rate” calculation	IILS calculations based on WEO IMF 2009b
Employment growth for high GDP per-capita countries	Quarterly growth rate of total employment	Economic Outlook No. 85. OECD 2009c
Employment growth for medium GDP per-capita countries	Annual growth rate of total employment	Economic Outlook No. 85. OECD 2009c (Mexico); WDI, World Bank (Argentina); ILO, Laborsta database (Brazil, Indonesia Russian Federation and Turkey)
Frequency of financial crises	Timeframe of financial crises in the countries analysed	Author estimates based on Laeven and Valencia, 2008

To construct the panel, data on employment growth around the years of crises were collected and centred in t_0 . This crisis-specific central time period corresponds to the year when the country experienced the lowest GDP annual/quarterly growth rate. In this way, a panel was constructed with an average of 51 observations for employment growth around the crises ($t-25$ to $t+25$) for high GDP per-capita countries and 13 observations for employment growth around the crises ($t-6$ to $t+6$) for medium GDP per-capita countries. Table B1.2 gives a synthetic review of the econometric estimates reporting these elasticities.

To take into account the peculiarities of the data set, regressions have been rerun to account for heteroscedasticity. To ensure that one or some of the countries did not influence the results, reduced regressions were also estimated by

Table B1.2 Regression results^{1,2}

	High GDP per-capita		Medium GDP per-capita	
	Group 1	Group 2	Group 1	Group 2
GDP (Quarterly/Annual growth rate)	0.132 (6.30)**	0.292 (6.58)**	0.219 (5.13)**	0.229 (4.26)**
Lag 1 of GDP	0.139 (6.75)**	0.216 (4.69)**		
Lag 2 of GDP	0.102 (4.97)**	0.153 (3.44)**		
Lag 3 of GDP	0.078 (3.80)**			
Lag 4 of GDP	0.042 (2.11)*			
Constant	-0.143 (-4.83)**	-0.346 (-4.95)**	1.06 (3.88)**	0.677 (2.15)*
Fixed effects	Yes	Yes	Yes	Yes
Observations	372	147	106	67
Number of crisis episodes	8	3	9	6

Notes: ¹ Estimated based on ordinary least squares. All regressions are controlled for country-fixed effects. Absolute value of t-statistics in parentheses. Significance levels: * significant at 5 per cent; ** significant at 1 per cent. ² For country groups see above or box 1.1.

Table B1.3 Alternative estimators^{1,2}

Panel A. High GDP per-capita countries, Group 1

	Baseline equation (heteroscedasticity)	GLS	GLS (heteroscedasticity)	GLS (auto-correlated errors)
GDP (Quarterly growth rate)	0.132 (6.30)**	0.146 (6.65)**	0.111 (6.18)**	0.083 (5.81)**
Lag 1 of GDP	0.139 (6.75)**	0.154 (7.13)**	0.126 (7.18)**	0.114 (7.50)**
Lag 2 of GDP	0.102 (4.97)**	0.117 (5.41)**	0.110 (6.20)**	0.110 (7.16)**
Lag 3 of GDP	0.078 (3.80)**	0.090 (4.18)**	0.098 (5.55)**	0.091 (5.97)**
Lag 4 of GDP	0.042 (2.11)*	0.053 (2.56)*	0.065 (3.83)**	0.050 (3.72)**
Constant	-0.143 (-4.83)**	-0.181 (-5.99)**	-0.178 (-6.90)**	-0.159 (-4.69)**
Observations	372	372	372	372
Number of crisis episodes	8	8	8	8

Panel B. High GDP per-capita countries, Group 2

	Baseline equation (heteroscedasticity)	GLS	GLS (heteroscedasticity)	GLS (auto-correlated errors)
GDP (Quarterly growth rate)	0.292 (6.58)**	0.282 (6.16)**	0.300 (7.15)**	0.279 (6.51)**
Lag 1 of GDP	0.216 (4.69)**	0.208 (4.36)**	0.215 (4.91)**	0.222 (5.25)**
Lag 2 of GDP	0.153 (3.44)**	0.149 (3.26)**	0.125 (2.99)**	0.135 (3.17)**
Constant	-0.346 (-4.95)**	-0.327 (-4.67)**	-0.381 (-5.76)**	-0.371 (-4.66)**
Observations	147	147	147	147
Number of crisis episodes	3	3	3	3

Panel C. Medium GDP per-capita countries, Group 1

	Baseline equation (heteroscedasticity)	GLS	GLS (heteroscedasticity)	GLS (auto-correlated errors)
GDP (Annual growth rate)	0.219 (5.13)**	0.211 (5.12)**	0.164 (5.24)**	0.178 (5.61)**
Constant	1.06 (3.88)**	1.09 (4.03)**	1.17 (6.35)**	1.16 (5.71)**
Observations	106	106	106	106
Number of crisis episodes	9	9	9	9

Panel D. Medium GDP per-capita countries, Group 2

	Baseline equation (heteroscedasticity)	GLS	GLS (heteroscedasticity)	GLS (auto-correlated errors)
GDP (Annual growth rate)	0.229 (4.26)**	0.236 (5.31)**	0.111 (2.58)*	0.096 (2.65)**
Constant	0.677 (2.15)*	0.656 (1.99)*	1.73 (5.66)**	1.80 (5.04)**
Observations	67	67	67	67
Number of crises episodes	6	6	6	6

Notes: ¹ All regressions are controlled for country-fixed effects. Absolute value of t-statistics (z-statistics in the tests of autocorrelation) in parentheses. Significance levels: *significant at 5 per cent; **significant at 1 per cent. ² For country groups see above.

excluding the countries analysed one at a time. Moreover, table B1.3 presents GLS estimates and controls for auto-correlated error terms. As can be seen in all panels of table B1.3, all coefficients remain highly significant and the absolute size of the estimated effects changes relatively little between different estimation methods, giving some confidence in the estimated effects.

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Making finance work for the real economy: Challenges for policy*



Main findings

- As documented in Chapter 1, considerable support has been provided to the financial sector in developed countries as part of the response to the crisis. The purpose of this chapter is to show that structural action is now needed in order to ensure that the financial sector supports sustainable development of the real economy.
- Indeed, the crisis has highlighted the perverse effects of “financialization” – an increasingly important role of financial markets in the operation of the non-financial sector. First, financialization has reduced the scope for development of the real economy. Financial sector’s share of total corporate profit reached 42 per cent before the crisis, up from about 25 per cent in the early 1980s. Furthermore, financial sector’s profit as a share of total wages and salaries of all private sector workers increased from 24 per cent to 40 per cent in the period from 1990 to 2005. The sector has attracted many of the best qualified personnel, employing over 40 per cent of graduates from the most prestigious business schools. While real wages in the non-financial sector stagnated over the past 15 years or so, they grew significantly in the financial sector – driven by growing real compensation for the executives, traders and other qualified financial personnel.
- Second, within the non-financial sector, incentives are increasingly driven by capital markets and the imperative for quick and better financial returns:
 - During the 2000s, less than 40 per cent of profits of non-financial firms in developed countries were used to invest in physical capacity, which is 8 percentage points lower than during the early 1980s. By contrast, dividend payouts have increased in all advanced economies and, in some cases, most of the new profits have been used to finance these dividends.

* The authors would like to thank Dawn Gearhart for excellent research assistance.

- Ever-growing pressures for quick and better financial returns have had a disproportionate effect on wages and job stability in the non-financial sector, where most workers are employed. Among the advanced economies, wage shares fell by over 9 percentage points during the period 1980–2005. This chapter shows a link between the fall in wage shares and the extent of financialization. Moreover, countries with the highest union densities saw the lowest increase in financialization, while countries with the lowest union densities saw the greatest increase in financialization. This suggests that social dialogue in the real economy might help to mitigate some of the pressures arising from financialization.
- Leveraged buyouts (LBOs) – a manifestation of finance’s growing role in the real economy – saw significant growth across the globe. Nearly 70 per cent of all LBOs (or US\$2.7 trillion) occurred after 2001. LBOs have a direct impact on employment and wages – they can result in renegotiation of contracts and wages with employees, reduce employment in a firm as part of its restructuring deal and may have an adverse impact on pension schemes and retirement benefits for workers.
- These trends are both economically inefficient and socially harmful. They lie at the heart of the crisis; and yet not enough has been done to arrest them. This chapter shows that most of the post-crisis measures aimed at regulating the financial sector and aligning its incentives with those of the real economy are still under consideration. Clearly it is crucial to move ahead with reforms in this area in order to promote recovery and make the global economy fairer and more efficient.

Introduction

The financial and economic crisis has underscored a structural transformation that has taken place in terms of the financial sector’s role in the global economy. In particular, financial markets and institutions have an increasing influence in the operation of the real economy (i.e. workers, entrepreneurs and businesses).

More generally, while there are several systemic problems that collectively led to the financial crisis, there is a broad consensus that the two major contributing factors were: (i) inadequate financial regulation, which led to excessive risk taking, growth in shadow banking, such as private equities and hedge funds, and the compensation practices that were aligned with risk taking (Butler, 2008, 2009; Diamond and Rajan, 2009; Krugman, 2009; Rodrik, 2009; Stiglitz, 2008); and (ii) failures of corporate governance, which led to an obsessive focus among non-financial enterprises on quarterly reporting obligations and the quest for quicker and better financial returns, not necessarily in the interest of the long-term needs of the enterprises in question (Bebchuk, 2008, 2009; Epstein, 2005; Krippner, 2005; Milberg, 2007; Palley, 2009; Stockhammer, 2007).

In order to look beyond the crisis, as stressed in Chapter 1, and create a financial system which is sustainable and which serves the real economy more effectively, it is imperative to understand the imbalances that financial developments have created in terms of enterprises, jobs and incomes. The purpose of this chapter is to assess these imbalances and their implications for the world of work.

Section A introduces the concept of “financialization” of the economy and examines how the role of the financial sector has expanded disproportionately in

relation to the non-financial sector. Section B examines how financial objectives have been implemented progressively within the non-financial sector itself and the implications of this trend for the world of work. Section C examines a special case of the financial sector's dominance over the real economy, namely leveraged buy-outs (LBOs) and their growth and impact on employment and wages.

A. Financial sector growth vis-à-vis the non-financial sector

Systemic failures, mentioned above, have facilitated a protracted growth of the financial sector in developed countries. For the purposes of this chapter, the financial sector includes finance, insurance, and real estate. In line with the literature, financial sector's size is measured by its value added to GDP and its share of total corporate profits. One could use other measures of financial sector's size like stock market capitalization or bank lending to private businesses, but a broader measure as used in this chapter is more likely to capture all different elements of finance. This section examines the impact of growth in this sector on the sustainable development of the real economy.

In the last 30 years, finance's share of GDP almost doubled...

In the last 30 years, finance's share of GDP among advanced economies has increased tremendously.¹ For example, in the United States, the sector's share increased from 13 per cent in 1970 to 20 per cent in 2007. Similarly, in the case of the European Union, finance's share of GDP doubled from 15 per cent in 1970 to 30 per cent in 2007.² In the case of emerging economies, finance's share of GDP is around 10 per cent, while for most developing economies, it is 5 per cent or less.

...and has grown markedly as a share of corporate profits...

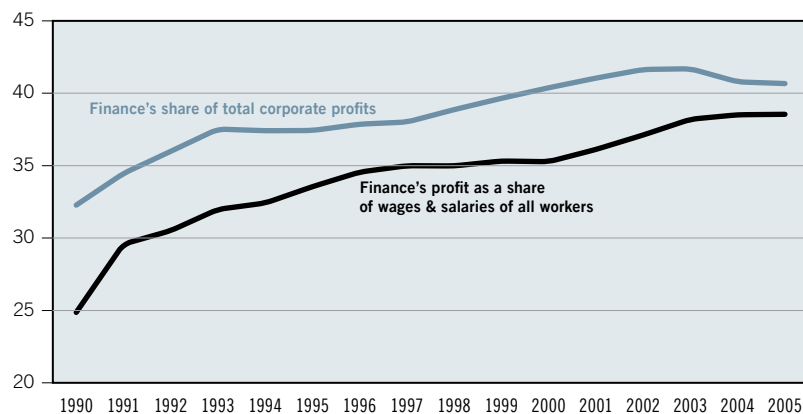
Profits accrue primarily through financial channels rather than through trade and commodity production (Krippner, 2005). For advanced economies, finance's share of corporate profit almost doubled from 25 per cent in the early 1980s to 42 per cent in 2007 (see figure 2.1). For example, in Australia, Italy and Japan, finance's share of profit doubled in the period from 1970 to 2005. In Spain and France, finance's share of profit increased by a factor of 1.5 while, for Germany, the share of profits since the 1990s has hovered around 44 per cent. The United Kingdom saw the most spectacular increase in finance's share of corporate profit from the 1980s to the 2000s – it increased by a factor of three.

Financial sector's profit in 2005 was two thirds of the wages and salaries of all private sector workers (see figure 2.1). It increased from 25 per cent in 1990 to 40 per cent in 2005 – a spectacular rise in a period of a mere 15 years. These trends point to structural transformations of the global economy where finance

1. Finance includes finance, insurance, and real estate (FIRE). In case of EU, it also includes business services which partially accounts for a higher share of GDP for the sector.

2. The EU includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

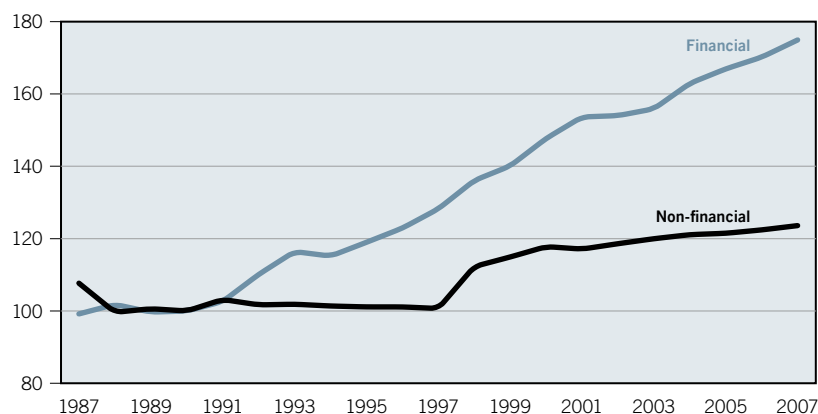
Figure 2.1 The rising incidence of profits of the financial sector in advanced economies, 1990–2005



Notes: Finance includes finance, insurance, and real estate (FIRE) and gross operating surplus (GOS) is the measure of profit. Advanced economies include Australia, Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Portugal, Spain, Sweden, UK and the US. 'Wages and Salaries of all workers' does not include public sector or government workers.

Source: ILS estimates based on national accounts.

Figure 2.2 Real wage gap between financial and non-financial firms in the United States, 1987–2007



Notes: The figures give real average compensation per employee, and therefore do not take into account changes in the incidence of part time employment. This may explain changes in real wages between 1996 and 1997 in the US non-financial sector. However it is unlikely that changes in part time employment affect the relative trends of financial sector real wages versus non-financial sector real wages.

Source: ILS estimates based on the Bureau of Economic Analysis.

has become the driver of the real economy rather than an enabler or a supporter of the real economy (Adrian and Shin, 2009; Stiglitz, 2009).

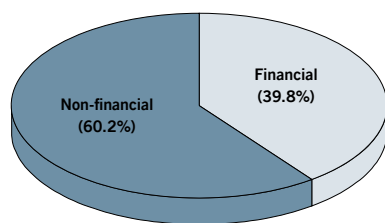
Meanwhile, in the case of developing and emerging economies, finance's share of corporate profits has increased modestly³ and in some cases, there has been virtually no increase.

...permitting higher compensation vis-à-vis wages in the non-financial sector...

As the financial sector grew, the wage gap between financial and non-financial firms widened. For example, the real wage gap between financial and non-financial firms in the United States widened from US\$11,000 in 1987 to US\$40,000 in 2007 (per annum per employee; see figure 2.2). Meanwhile, in the European Union, the wage gap between financial and non-financial firms doubled from 1985 to 2005. These past trends in compensation in the financial sector have continued throughout 2008 and 2009. For example, some recipients of government

3. Countries include Brazil, China, India, Mexico, the Russian Federation and South Africa. However, the data coverage is limited and an aggregate calculation, such as that presented in figure 2.1, was not possible.

Figure 2.3 Career choice of top business school graduates in 2008



Notes: This average is based on the career choices of business school graduates from the world's top ten business schools; schools included are from China, France, the United Kingdom and the United States. The break-down within the non-financial sector is not available for most schools.

Source: ILS based on university web sites.

bailout money through the Troubled Asset Relief Program (TARP) in the United States paid handsome bonuses to their employees in 2008. Citigroup, Merrill Lynch (which does not exist anymore) and Wells Fargo paid bonuses, even while enduring massive losses. In the case of Goldman Sachs, JP Morgan Chase and Morgan Stanley, bonus payments per employee exceeded earnings per employee.

Studies have shown that, compared to the non-financial sector in the United States, wages in the financial sector increased considerably from the 1980s to 2000s and, in the case of executives, was not linked to firm performance (*World of Work Report 2008*). Before the 2008 crisis and the Great Depression, “the compensation of employees in the financial industry appeared too high to be consistent with a sustainable labour market equilibrium” (Philippon and Reshef, 2009).⁴ For example, controlling for education level and other observable characteristics, employees in the financial sector earned 3 to 4 per cent more than employees in the rest of the private sector during the 1970s (Philippon and Reshef, 2007). However, in the post-1980s world of deregulation and innovation, the wage premium in the financial sector rose to 20 per cent. Furthermore, a more recent study by Philippon and Reshef (2009) finds a robust and economically positive effect of deregulation on wages in the financial sector. It shows that financiers in the United States have been “overpaid by 30 to 50 percent since the late 1990s”.

...and the allocation of talent was skewed towards the financial sector.

As the financial sector grew in size, it often attracted the best and the brightest. For example, among the Master of Business Administration graduates from the top ten business schools in the world (which includes universities in China, France, the United Kingdom and the United States), 40 per cent of the graduates took jobs in the financial sector, while 60 per cent took jobs in the non-financial sector (see figure 2.3). For some years, for example 2002/03, the breakdown was 50:50.

Even after adjusting for the self-selection bias of students going into business schools, it is evident that the financial sector has been receiving a disproportionate share of the best and the brightest graduates. Longer time series data, available for a few business schools, show that, in the 1990s and 2000s, the share of graduates taking jobs in the financial sector is significantly higher than during the 1970s and 1980s. The general trend mimics the increasing size and influence of the financial sector in the real economy.

4. During the 1970s, when employees in the financial sector earned 3 to 4 per cent more than employees in the rest of the private sector, they also enjoyed substantially lower *unemployment risk*. However, after 1980, *unemployment risk* in the financial sector started to catch up with the rest of the private sector and the wage premium also increased to 20 per cent. Half of the increase in wage premium is accounted for by the increase in *unemployment risk*, but the other half is not explainable (Philippon and Reshef, 2007).

Growth was fuelled by securitization practices and recourse to debt among financial institutions.

Securitization of credit (the practice of parcelling and selling of loans to investors), has grown in prominence since the early 1980s, with particularly strong growth between 2003 and 2007. Securitization performs two very useful functions, namely providing greater liquidity for investors and reducing risks for individual banks by distributing credit risk more widely. However, securitization can also lead to a concentration of risks within the banking system itself when banks buy each other's securities with borrowed money, which is what happened in the lead up to the crisis of 2008–09 (Shin, 2009). Securitization of mortgages reflected two new developments within the global financial system: (i) financial globalization, where securitization creates financial paper that is freed from national boundaries (hence, foreign investors with no direct access to America's homeowners could buy Mortgage Backed Securities originating from the US real estate market); and (ii) the relative decline of the importance of banks, where the lines between commercial and investment banks were blurred.⁵ As highlighted by recent developments, these two features (while not necessarily detrimental) have proven to be powerful multipliers of the crisis.

Growth in securitization was enabled by an increasing reliance on debt – among advanced economies, debt to GDP ratio for financial institutions took off in the mid-1990s. Leveraging (debt to equity ratio) increased among major banks (investment and traditional), in both the United States and Europe.⁶ In June 2008, the average leverage ratio for Europe's 12 largest banks was 35 to 1 and, in some of the largest banks, the ratio was 50 to 1. This is significantly in excess of the 10–15 to 1 ratio that is typical of a more conservative bank. Meanwhile, the largest American banks had a leverage ratio of 30 to 1, and 50 to 1 in some cases.⁷

B. Financialization of the non-financial economy: Trends and social impacts

Not only has the financial sector absorbed a disproportionate and growing share of valuable resources but, in addition, its practices and values have penetrated the non-financial economy. This is because firms have increasingly been managed according to the reporting rules and short-term goals of capital markets. Corporate managers have adopted the behaviour of the financial markets and, as a result, their interests are more closely aligned with those of financiers than with the real economy (Epstein, 2005; Krippner, 2005; Krugman, 2009; Palley 2009; Stockhammer, 2007; Stiglitz, 2009).

5. See D. B. Papadimitriou and L. Randall Wray, "Minsky's stabilizing an unstable economy: Two decades later," in H. Minsky's "Stabilizing an unstable economy" (McGraw-Hill, 2008).

6. Differences in accounting regimes, balance sheet presentation and domestic regulatory arrangements make calculation and comparison of leverage ratios across jurisdictions very difficult. For example, Europe uses IFRS for accounting while the United States uses GAAP.

7. One of the factors that makes leveraging a potential problem is when the borrowed money earns a greater rate of return than the cost of interest on the debt, then a firm's return on equity becomes higher than if it did not borrow. Therefore, leveraging allows investors to earn greater potential returns than would otherwise have been possible. However, the potential for loss is also magnified because, if the investment does not earn an expected return, or it fails, the loan principal and accrued interest will still have to be repaid.

A growing share of profits has been used to pay dividends...

An important indicator of the capital markets' growing influence in the real economy is the evolution of dividend practices. In the past several decades, the distribution of profits between interest payments, dividends and retained earnings has been drastically modified. The reduction of debt by firms during the 1980s and 1990s has led to a decreasing share of interest payments into profits net of taxes from 70 per cent in 1980 to 50 per cent in 2007. However, the decline in interest payments has not produced an increase in retained earnings, as dividends have increased. Retained earnings stayed constant at around 18 per cent of profits after taxes, while the share of dividends has increased from 20 per cent in 1990 to 40 per cent in 2007. Dividends as a percentage of total profits in the United States doubled from 22.8 per cent in 1946–1979 to 46.3 per cent in 1980–2008.

This trend cannot be explained by a changing pattern in financing investment, as new stocks represent scarcely 3.8 per cent of new security issues. On the contrary, a possible explanation might be the deep institutional transformations that have taken place at the firm level since the 1970s. These transformations have led to the increasing power of shareholders. The share of profits distributed to shareholders has therefore increased from 30 per cent of corporate profits before tax in 1990 to 48 per cent in 2002.

Elsewhere, average dividend payouts (i.e., the share of profits distributed to shareholders) show similar patterns. For example, dividend payouts between 1995 and 2000 were above 50 per cent for Germany, Italy and the United Kingdom. It was above 40 per cent for Austria and France. The marginal payout between 2001–05 (change in dividends between 2001 and 2005 divided by the change in profits between 2001 and 2005), exceeded 70 per cent for France, Italy and Netherlands. It was above 40 per cent for Finland and Spain and around 30 per cent for Australia, Austria, Denmark and Japan.

Changes in the composition of pay, especially at the executive level, have further strengthened the influence of capital markets over non-financial firms. As discussed in *World of Work Report 2008*, although annual salaries have been increasing, the proportion of total pay that they represent has decreased in the past 20 years, while compensation through stock options has become the most important component, increasing from 35 per cent to 77 per cent (Jarque, 2008).⁸ Leverage in compensation – where incentives pay outweighs salary – has increased tremendously over the years, which in turn has increased risk taking. For example, in 1987, a short-term incentive award was 60 per cent of an average executive's salary but, in 2008, short-term incentive awards comprised 200 per cent of the salary.⁹ While it is true that tying executive pay to stock options tends to lead to increased sensitivity of pay to performance, it also tends to encourage short-termism – that is, a singular focus on quarterly earnings.

8. Stock gain refers to the value realized during the given fiscal year by exercising vested options granted in previous years. The gain is the difference between the stock price on the date of exercise and the exercise of the option.

9. G. Morgenson, "The quick buck just got quicker", in *The New York Times*, 16 Aug. 2009.

Table 2.1 Investment as a percentage of operating surplus (1980s to 2000s)

	1980s	2000s
Austria	50	44
Denmark	47	49
Finland	57	36
France	46	43
Germany	48	35
Ireland	44	28
Italy	36	33
Japan	59	56
Netherlands	39	38
Spain	40	47
Sweden	52	51
UK	48	42
US	44	39

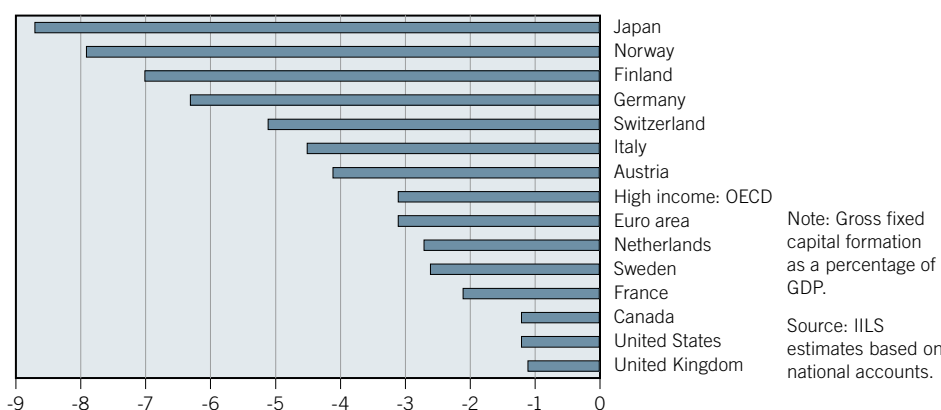
Source: IILS estimates.

...and less and less to fund productive investment in the real economy.

These changes have affected real investment in these companies: first, the “crowding out” of operational investment, because non-financial corporations earn higher returns from financial investments than non-financial investments; second, due to the increased pressure on firms to pay higher dividends, firms find themselves having to distribute a higher share of profits to shareholders. The direct consequence of this is that the share of profits directed into financing internal growth is reduced.

Empirical evidence shows that the share of investment as a percentage of operating surplus between the 1980s and the 2000s declined in almost all the advanced economies (see table 2.1). For example, for the EU, investment as a percentage of operating surplus declined from 47 per cent to 40 per cent, while for the United States it declined from 44 per cent to 39 per cent – a 5 percentage point decline in both cases. Some of the countries in Europe that have registered the sharpest declines are Austria (from 50 to 44 per cent), Finland (from 57 to 36 per cent), Germany (from 48 to 35 per cent) and Ireland (from 44 to 28 per cent).

Figure 2.4 Decline in investment as a percentage of GDP in advanced economies (from 1980 to 2006)



These figures show that rising profits have not translated into commensurate increases in real investment.

Meanwhile, investment as a percentage of GDP has declined in the majority of advanced economies since the 1980s. For example, for high-income OECD countries, investment as a percentage of GDP declined by 3.1 percentage points from 1980 to 2006 (see figure 2.4). Furthermore, in the same period it declined by 3.1 percentage points in the Euro Area, by 6.3 percentage points in Germany, by 8.7 percentage points in Japan and by a little over a percentage point in the United Kingdom and the United States.

Financialization has contributed to reducing the share of labour in national income.

The transformations in the financial sphere have altered the bargaining power within firms. Although shareholders support the risk *ex ante*, they have been able to reduce the risk they support *ex post*. Part of the risk has been transferred to employees and managers through flexible labour contracts and flexible wage income. As figure 2.5 shows, for the five most financialized countries, wage share declined by 3.6 per cent over the period 1989 to 2005, while for the five least financialized countries, wage share declined by 2 per cent. More generally, the decline in the wage share documented in *World of Work Report 2008* can be partly ascribed to the growing pressures from capital markets for quicker and better returns.¹⁰

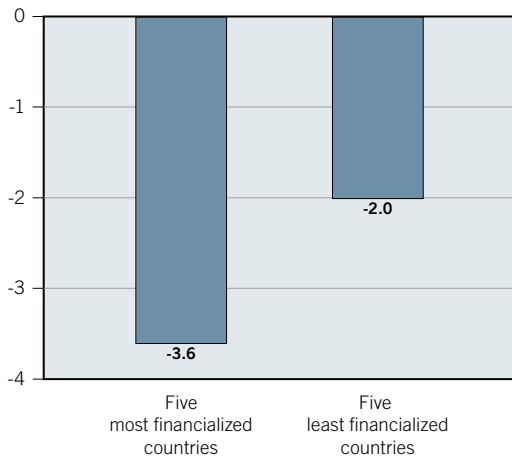
To some extent, social dialogue may mollify the pressures arising from financialization. As figure 2.6 shows, for the five least unionized advanced economies, the percentage change in finance's share of corporate profit was the highest, while for the five most unionized, the percentage change in finance's share of corporate profit was the lowest. In other words, countries with the highest union densities saw the lowest increase in financialization while countries with the lowest union densities saw the greatest increase in financialization.

C. Financialization as a source of instability for enterprises and jobs: The case of leveraged buyouts

Leveraged buyouts (LBOs), which involve acquisition of a firm or division of a firm by private equity firms or other investors, provide a vivid illustration of the growing role of finance within the real economy. LBOs are typically sponsored by private equity funds, which have a limited life and a limited investment horizon, after which they have to exit their investments (Strömberg, 2007). A typical funding of a buyout involves two-thirds of debt and, therefore, access to a highly liquid capital market is essential for buyouts and the environment during the boom years of the 2000s was conducive to their growth. The firm that is taken over is known as the “target firm”, and the investor funding the takeover is known as the “buyout sponsor” (which is usually a private equity). Private equity advocates argue that buyouts occur in old and declining industries but, in fact, buyouts occur in all sectors and industries, among both failing and growing firms (Strömberg, 2007). This section examines the growth in LBOs and their impact on the non-financial sector in terms of employment, wages and pensions.

10. See Chapter 1 of *World of Work 2008* for a more detailed discussion of this wage share data.

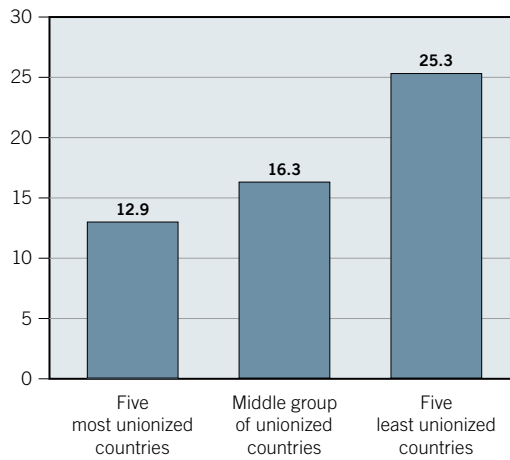
Figure 2.5 Financialization and wage share in advanced economies (percentage change in wage share, 1989-2005)



Notes: Advanced economies include Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Portugal, Spain, Sweden, United Kingdom and the United States. Financialization is measured by finance's share of corporate profit in 2005.

Source: IILS estimates.

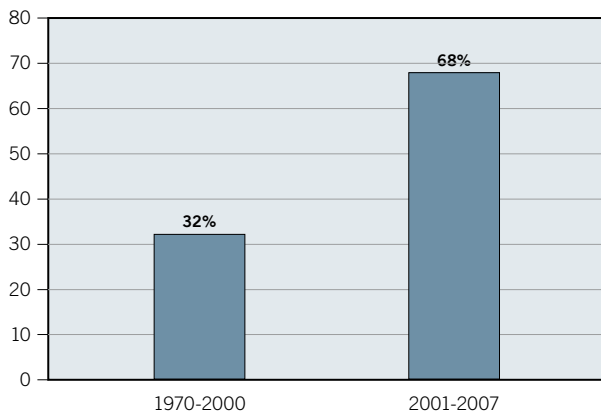
Figure 2.6 Financialization and unionization in advanced economies (percentage change in finance's share of profit, 1989-2005)



Notes: Advanced economies include Australia, Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Portugal, Spain, Sweden, the United Kingdom and the United States. Union density in 2005 is used as a measure of unionization; finance's share of corporate profit is used as a measure of financialization.

Source: IILS estimates.

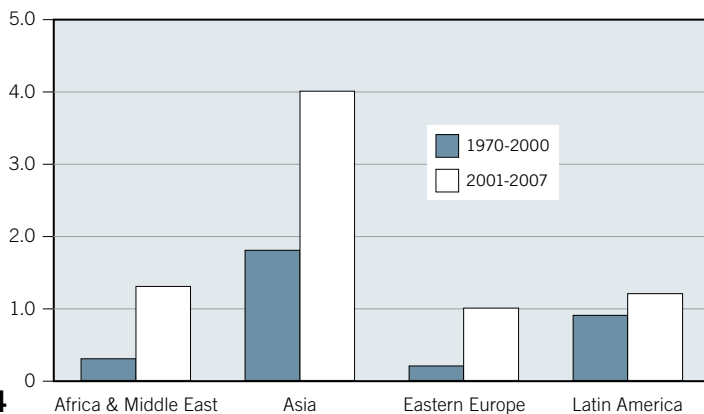
Figure 2.7 Magnitude and growth of LBO activity world wide (as a percentage of total LBOs (\$3.6 trillion))



Note: Based on a data set of more than 21,000 LBO transactions between 1970 and 2007, provided by Strömberg (2007).

Source: IILS based on Strömberg (2007).

Figure 2.8 LBOs in developing and emerging economies (1970-2007)



Note: Based on the values of deals in US\$.

Source: IILS based on Strömberg (2007).

Between 2001 and 2007, LBOs totalled US\$2.7 trillion or 5 per cent of 2007 world GDP.

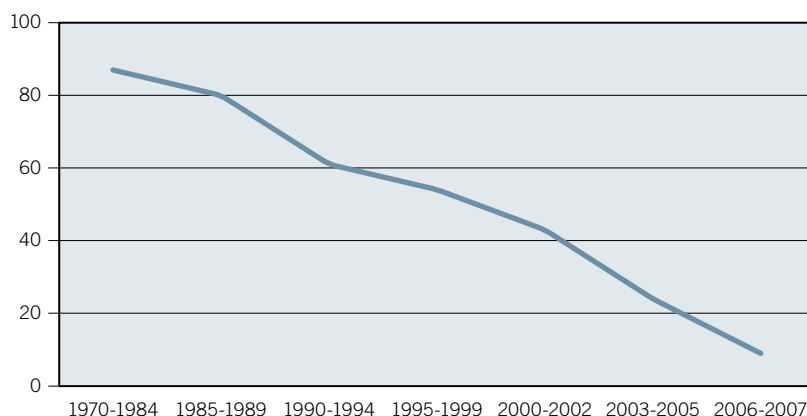
LBOs have undergone a period of explosive growth in the past few years: 68 per cent of all LBOs around the world – US\$2.7 trillion out of US\$3.6 trillion occurred after 2001 (see figure 2.7). The main features of LBOs are: (i) transfer of assets to a new company; (ii) increase in equity ownership of managers; (iii) increase in debt secured against the “target firm’s” assets and/or future cash flows; and (iv) involvement of “buyout sponsor” in the monitoring of the firm (Amess and Wright, 2007b).

The United States is the primary market for LBOs. From 2003 to 2007, the number of buyouts in the United States increased eightfold. But the LBO market is no longer primarily a US phenomenon – in the past few years, non-US buyout activity has grown more rapidly than that of the United States (Strömberg, 2007). Outside North America and Western Europe, buyouts account for 7 per cent of all LBOs in value, but this number masks the true growth of buyouts in developing and emerging economies. For example, in Africa and the Middle East, buyouts have more than quadrupled over the past seven years compared to the previous 30 years. In the same period, the number of buyouts has more than doubled in Asia and increased by more than five times in Eastern Europe (see figure 2.8). Moreover, buyouts in developing and emerging economies tend to be large in relation to the GDP of those economies.

**LBOs focus increasingly on short-term returns:
Over 40 per cent of investors exit the firm within five years...**

There is a general tendency for “quick flips” – re-listing or exiting companies within a year after taking them private – that is, taking the “target firm” public (stock exchange listing) or selling it to another investor (new “buyout sponsor”). Of all the private equity buyouts, 42 per cent exited within the first five years of the initial transaction (Strömberg, 2007). Furthermore, the holding period for LBOs has declined steadily over the years (see figure 2.9) – “although LBOs sponsored

Figure 2.9 Making profits and running away (average holding period of investors in controlled companies, in months, 1970-2007)



Note: The graph shows the average holding periods for individual LBO transactions and includes exited deals only. Cohort analysis was carried out in order to allow for the fact that older deals are more likely to have been exited.

Source: ILS based on Strömberg (2007).

by private equity funds are more likely to experience a successful exit, they are also somewhat more likely to have their investments end up in financial distress, controlling for other factors” (Strömberg, 2007).

In the past few years, hedge funds have grown increasingly interested in private equity due to the solid returns such investments can offer. Due to the entry of hedge funds into the market, competition among lenders to provide funds to the leveraged finance industry has increased leverage ratios, driven down borrowing costs, and loosened terms (William and VanBever, 2006). Hedge funds traditionally have a more short-term perspective, and that changes the dynamics of operational overhaul that follows a typical buyout. Since this a relatively new phenomenon, this area has not been explored by academics (at least not by those without explicit corporate connections).

...with destabilizing effects on jobs and wages.

In 2009, more than half of the approximately 220 companies in the United States that have defaulted on their debt were either owned at one time or are still controlled by private equity firms.¹¹ So it should come as no surprise that buyouts have a direct impact on employment and wages at “target firms”. LBOs can renegotiate contracts and wages with employees, reduce staff levels in a firm as part of the restructuring deal and, in general, provide strong incentives for managers to make employment changes (Amess and Wright, 2007).

A study of 1,350 LBOs in the United Kingdom reveals that the employment impact of LBOs depends on the type of buyout. It is important to separate management buyouts (MBOs – where managers become significant owners) and management buyins (MBIs – which involve acquisition by external management and investors) because insiders and outsiders play different roles and the consequences in terms of employment and wages may be markedly different (Amess and Wright, 2007). Disaggregating the LBOs, Amess and Wright find (i) that wage growth is 0.31 percentage points lower for MBOs and 0.97 percentage points lower for MBIs, and (ii) employment growth is 0.51 percentage points higher for MBOs and 0.81 percentage points lower for MBIs. Even though the overall employment impact becomes positive in the case of MBOs, more than one-third actually report a reduction in employment. Meanwhile, in the case of MBIs, the overall employment impact remains negative, even after six years. Overall, the employment impact of LBOs is negative in more than one-third of all cases.

The majority of recent studies of LBOs in the United States show that they have a negative impact on employment. A study of 5,000 US firms (with about 300,000 establishments) acquired in private equity transactions between 1980 and 2005 shows that employment shrinks more rapidly in “target firms” than in “control firms” and that the average difference after two years is about 7 per cent in favour of control firms (Davis et al., 2008). Furthermore, employment grows more slowly in “target firms” than in “control firms”. This is primarily as a result of job destruction in “target firms” because, in terms of job creation, both target and control firms fare equally well. Moreover, following a buyout by a private equity company, firms tend to engage in more acquisitions and disinvestment than control firms (Davis et al., 2008). Furthermore, the employment impact of buyouts also stems from the fact that some of the firms subsequently fail and go out of business – 6 per cent of all LBO transactions eventually fail and end up in financial

Box 2.1. Dividend recapitalizations – A risky practice for the real economy and jobs

“Dividend recapitalization” is a financial practice in which the target firm of a buyout takes on additional debt, which it then uses to pay its buyout sponsor (usually a private equity firm) a dividend.¹ The primary objective of this practice is to boost returns and to recoup the private equity firm’s initial investment quickly. Dividend recapitalization can be planned and carried out very swiftly (even within days). From 2003 to 2007 in the United States, 188 companies issued more than US\$75 billion in debt that was used to pay dividends to private equity firms.² For example, in the first seven months of 2007, there were 129 dividend recapitalizations for a total of US\$47 billion.³

The story in Europe is similar. During the first half of 2007, dividends extracted continued at record levels: of the 19 recapitalizations for the purpose of dividend payments in the first half of 2007, buyout firms paid out €6.1 billion, over 80 per cent of private equity firms’ initial investment, with an average holding period of 20 months.⁴ For the same period in 2006, the total payout was €5.3 billion for 28 deals.

According to Standard & Poor’s, dividend recapitalization can have negative, and potentially devastating, consequences on the buyout (or target) firm.⁵ This practice increases the debt burden of the firm and the probability of debt default in the longer term – even through significant profits can be made in the short term. The impact on jobs, wages and workers’ pensions can be significant too. Despite the enormous risks, at the height of the boom years (2003–2007), bankers and investors welcomed dividend recapitalization because of the higher returns that came with taking greater risks. On the bankers’ side, this was part of the excessive risk taking and excess liquidity environment, and on the private equity side, it was a source of quick money with an easy exit from the deal. In short, dividend recapitalization is a winning bet for bankers and private equity funds, but a losing bet for the target firms and their workers and pensioners.

¹ This practice became popular in 2002–03 when the Initial Public Offer market was weak. Before dividend recapitalization gained in popularity, the usual practice of a private equity firm was to “acquire the company, cut the fat, improve operations, and make a profit by taking it public again”. But, in 2002–03, the market for IPOs was weak, and the mechanism employed to fill the void was to exploit dividend recapitalization. Even when the IPO market rebounded in 2005, this practice continued, seeing spectacular growth through 2006 and the first half of 2007 (source: Standard & Poor’s). ² Op. cit., Creswell, 5 Oct. 2009. ³ Source: Deal Journal, “Return of the dividend cap?”, *Wall Street Journal*, 1 April 2008. ⁴ Fitch Ratings, “Just as the music stopped: European recapitalised LBOs in H107”, 4 Sept. 2007. ⁵ Standard & Poor’s, “The dividend recap game: Credit risk vs. the allure of quick money”, 7 Aug. 2006.

distress – this is a higher failure rate in comparison to bankruptcy rates among the publicly traded firms in the United States (Strömberg, 2007).

Meanwhile, a study of buyouts in France during the 1980s and 1990s reveals that “target firms” post-buyout do not perform well (Desbrières and Schatt, 2002).¹² The study shows that the return on equity falls for the “target firms” after the buyout when compared to their industry counterparts. Furthermore, the same is true with regard to return on investment and margin ratios and also, post-buyout, their risk grows because of the increase in debt level and decrease in liquidity ratio (Desbrières and Schatt, 2002). Contrary to the popular conception that buyouts occur in declining firms, management buyouts in France are carried out on firms whose financial situation is better than that of other firms in the same sector of activity (Desbrières and Schatt, 2002).

Besides the adverse impact on employment and wages, buyouts could adversely impact pension schemes. As part of the buyout deal, the sponsor (usually private equity firms) may stop contributing to the pension schemes, resulting in employees’

12. French buyouts differ from those in the United Kingdom and the United States in two ways: first, a higher concentration of shareholding in the acquired firms before the buyout; and, second, a lower debt level in the financial structure of the holding companies (Desbrières and Schatt, 2002). Furthermore, LBOs in France are mostly used when a transfer of or a succession in family businesses is involved.

Table 2.2 Current state of financial sector reform in advanced economies

	A. Regulation			B. Limits on risk taking			C. Compensation	
	Provision for systemic risk regulator*	Changes in micro and macro prudential regulation	Regulation of shadow banking	Changes in capital adequacy rules	Regulation of rating agencies	Increased competition or breaking up banks	Limits on executive compensation	Bonus pay regulation
Australia							UC	
Austria	UC	UC	UC	UC	Y	N	UC	UC
Belgium	UC	UC	UC	UC	Y	N	UC	UC
Canada				UC			N	
Denmark	UC	UC	UC	UC	Y	N	UC	UC
Finland	UC	UC	UC	UC	Y	N	UC	UC
France	UC	UC	UC	UC	Y	N	Y	Y
Germany	UC	UC	UC	UC	Y	N	Y	Y
Greece	UC	UC	UC	UC	Y	N	UC	UC
Ireland	UC	UC	UC	UC	Y	N	UC	UC
Italy	UC	UC	UC	UC	Y	N	UC	
Japan				UC			N	
Republic of Korea	UC			UC			N	
Netherlands	UC	UC	UC	UC	Y	N	UC	UC
New Zealand							UC	
Norway						N	UC	
Portugal	UC	UC	UC	UC	Y	N	UC	
Spain	UC	UC	UC	UC	Y	N	UC	
Sweden	UC	UC	UC	UC	Y	N	UC	
Switzerland						N	N	N
United Kingdom	UC	UC	UC	UC	Y	N	N	UC
United States	UC	UC	UC	UC	UC	N	N	UC

Notes: Y = “yes”, N = “no”, and UC = “under consideration.” The cut-off date is Nov, 2009

*EU countries have agreed to create European Systemic Risk Board, whose recommendations will not be legally binding.

Source: IILS based on Bloomberg, CNBC, BIS, IMF, and national sources

retirement plans being jeopardized. For example, this happens in a case where the “buyout sponsor” cashes out by selling the firm to the firm’s employee stock ownership plan (which is meant to pay for the employees’ retirements). See Box 2.1 for an illustration of a practice called “dividend recapitalization”, which tends to have an adverse impact on a firm’s debt load and, potentially, its workers’ pensions schemes.

There are several research papers, commissioned by the private equity industry, which have a general tendency to show significant positive effects of buyouts on employment. However, most of the studies suffer from a number of flaws, both in sampling and data quality, “rendering their estimates of employment impact effectively worthless” (Hall, 2007). One of the main reasons why it is difficult to have any confidence in evidence and statistics provided by the private equity industry is due to “information opacity” – unlike publicly listed companies, private equity companies are not required by law to disclose information. Moreover, they control the information that comes out of firms, making it difficult to trust survey results from this source.

Conclusion

As this chapter shows, while finance enables proper functioning of the real economy, it has the potential to create instabilities and induce large negative shocks to economic output and general well-being. Its growing size and influence over the real economy comes with benefits and costs, but the crisis of 2008–09 shows that the costs are enormous. When they engage in excessive risk taking, large financial institutions endanger entire financial systems, and irresponsible financial actors could wipe out the savings and retirement plans of millions. The private value of the functions which the financial sector performs is not always aligned with the social value, and it is the government's role to align these values. Recognizing the limitations of finance, its actors and related institutions, is an important step forward for promoting a better global financial system. So far, governments have done little to tackle the financialization of the real economy and the pace of reform has been excruciatingly slow (table 2.2 captures the lacklustre reform effort). It has been more than a year since the global financial system came close to total collapse, but the systemic problems – such as the lack of adequate regulation, excessive risk taking and distortionary compensation practices – have still not been adequately addressed. If the status quo prevails, the dominance of finance over the real economy will continue and, in all likelihood, become even stronger in the future.

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Rebalancing globalization:

The role of labour provisions in existing
international trade arrangements
and development finance policies



Main findings

- As highlighted in Chapter 1, a significant debate has emerged on the question of how globalization can be made fairer in the wake of the global crisis. As a contribution to the debate, this chapter takes stock of two of the key existing arrangements that take the social dimensions of globalization into account: labour provisions in international trade arrangements and in the policies of development finance institutions (DFIs).
- A key finding of this chapter is that labour provisions adopted in trade arrangements have multiplied over the past 25 years.
 - Labour provisions in trade arrangements can be categorized as conditional or promotional in nature. Conditional provisions rely upon either sanctions or positive incentives. Promotional labour provisions focus on elements such as monitoring and capacity building. To date, 37 of the 186 trade agreements that are currently in force and have been notified to the WTO were found to contain labour provisions, an increase from only four such agreements in 1995. Of these provisions, 46 per cent are conditional in nature, while 54 per cent have a promotional character. Two of the current eleven Generalized Systems of Preferences include conditional labour provisions.
 - Nine trade agreements concluded among developing and emerging economies that contain labour provisions were identified in this study. With one exception, these trade agreements were found to involve only promotional elements.
 - About 60 per cent of the labour provisions in trade agreements examined in this study make specific reference to the ILO 1998 Declaration or to ILO Conventions.
 - In some cases, the same beneficiary country is subject to different labour provisions, depending on the trade agreement in question. As a result, some countries have to comply with diverging types of labour provisions.

- Many of the major DFIs (including international, regional and bilateral development banks) have started to include labour provisions in their operations over the past ten years. At least twelve of the 16 DFIs examined make reference to the ILO 1998 Declaration or to ILO Conventions. Many of these institutions have put in place comprehensive procedures, including recourse by stakeholders affected under these policies to a separate review body.
- The rapid increase in labour provisions suggests a growing interest among governments in making globalization fairer, which is an important dimension of the Global Jobs Pact. Further research is required to understand how the practical application of labour provisions in trade arrangements and DFI policies, as well as the use of the different conditional or promotional elements, contributes to the improvement of employment and working conditions in the global economy.

Introduction

The advent of the global crisis has added a new dynamism to the ongoing debate concerning what measures are required to reinforce the social dimensions of the globalization process (ILO, 2004).¹ Evidence suggests that trade and investment liberalization and faster capital mobility have not been accompanied by similar improvements in working conditions. This is illustrated by the weakening labour market position of low-paid workers and the widening of income inequalities that preceded the crisis (IILS, 2008). As discussed in Chapters 1 and 2, these trends may escalate in the aftermath of the crisis.

The purpose of this chapter is to contribute to the debate by presenting the results of a research effort to map out the main structure, normative features and initial experiences of the implementation of labour provisions within two important vectors of globalization, namely (i) unilateral, bilateral and regional trade arrangements and (ii) the policies of DFIs. Labour provisions in private-sector initiatives, such as codes of labour practice of multinational companies, are not covered by this study. Likewise, the study does not examine broader issues of how international labour standards are set and implemented.²

In this chapter, the term “labour provisions” is defined as comprising (i) any labour standard which establishes minimum working conditions, terms of employment or worker rights, (ii) any norm on the protection provided to workers under national labour law and its enforcement, as well as (iii) any framework for cooperation in and/or monitoring of these issues. Where reference is made to the standards established by the ILO, the terms “international labour standards” or “ILO instruments” will be used.

This chapter is structured as follows. Section A focuses on labour provisions in trade arrangements. The section gives an overview of the evolution, normative coverage and practical application of these provisions. Section B deals with labour provisions adopted in DFI policies. After outlining the context of the relevant DFI activities, there follows an overview of various initiatives designed to incorporate labour provisions within DFI policies. Some initial insights concerning the implementation of these provisions are presented, as well as some final considerations.

1. As put forward in ILO: *A Fair Globalization*, Geneva, 2004.

2. The implementation and compliance with international labour standards by states can, among other things, be assessed through the annual reports of the Committee of Experts on the Application of Conventions and Recommendations. See, in this regard, Boivin and Otero (2006).

A. Labour provisions in trade arrangements: Current situation and trends

Numerous approaches have sought to reconcile the objective to promote free trade with the provision of decent working conditions. Part of the discussion has concerned the insertion of a labour provision into the multilateral framework of trade regulation (Charnovitz, 1987), which has proven to be difficult to achieve.³ Instead, this process has continued to unfold through different channels. Hence, the purpose for this chapter arises from an interest to map out the use of labour provisions in the rising number of bilateral and regional trade agreements. At the international level, an important step was taken with agreement on the four Core Labour Standards (CLS), as defined in the ILO Declaration of 1998 (ILO, 1998), which are further specified in the ILO's Fundamental Conventions.⁴ As will be seen in this chapter, the CLS have been a point of reference for many labour provisions elaborated within trade agreements. More recently, the adoption of the ILO Declaration of 2008 has further elaborated the implications of such labour standards.⁵ This first section discusses the use of labour provisions in two sets of trade arrangements existing to date: (i) unilateral systems of trade preferences and (ii) bilateral and regional trade agreements.⁶

1. Typology of labour provisions available in trade arrangements

Labour provisions have been included in numerous trade arrangements, which can be characterized as unilateral trade arrangements, or trade agreements concluded by two or more parties. While many trade agreements only cover trade-related aspects, other so called integration agreements also deal with non-trade issues, such as infrastructure programmes. Labour provisions may be included into the trade instrument itself, or in accessory documents, such as side agreements or memoranda of understanding, the latter of which are usually not legally binding.

3. See the Singapore Ministerial Declaration, WTO Ministerial Conference, Singapore, 9–13 December 1996, available at: http://www.wto.org/english/thewto_e/whatis_e/tif_e/bey5_e.htm: “We renew our commitment to the observance of internationally recognized core labour standards. The International Labour Organization (ILO) is the competent body to set and deal with these standards, and we affirm our support for its work in promoting them. We believe that economic growth and development fostered by increased trade and further trade liberalization contribute to the promotion of these standards. We reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries, particularly low-wage developing countries, must in no way be put into question. In this regard, we note that the WTO and ILO Secretariats will continue their existing collaboration.”

4. The Declaration on Fundamental Principles and Rights at Work – 86th Session, Geneva, June 1998 requires ILO member States to comply with and promote rights and principles in four areas: Freedom of association and the effective recognition of the right to collective bargaining; elimination of all forms of forced or compulsory labour; effective abolition of child labour; and elimination of discrimination in respect of employment and occupation. This applies regardless of whether the member State has ratified the eight relevant ILO Fundamental Conventions (No. 29, 87, 98, 100, 105, 111, 138, and 182).

5. The 2008 Declaration on Social Justice for a Fair Globalization states, among other things, “that the violation of fundamental principles and rights at work cannot be invoked or otherwise used as a legitimate comparative advantage and that labour standards should not be used for protectionist trade purposes” (ILO, 2008).

6. The following discussion of bilateral and regional trade agreements draws upon the 186 trade agreements which are currently in force and have been notified to the WTO until 29 October 2009 as well as five agreements which had not yet been notified to the WTO at the time of writing.

Labour provisions differ considerably with regard to their normative content and the legal implications they entail. These provisions may contain legally binding normative standards or have the nature of a political commitment.⁷ With regard to the normative content, some of these provisions commit countries to adhere to certain labour standards, which may refer to CLS, as embodied in the ILO Declaration of 1998 or to ILO Conventions. In other cases, labour provisions may commit countries to enforce labour standards under their own national labour law. In addition, some labour provisions commit the state parties to raise the level of protection of their labour laws progressively, or at least not to downgrade them with a view to promoting exports or investment.⁸ Labour provisions may also require or allow for cooperation and technical assistance on labour issues, in the form of exchange of information or technical or financial assistance.

The scope of the application of labour provisions in trade agreements also differs. The provisions may apply to labour issues concerning trade relations between the parties, or to any trade relations of either of the parties. They may, however, apply more broadly to labour issues, regardless of their links to trade relations.

Labour provisions may also be categorized according to their legal implications in the event of a breach of the respective obligations. Some trade arrangements provide for additional trade concessions if a country takes specific steps to comply with specific labour standards. In other cases, a breach of the labour provisions may allow the states concerned to withhold certain trade advantages provided for by the arrangements (such as tariff preferences).⁹ Disincentives may also be non-trade-related, such as monetary fines or a suspension of cooperative activities. Finally, some labour provisions do not provide for specific economic consequences in the case of a breach of the commitment but rather allow the parties to address the issue by regular monitoring by expert bodies, diplomatic consultations and/or cooperation activities (such as exchange of information or technical and financial assistance).

For the purposes of the present chapter, a distinction is made between conditional labour provisions (incentive- or sanction-based) and promotional labour provisions (focusing on supervision and/or capacity building). That said, in a number of cases, conditional labour provisions are combined with elements of capacity building.

While a large proportion of trade agreements contain references to labour concerns in their preamble¹⁰ or in their general objectives, this study limits itself to labour provisions that contain specific labour standards and/or a framework for cooperation, monitoring or consultation on that subject. Also, the vast number of provisions on human resource development and labour migration lies outside the scope of the study.

7. The Arrangement on Labour between New Zealand and the Kingdom of Thailand of 2005, for example, provides that “[t]his Arrangement will not legally bind the Participants” (Section 4.1).

8. Such provisions are also contained in certain investment treaties, for instance the bilateral investment treaty between the United States and Uruguay of 2004.

9. Some trade agreements exempt the parties from the obligations under the trade agreement for certain labour-related reasons. However, these provisions differ from others in that they do not contain requirements in the area of labour which a state has to comply with, but rather an exception to the obligations of the trade agreement. They are therefore not considered a labour provision for the purpose of this study. Most of these provisions are very limited, referring only to “prison labour”. Only one agreement refers to child labour (the Agreement on the Caribbean Community and Common Market of 1997).

10. For an analysis in this respect see Bourgeois et al. (2007).

2. What are the key features of labour provisions in trade arrangements?

Conditional approaches are available in some unilateral arrangements...

Labour provisions were first introduced into the United States' Generalized System of Preferences (GSP) in 1984. This trade arrangement includes, as one of the conditions for eligibility for the trade preferences, that the country concerned "must have taken or is taking steps to afford internationally recognized worker rights". Submissions alleging a breach of this provision may be filed by the social partners and relevant civil society organizations. However, the US administration has a margin of discretion regarding the application of this provision.¹¹ The United States has inserted similar labour provisions into its more far-reaching preferential trade arrangements, such as the Caribbean Basin Recovery Act (1990), the Andean Opportunity Act (1991) and the African Growth and Opportunity Act (2000) (Greven, 2005).¹²

In 1995, the European Commission of the European Union (EU)¹³ introduced a labour provision into its GSP, as seen in table 3.1 (Orbie and Tortell, forthcoming).

Particularly noteworthy in terms of this development is the shift from a merely sanction-based approach to a twofold "carrot and stick" approach, involving both sanctions in the event of "systematic and serious violations" of the labour provisions and additional preferences in the event of full implementation of these rights.¹⁴ It should be emphasized that, rather than developing its own criteria for labour standards, the EU has consistently referred to the relevant ILO conventions. A significant development concerns the fact that, initially, the EU GSP only referred to some of the ILO Fundamental Conventions but, following the 1998 Declaration, the EU has successively increased the scope of its two labour provisions and has covered all ILO Fundamental Conventions since 2002.¹⁵

11. For instance, the labour clause of the US GSP provides for withdrawal if a trade party is not "taking steps" and can be waived for reasons of national economic interest, leaving authorities a wide margin of interpretation (Greven, 2005).

12. In addition, the US Congress enacted trade regulation, which makes the continuous denial of labour standards covered by the GSP labour provisions subject to trade sanctions, including the withdrawal of trade benefits (Section 301(b) and (d) of the US Omnibus Trade and Tariff Act 1974, as amended in 1984) and banning from the US market goods produced by child labour (Bonded Child Labour Elimination Act 1930, as amended in 1997). However, as this study only deals with labour provisions in trade agreements and unilateral systems of trade preferences, these instruments are beyond the scope of this chapter.

13. After the entry into force of the Treaty of Lisbon on 1 December 2009 the European Union replaced the European Community (EC), which was until then the legal entity dealing with the trade issues of the EU Member States. Where this paper refers to specific legal acts, the original titles (referring to the EC) will be used.

14. The latter is commonly referred to as GSP+.

15. Since 2005, the labour provisions have been integrated into a more comprehensive arrangement, which also covers a broader range of human rights, environmental and good governance instruments, see Council Regulation (EC) No 980/2005 of 27 June 2005 applying a scheme of generalised tariff preferences, OJ L 169, 30.6.2005, pp. 1-43 and Council Regulation (EC) No 732/2008 of 22 July 2008 applying a scheme of generalised tariff preferences for the period from 1 January 2009 to 31 December 2011, OJ L 211, 6.8.2008, pp. 1-39.

Table 3.1 Evolution of labour provisions in the EU GSP, from 1995 to 2002

	Reference to ILO instruments	Enforcement mechanisms
1st Generation (1995)*	Conventions No. 29 and 105	Withdrawal of trade preferences in case of “systematic and serious violations” of these Conventions
2nd Generation (1999)*	Conventions No. 29 and 105 (for sanction-based labour provisions) Conventions No. 87, 98, 100, 111, 138 and 182 (for incentive-based labour provisions)	Withdrawal of trade preferences in case of “systematic and serious violations” of Conventions No. 29 and 105 Additional preferences for full compliance with Conventions No. 87, 98, 100,111, 138 and 182
3rd Generation (2002)*	1998 Declaration, all Fundamental Conventions	Withdrawal of trade preferences in case of “systematic and serious violations” of the Fundamental Conventions Additional preferences for full compliance with these conventions**

Notes: * Dates refer to the year in which the ILO instruments entered into force. ** Since 2006 countries additionally must have ratified all ILO Fundamental Conventions in order to be eligible for the additional preferences.

Source: IILS, based on information collected on EU trade arrangements.

...as well as in a number of trade agreements concluded by the United States and Canada...

The first agreement linking labour provisions to economic consequences is the North American Agreement on Labor Cooperation (NAALC) of 1994, a side agreement to the North American Free Trade agreement (NAFTA). The United States has developed this approach further in later trade agreements, an overview of which is provided in table 3.2.

While striving for a high level of protection, the earlier US trade agreements focus on the obligation to enforce national labour law in the area detailed by the respective agreements.¹⁶ Also, all agreements concluded after 1998 refer to the ILO 1998 Declaration, although the scope of the labour provisions does not necessarily fully incorporate those of the Declaration. However, this approach has changed recently. The most recent US trade agreements with Peru, Colombia, and the Republic of Korea, the latter two of which have yet to enter into force, require the parties to comply with the ILO’s CLS, in addition to enforcing their national labour laws.

All of the agreements provide for a follow-up mechanism related to differences about the labour provisions, which may, as a last resort, lead to economic consequences for the party in breach of the labour provisions.¹⁷ The NAALC allows fines up to US\$ 20 million. However, these only applied to three out of the eleven areas of labour law mentioned in the agreement. With the notable exception of the United States–Jordan Trade Agreement,¹⁸ all the later agreements with Australia, Bahrain, the Central-American countries and the Dominican Republic (CAFTA),

16. While referring to the ILO Declaration of 1998, a number of US trade instruments differ from the usually accepted CLS by excluding non-discrimination and yet including others such as OSH or even minimum wages. This has been criticised by some fearing that such a design might in the long run dilute the notion of CLS (see Doumbia-Henry and Gravel, 2006).

17. In cases where the fines are not paid, equivalent trade sanctions may be imposed.

18. In the case of the United States–Jordan Trade Agreement, the parties exchanged side letters prior to the adoption of the agreement, according to which no sanctions were to be used in the case of differences arising between the parties. However, the option of what other measures should be taken in the event of a breach of the labour clause was left open (Bolle, 2003).

Table 3.2 Evolution of labour provisions in US trade agreements from 1994 to 2009

Name and date of entry into force of the trade agreements	Reference to ILO instruments	Scope and content of labour provisions	Enforcement mechanisms
NAFTA/NAALC (1994)	No	Strive for a high level of national labour laws in the area of CLS , as well as minimum working conditions*** and migrant rights Enforcement of labour laws in these areas****	Fines up to US\$ 20 million /0.07 of total trade volume (goods) (only in the case of non-application of national labour law in the field of child labour, occupational safety and health and minimum wage)
Trade Agreement with Jordan (2001)	ILO 1998 Declaration	“Strive to ensure” CLS (except non-discrimination) and minimum working conditions Enforcement of labour laws in these areas**** No encouragement of trade or foreign direct investment through weakening labour laws	Regular trade sanctions under the regular dispute settlement mechanism of the agreement
Trade Agreements with Chile (2004), Singapore (2004), Australia (2005), Morocco (2006), Bahrain (2006), Central America/ Dominican Republic (CAFTA-DR) (2006), Oman (2009)	ILO 1998 Declaration, Convention No. 182**	“Strive to ensure ” CLS (except non-discrimination) and minimum working conditions Enforcement of labour laws in these areas**** No encouragement of trade or investment through weakening of labour law in contravention of the labour principles contained in the agreement	Fines up to US\$ 15 million in the case of non-application of national labour law in these areas (to be paid into a special labour rights fund)
Trade Agreements with Peru (2009), Colombia*, the Republic of Korea*	ILO 1998 Declaration, Convention No. 182**	Ensure respect of CLS as contained in the ILO Declaration, and enforcement of related national laws**** No weakening of labour law in a manner affecting trade or investment if this contravenes CLS	Regular trade sanctions or monetary assessment under the regular dispute settlement mechanism of the agreement

Notes: * Signed but not yet in force. ** Promoting compliance with Convention No. 182 is mentioned as a possible priority for labour cooperation. The United States–Australia Trade Agreement does not refer to this Convention. *** For the purposes of this table, the term “minimum working conditions” is used to describe minimum standards regarding hours of work, minimum wages and occupational safety and health. **** This applies to the extent that it “affects trade” or is (in the case of NAALC) “trade-related”.

Source: ILS based on information collected on US trade agreements.

Chile, Morocco and Singapore, opted for fines. These fines are intended to be paid into a fund designed to address the labour rights violations concerned, capacity building and other measures. This approach has been reversed again in the most recent generation of US trade agreements, which makes breaches of labour provisions subject to the regular dispute settlement mechanism, which applies to trade disputes under these trade agreements. It should be noted, however, that all of these dispute-settlement mechanisms emphasize the amicable resolution of disputes and usually include numerous stages of consultation and reviews through a panel and/or other neutral bodies before any economic disincentives may be applied.

A unique approach has been undertaken with the United States–Cambodia Textile Agreement, which employed positive incentives rather than disincentives. Under this agreement, enhanced market access was offered in exchange for compliance with certain labour standards. For this purpose, a number of goals in terms of compliance with labour standards were defined at the inception of the Textile Agreement; for example, the quota for market access would be increased if the companies within the apparel sector – which account for 90 per cent of all Cambodia’s exports – met the criteria (Polaski, 2008).

Labour provisions in the context of Canada’s trade agreements have undergone a development comparable to that in the United States, from focusing on

Table 3.3 Evolution of labour provisions in Canadian trade agreements (other than NAALC/NAFTA) from 1997 to 2009

Name and date of entry into force of the agreements*	Reference to ILO instruments	Labour obligations	Enforcement mechanisms**
Trade Agreement with Chile (1997)	No	Strive for a high level of national labour laws in the area of CLS, as well as minimum working conditions*** and migrant rights Enforcement of national labour laws in these areas	Fines up to US\$ 10 million (for the non-application of national labour law in the area of child labour, occupational safety and health and minimum wages)
Trade Agreement with Costa Rica (2002)	ILO 1998 Declaration	Strive for a high level of national labour laws in the area of CLS, and to promote minimum working conditions*** and migrant rights Enforcement of national labour laws in these areas	Only modification of labour cooperation activities (in the case of the non-application of national labour law in the areas)
Trade Agreements with Peru (2009), Colombia (signed but not yet in force)	ILO 1998 Declaration, Convention No. 182****	Respect for CLS, occupational health and safety, minimum wages, hours of work and migrant rights Enforcement of national labour law in these areas *****	Fines up to US\$ 15 million (only for issues covered by the ILO 1998 Declaration) to be paid into a special labour rights fund
Trade Agreements with Jordan (signed but not yet in force)	ILO 1998 Declaration, Convention No. 182****	Respect for CLS, occupational safety and health, minimum wages, due overtime pay and migrant rights Enforcement of national labour laws in these areas*****	Fines (only for issues covered by the ILO 1998 Declaration) to be paid into a special labour rights fund

Notes: * All agreements are labour side agreements. ** The enforcement mechanism only applies to "trade-related" matters. *** For the purposes of this table, the term "minimum working conditions" is used to describe labour standards regarding hours of work, minimum wages and occupational safety and health. **** The Convention is mentioned in the context of labour cooperation under this agreement. ***** These agreements additionally preclude the Contracting States from encouraging trade or investment through weakening of labour law against the labour principles contained in the agreement.

Source: IILS, based on information collected on Canadian trade agreements.

mere enforcement of national labour law to requiring compliance with minimum labour standards (see table 3.3). Labour provisions have not been included in the text of a Canadian trade agreement proper but, similar to the case of NAFTA, in special side agreements. Each of Canada's labour provisions, except that with Costa Rica, provides for fines in the case of non-compliance. The fines are to be gathered into a fund for the remediation of labour rights problems. They range from a maximum of US\$ 10 million in the older trade agreements, to a maximum of US\$ 15 million in the more recent trade agreements, and are without any limits in the case of the Trade Agreement between Canada and Jordan, which was signed in 2009 but not yet entered into force at the time of writing. All of these agreements provide for dialogue between the parties and include technical assistance. These activities are handled by a ministerial council for each agreement, assisted by national offices for each country. With regard to the enforcement mechanism, the emphasis is again on the amicable resolution of the dispute through consultation, rather than on the imposition of sanctions.

...while labour provisions in trade agreements concluded among African, Asian, Latin American and the Caribbean countries and the European Union are mainly of a promotional nature.

Aside from conditional provisions which link the compliance with labour standards to tangible economic consequences, a number of promotional labour provisions can be identified.

70 Three **African regional trade agreements** contain a labour dimension, as illustrated by table 3.4. These labour provisions do not contain commitments to

Table 3.4 Labour provisions in African trade agreements

Name and date of entry into force of the trade agreements	Reference to ILO instruments	Scope of labour provisions
Treaty of the Economic Community of West African States (1993)*	–	Cooperation regarding employment matters, labour law harmonization and the promotion of women's professional organizations
Agreement Establishing the Common Market for Eastern and Southern Africa (COMESA) (1994)	–	Cooperation regarding employment conditions and labour law
Treaty for the Establishment of the East African Community (EAC) (2000)	–	Cooperation on employment and working conditions with an emphasis on gender equality, including the abolition of discriminatory law and practice

Note: * This agreement was revised in 2005.

Source: ILS, based on information collected on African trade agreements.

specific labour standards or specific levels of protection, but instead focus upon cooperation in labour matters.

Trade agreements concluded by Asian countries and areas also increasingly involve a labour dimension, often in the form of side arrangements.¹⁹

As is apparent from table 3.5, most of these labour provisions emphasize cooperation in labour matters, mainly through exchange of information and joint projects. Almost half of these have created specific institutions in this respect. Also, almost all of these arrangements provide for some sort of additional commitments. Among these commitments, the requirement not to lower the level of protection of their national labour law in order to encourage trade and investment is the most widespread. Four of these labour provisions are contained in side arrangements or memoranda of understanding. These arrangements are typically not legally binding, although three of them provide for amicable consultations for the resolution of differences.²⁰

In the case of the Taiwan, China–Nicaragua Trade Agreement, the Japan–Philippines Trade Agreement, and the Japan–Switzerland Trade Agreement, labour provisions were incorporated into the trade agreement itself. While the Taiwan, China–Nicaragua Trade Agreement contains a commitment to comply with certain labour rights and to implement national law in these areas, the Japan–Philippines Trade Agreement and the Japan–Switzerland Trade Agreement only preclude the state parties from lowering the level of their labour laws with the intention of encouraging investment. Disputes regarding interpretation and application under all three agreements may be submitted to the regular dispute settlement body, although the agreements emphasize prior consultation in order to avoid such a dispute arising (Bourgeois et al., 2007).

A special case is the Association of Southeast Asian Nations (ASEAN), established 1992. While not including labour provisions in the text of the agreement or a side arrangement, the ASEAN countries adopted an action plan on occupational

19. In the context of the Agreement on the South Asian Association for Regional Cooperation (SAARC), a Social Charter was adopted in 2004 which deals with women's and children's rights without, however, expressly touching upon labour issues.

20. The Labour Side Arrangement between New Zealand and Thailand explicitly states that it does “not legally bind the Participants”.

Table 3.5 Labour provisions in trade agreements concluded by Asian countries and areas

Name and entry into force of the trade agreements	Reference to ILO instruments	Commitment to certain minimum labour standards**	Not encourage trade or investment through weakening labour laws	Cooperation on labour issues	Specific institutions	Consultation mechanisms in case of differences
New Zealand–Thailand Trade Agreement * (2005)	1998 Declaration	Yes	Yes	Yes	Labour Committee	Yes
Chile–China Trade Agreement * (2006)	No***	No	No	Yes	No	No
Trans-Pacific Partnership Agreement* (2006)	1998 Declaration	Yes	Yes	Yes	National contact points	Yes
New Zealand–China Trade Agreement * (2008)	1998 Declaration	No	Yes	Yes	No (but senior official meetings)	No (but discussions of labour issues of mutual concern possible)
Japan–Philippines Trade Agreement (2008)	No	No	Yes	No	No	Yes****
Taiwan, China–Nicaragua Trade Agreement (2008)	No	Yes	Yes	Yes	Labour Affairs Committee	Yes****
Japan–Switzerland Trade Agreement (2009)	No	No	Yes	No	No	Yes****

Notes: * The labour provisions are contained in a labour side arrangement or memorandum of understanding. ** These commitments are typically not formulated as a concrete obligation, but rather as a political objective. *** However, the preamble of this agreement refers to objectives of the ILO. **** The labour provisions of this agreement are subject to the regular dispute settlement mechanism, which may as a last resort entail the suspension of trade benefits. However, this may in practice be difficult because the suspension of benefits would have to correspond to the economic disadvantage caused by the breach of the labour provision, which may be difficult to prove.

Source: IILS, based on information collected on Asian trade agreements.

safety and health in 2007.²¹ This action plan commits ASEAN member states to develop a checklist based on ILO's international labour standards and best practices, which aims to enable member states to align their policies. The action plan encourages the exchange of experiences and the involvement of the ILO through capacity building.²²

Also the labour provisions of the **trade agreements concluded by the EU** and other states have undergone a considerable evolution.²³ Labour provisions in the EU's trade agreements prioritize technical assistance and development co-operation (Bartels, 2008). The main patterns in the EU's approach to the labour dimension in trade are presented in table 3.6.

21. See at: <http://www.aseansec.org/20917.pdf>.

22. Along these lines, a memorandum of understanding between the ILO and ASEAN was signed, providing, among other things, for exchange of information and joint workshops, available at: <http://www.aseansec.org/20686.htm>.

23. The EU itself is based on a treaty which, among other things, extensively regulates the internal and external trade of the EU and also contains provisions on labour issues. The EU institutions have also adopted highly comprehensive labour legislation, including on minimum working and employment conditions and workers' consultation (Bercussion, 2009). However, the EU's stage of integration by far exceeds that of other integration agreements and EU legislation increasingly resembles national federal law in terms of its contents, scope and legal effect within the legal orders of the EU member states. For this reason, the EU labour legislation is not considered a labour provision for the purpose of this study. The same applies, for similar reasons, to the European Economic Area.

Table 3.6 Different types of labour provisions in EU's trade agreements

Name and date of entry into force of the trade agreements	Reference to ILO instruments	Scope of provisions
Trade Agreements with the Palestinian Authority (1997), Morocco (2000), Israel (2000), Algeria (2005), Cameroon (2009)	No	Cooperation and/or dialogue on selected issues related to labour standards
Trade Agreement with Chile (2003)	Fundamental Conventions	Commitment to give priority to the respect for basic social rights, including through the promotion of ILO Fundamental Conventions and social dialogue Cooperation on various labour and social issues
Trade Agreements with South Africa (2000), ACP Countries (2003)*	Fundamental Conventions	Reaffirms the parties' commitment to the ILO's CLS Cooperation on various labour and/or social issues
Trade Agreement with the CARIFORUM Countries (2008)	1998 Declaration, Fundamental Conventions	Commitment to (i) ensuring compliance with ILO CLS, (ii) not weakening or failing to apply national labour legislation to encourage trade or investment Cooperation and monitoring framework with stakeholder participation, optional ILO consultation Framework for amicable solution of differences – if the dispute cannot be solved through consultation, appropriate measures other than on trade sanctions may be taken (e.g. readjustment of cooperation activities)
Trade Agreement with the Republic of Korea (NA, signed in 2009 but not yet ratified)	1998 Declaration, Fundamental Conventions, while encouraging the parties to ratify other up-to-date ILO Conventions	Commitment to (i) realizing and promoting ILO Fundamental Conventions, to (ii) implementing any ILO Conventions ratified, to (iii) not weakening or failing to apply national labour laws in a way that affects trade or investment Cooperation framework with shareholder participation, optional ILO consultation**

Notes: * This agreement has not been notified to the WTO. ** These provisions only apply to "trade-related aspects of labour".

Source: IILS, based on information collected on EU trade agreements.

Certain agreements provide for cooperation and dialogue in a number of different areas.²⁴ Since the late 1990s, the EU has increasingly made reference to ILO CLS in its bilateral agreements and has emphasized the role of the ILO in this regard (European Commission, 2004). The recent EC–Cariforum Trade Agreement of 2008 goes one step further. Referring to the ILO Declaration of 1998 and the concept of decent work, it submits the parties to a number of concrete commitments. Parties may request consultations in the event of differences over the labour provisions' interpretation and implementation which may involve the consultation of an expert committee and the ILO. If no dispute resolution is achieved within nine months, either party may bring the case before the regular dispute settlement mechanism. If no agreement is reached, temporary measures can be taken. However, these measures may not affect trade concessions but only deal with other issues covered by the agreement, such as cooperation activities. This agreement also includes a cooperative framework, which may provide a tool for capacity building in problematic labour areas in the Cariforum States.

The EC-Republic of Korea Trade Agreement (which, as of December 2009, had yet to be ratified), further developed this approach, opting for a joint chapter

24. It should be noted though that the EU frequently provides technical assistance and cooperation in the area of labour standards to its economic partners even where this is not explicitly stipulated in the text of the trade agreement.

Table 3.7 Labour provisions in Latin American and Caribbean regional trade agreements

Name and date of entry into force of the trade agreement	Specific instruments	Reference to ILO instruments	Commitments to certain minimum labour standards	Framework for Labour Cooperation or Monitoring
Treaty on the Caribbean Community and Common Market (CARICOM) (1973)	Text of the Revised Treaty (1997)	No	No	Technical Cooperation within the Council for Human and Social Development
	Charter of Civil Society for the Caribbean Community of 1995	No	Yes (including freedom of association, child labour, working conditions and occupational safety and health)	Review of progress by the Secretary-General
	Declaration of Labour and Industrial Relations Principles of 1998	International Labour Conventions	Yes (covering numerous areas of labour law, including CLS)	No
Cartagena Agreement on the Andean Community (1988)	Andean Instrument on Occupational Safety and Health (1999, as revised in 2004)	No	Yes (in the area of occupational safety and health)	Technical assistance through a Labour Committee, assistance in case of differences regarding the interpretation of the Andean Instrument
MERCOSUR (1991)	Social-Labour Declaration (1998)	1998 Declaration	Yes (covering numerous areas of labour law, including CLS)	Dialogue, cooperation and review of progress by the Comisión Socio-Laboral

Source: ILS, based on information collected on Latin American and Caribbean trade agreements.

on labour and environmental issues. While its commitments largely correspond to those contained in the EC–Cariforum Trade Agreement, it provides for the creation of two Domestic Advisory Groups (one for each party), which will provide advice on the implementation of the labour provisions. Unlike the EC–Cariforum Trade Agreement, this agreement explicitly excludes recourse to the regular dispute settlement mechanism and possible sanctions.

Labour provisions in **Latin American and Caribbean trade agreements** first emerged in the context of regional integration during the 1990s. While the three trade agreements (i.e. the agreements on the Andean Community, the Caribbean Community and MERCOSUR) differ in terms of their integration approaches, they all include a social dimension, albeit added as a complement to the respective agreements in the form of a declaration or another instrument. The state parties of all three trade agreements commit to various labour provisions although, in the case of the Andean Community, this is limited to occupational safety and health. Each of these labour provisions provides for some follow-up, be it through technical cooperation or monitoring by a specific body or committee (see table 3.7).

Latin American countries and areas have also included labour provisions in more recent bilateral trade agreements or related side arrangements (see table 3.8). In particular, the gradual evolution of the labour provisions in Chile’s trade agreements is noteworthy. This development started with labour cooperation (in the context of the Trade Agreement with China) and, successively, included a reference to the ILO Declaration (in its Trade Agreement with Australia) and comprehensive commitments to labour standards (in its most recent Trade Agreement with Colombia, which, however, does not provide for recourse to the Trade Agreement’s regular dispute settlement mechanism, which may entail trade sanctions).

Table 3.8 Labour provisions in bilateral trade agreements concluded by Latin American countries and areas *

Name and date of entry into force of the trade agreement	Reference to ILO instruments	Commitments to certain minimum labour standards***	Enforcement of national law in certain areas	Not encourage trade or investment through weakening labour law	Cooperation on labour issues	Consultation mechanisms in case of differences	Specific institutions
China–Chile Trade Agreement (2006)**	No****	No	No	No	Yes	No	No
Taiwan, China–Nicaragua Trade Agreement (2008)	No	Yes	Yes	Yes	Yes	Yes	Labour Affairs Committee
Australia–Chile Trade Agreement (2009)	1998 Declaration	No	No	No	Yes	No	National Contact Point
Chile–Colombia Trade Agreement (2009)	1998 Declaration	Yes	Yes	Yes	Yes	Yes	National Contact Points, High-Level Meetings

Notes: * Table 3.8 does not deal with the labour provisions in trade agreements concluded between Latin American countries and Canada, the EU and the United States, which are addressed in the text above. ** The labour provisions are contained in a labour side arrangement or memorandum of understanding. *** These commitments are typically formulated as political objectives, the normative content of which is sometimes rather vague. **** However, the preamble of this agreement refers to objectives of the ILO.

Source: IILS, based on information collected on Latin American trade agreements.

3. What are the practical implications of labour provisions?

A growing number of trade arrangements include labour provisions...

Due to their decentralised character and their high proliferation, it is difficult to quantify trade arrangements, in particular trade agreements (Fiorentino et al., 2006). The following calculations are based on the WTO Regional Trade Agreements Information System,²⁵ which lists trade agreements notified to the WTO, and the UNCTAD web site, which lists GSPs currently in force.²⁶ Two of the eleven existing GSPs include conditional labour provisions. Out of the 186 trade agreements that are in force and have been notified to the WTO, 37 include either conditional or promotional labour provisions.²⁷

As shown in figure 3.1, panel A, the number of trade agreements with conditional labour provisions, as well as those with promotional labour provisions, have increased considerably during the past 20 years (see also table 3.9). While no agreement containing labour provisions had entered into force in 1990, the number had risen to 14 promotional and seven conditional provisions, respectively,

25. See at <http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx>.

26. There are currently eleven unilateral GSPs, adopted by Australia, Belarus, Canada, the European Union, Japan, New Zealand, Norway, the Russian Federation, Switzerland, Turkey and the United States, see <http://www.unctad.org/Templates/Page.asp?intItemID=2309&lang=1>.

27. This figure refers to the so-called “integrated” trade agreements notified to the WTO. According to this method of calculation, trade provisions negotiated between the same parties on goods and services, respectively, are counted as one trade agreement regardless of whether they are strictly contained in the same agreement (which is most frequently the case) or not. Also, mere acts of accession to already existing trade agreements are not counted.

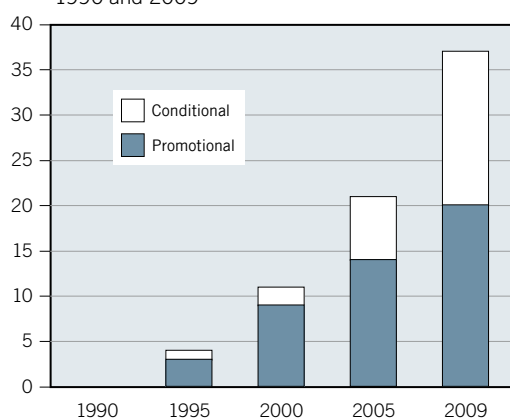
Table 3.9 Incidence of trade arrangements with labour provisions

Generalized systems of preferences		Trade agreements		
Total number	Number including conditional labour provisions	Total number	Number including conditional labour provisions	Number including promotional labour provisions
11	2	186	17	20

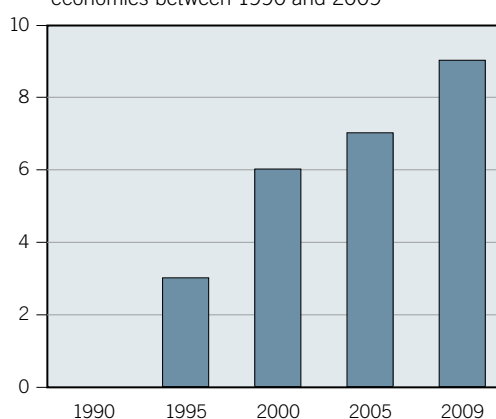
Source: ILS, based on information collected on trade agreements and policies.

Figure 3.1 The rising trend in the number of trade agreements with labour provisions*

Panel A. Evolution in numbers of labour provisions in bilateral and regional trade agreements between 1990 and 2009



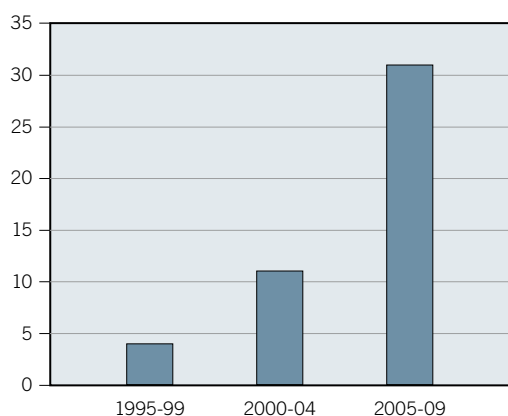
Panel B. Evolution in numbers of labour provisions in bilateral and regional trade agreements concluded between developing and emerging economies between 1990 and 2009



Note: * The data on 2009 refer to the period from 1 January of 2009 to 29 October of 2009.

Source: ILS estimates based on the WTO Regional Trade Agreements Information System and information of national governments and treaty bodies.

Figure 3.2 Share of trade agreements with labour provisions compared to the total number of trade agreements entered into force from 1995-2009* (percentage)



Note: * The data on 2009 refer to the period from 1 January of 2009 to 29 October of 2009.

Source: ILS estimates based on the WTO Regional Trade Agreements Information System and information from national governments and treaty bodies.

Table 3.10 Imports covered by labour provisions as a percentage of total imports from beneficiary countries, 2008

US GSP	US AGOA	US ATPA	US CBERA	EU GSP	EU GSP+
16.1	69.0	60.5	24.3	8.2	23.2

Source: ILS estimates based on EU Commission Directorate General Trade, available at: http://ec.europa.eu/trade/issues/global/gsp/index_en.htm; United States International Trade Commission 60th Report, USITC Publication 4091, July 2009, *The Year in Trade 2008*, Operation of the Trade agreements Program.

by 2005.²⁸ By 2009, a total of 20 promotional and 17 conditional labour provisions had entered into force.

Particularly noteworthy, the share of trade agreements which include labour provisions has risen in recent years. Figure 3.2 compares the evolution of such agreements which have come into force over three different periods. As seen in the figure, only four percent of trade agreements that entered into force in 1995-99 contained labour provisions, rising to eleven percent from 2000-04. However, the incidence of labour provisions in such trade agreements rapidly increased more recently to 31 percent from 2005-09 – now comprising nearly one-third of all trade agreements which entered into force over that period.²⁹

...labour provisions are involved not only in North–South trade agreements, but also in a growing number of agreements between developing and emerging economies...

There has been an increase in the number of agreements to which only developing and emerging economies are parties (Fiorentino et al., 2006). Figure 3.1, Panel B shows that, from zero in 1990, nine trade agreements including labour provisions have been signed to date between developing and emerging economies. An analysis of these provisions indicates that, with one exception, only promotional labour provisions have been involved in these cases.³⁰

...and their economic coverage can be significant, while varying.

The US GSP and the EU GSP cover less than one-fifth and less than one-tenth, respectively, of the imports from the beneficiary countries concerned. Under the African Growth and Opportunity Act (AGOA), 69 percent of the imports from beneficiary countries are covered and the figure is about 60 percent in the case of Andean Trade Preference Act (ATPA). The special incentive arrangement of the EU GSP and the US Caribbean Basin Economic Recovery Act (CBERA) cover about one-quarter of the imports of the beneficiary countries concerned (see table 3.10).

28. Note that the earlier Accession Agreements concluded by the EU are not included in these figures.

29. The percentage refers to “integrated” trade agreements (see above) without the accession agreements and preceding agreements with states that are meanwhile EU member states. Where the labour provisions were added to the trade agreement after the agreement’s entry into force, the figure refers to the date of entry into force of the trade agreement.

30. Only the Taiwan, China-Nicaragua Trade Agreement contains a labour provision that can, in principle, lead to the suspension of trade benefits.

The economic scope of regional trade agreements is not easy to measure, due to the difficulty of determining the precise trade volume covered by trade agreements. Kawai Dean and Wignaraja (2007:12) recognize that it is challenging to establish the volume of a country's trade covered by trade agreements due to the numerous exceptions for specific goods provided within those agreements. The overall trade volume is often quite significant. The final relevance for the countries concerned will, however, depend on a number of specific factors (such as the importance of trade covered by the labour provision versus trade with other trading partners, or the extent to which social provisions are, or are not, implemented). On a more general note, the application of sanctions through a labour provision may also affect the reputation of the country, which may lead to disadvantages in economic and political relations with other countries (Kryvoi, 2008). Depending on the specific situation, this may provide political leverage beyond the economic scope of the agreement.

The growing number of bilateral and regional trade agreements concluded in recent years, and the variation in the character and specific content of these agreements as noted above, also raises a coordination issue. Countries which have concluded agreements with several trading partners may find themselves subject to different labour provisions, depending on the trade agreement in question. This may result in a situation where a country may be bound to comply with diverging types of labour provisions.

Sanction-based labour provisions have been invoked in a number of cases...

In relation to the US GSP, table 3.11 provides details concerning the 57 cases examined by the US Trade Representative (USTR), from 1985 to 2007, 13 of which have led to the withdrawal of preferences. In five cases, the preferential treatment was later reinstated. In 2008, the USTR accepted two new complaints, which are still under examination.

In the case of the EU GSP, two investigations have led to the withdrawal of trade preferences since the introduction of the labour provisions into this trade arrangement in 1995, relating to Myanmar and Belarus, respectively.³¹ Another complaint was filed with the Commission concerning bonded child labour in Pakistan. Here, the EU opted for a different approach, refraining from initiating an investigation and focusing instead on political dialogue (Brandtner and Rosas, 1999). In this context, the EU also increased its support to the activities of the ILO's Programme on the Eradication of Child Labour in Pakistan (Greven, 2005).

To date, none of the labour provisions in trade agreements examined in this chapter has led to any sanctions (Witte, 2008). However, some of these labour provisions have been used to a certain extent. For example, 37 submissions were presented under NAALC by 2008, none of which went beyond the early stage of ministerial consultations. Over half of these cases have been followed up by cooperation activities, such as joint working groups or seminars.³² A case was

31. Council Regulation (EC) No. 552/97 of 24 March 1997, temporarily withdrawing access to generalized tariff preferences from the Union of Myanmar, OJ L 85, 27 Mar. 1997, pp. 8–9; Council Regulation (EC) No. 1933/2006 of 21 December 2006 temporarily withdrawing access to the generalized tariff preferences from the Republic of Belarus, OJ L 405, 30 Dec. 2006, pp. 35–40.

32. Compa notes, however, that many of these have been boycotted by unions and NGOs, who alleged that the workshops were not relevant to the problem of the case (Compa and Brooks, 2008, p. 9)

Table 3.11 Petitions under the labour provisions of the US GSP, 1985 to 2007

Petitions accepted and investigations self-initiated by USTR	Petitions rejected	Countries' benefits wholly or partially suspended	Petitions resolved through steps taken by the country in question	Reinstatement of benefits following a suspension
57	54	13	34	5

Note: The apparent discrepancy between the number of petitions accepted and the number of resolved cases is explained by the cases currently under review, a number of cases where multiple petitions were filed for the same country and were later merged into a single case, and instances in which cases were allowed to expire.

Source: USTR, 2008.

filed against Guatemala in 2008 as part of the CAFTA (Compa and Brooks, 2008, p. 32),³³ which led to specific recommendations and the case has been kept under review.³⁴

...but little is known about their effectiveness...

The question of the effectiveness of sanction-based labour provisions on actual workers' situations does not allow for a clear-cut answer. It does, however, seem that labour provisions have had an impact on the labour situation in some cases.

As concerns the unilateral labour provisions of the US GSP, some scholars have argued that the threat of withdrawal of tariff preferences has led in certain cases to improvement in the situation of workers (Frundt, 1998; Compa and Vogt, 2001). In general, the effect of these labour provisions on the situation of workers depends to a large extent on the presence of domestic social partners (Greven, 2005; Witte, 2008). In addition, other factors, including the economic dependence of the beneficiary country on market access and its own technical capacity to remediate the problem, seem to co-determine the impact of the US GSP's labour provision (Elliott and Freeman, 2003).³⁵

Scholars generally agree that the impact of the NAFTA labour provisions has been rather limited and that only a few of these cases resulted in direct substantial improvement of workers' situations (Greven, 2005; Dombois, 2006; Finbow, 2006; Schurtman, 2008). In the absence of sanctions, the main enforcement tool has been public censure, the results of which are difficult to measure (Dombois, 2006). Factors such as difficulty of implementation (Finbow, 2006) and lengthy or cumbersome procedures (Compa and Brooks, 2008) have been cited as possible reasons for the reduced interest of trade unions and NGOs in the NAALC (e.g. Blackett, 2007). However, scholars increasingly point to indirect and long-term advantages that have been gained through NAALC; these include increased knowledge and understanding about the respective parties' labour law systems and the formation of a number of trans-national alliances between unions and NGOs (Schurtman, 2008; Buchanan and Chaparro, 2008).

33. The complaint, lodged by the AFL-CIO, is available at: http://www.aflcio.org/issues/jobseconomy/globaleconomy/upload/guatemala_petition.pdf.

34. The report of the Office of Trade & Labor Affairs is available at: <http://www.dol.gov/ilab/media/reports/otla/20090116Guatemala.pdf>.

35. These authors carry out an extensive analysis based on cases under the US GSP between 1985 and 1996.

...as well as the use of cooperative elements of these arrangements.

In the light of the limited practical relevance of the sanction mechanisms, it has been argued that, in practice, the US trade agreements' main pillar is the element of cooperation (Griffin, 1997). Extensive cooperation activities have been conducted under NAALC, which consisted mainly of conferences, workshops and research activities. However, the number of these activities has declined in recent years (Finbow, 2006). Furthermore, a number of objections regarding their design have been raised (Polaski and Vyborny 2006; Finbow, 2006). Others defend cooperative activities as a necessary condition for the creation of a favourable environment for sustained functioning of the NAALC (Compa and Brooks, 2008).

With the United States–Chile Trade Agreement, a more practical approach to cooperation has been taken, involving activities to enhance Chile's institutional capacities by improving staff skills and enhancing institutional procedures for the application of labour law (García Hurtado, 2006). This approach has been reinforced in the context of CAFTA, where the US Government has provided US\$ 20 million per year since 2006 for capacity building in the area of labour standards in the CAFTA-DR countries.³⁶ Action plans have been developed by the US administration and the individual CAFTA states in consultation with the national social partners. These include a mechanism to verify progress toward the goals set out in the White Paper³⁷ which, among other things, involved monitoring by the ILO.³⁸ Cooperation activities have focused mainly on five areas, namely strengthening of labour ministries, improving the labour justice system and legal advice for workers, reducing discrimination in the *maquilas*, combating child labour and strengthening the culture of compliance regarding labour issues. While the US Department of Labor considers that a number of improvements have been made, in particular regarding the fight against child labour, NGOs and trade unions argued that the effect of these activities has been limited,³⁹ citing the reluctance of employers to respect labour rights, insufficient involvement of the social partners and relevant civil society organizations in implementation, as well as the lack of evaluation and accountability of the projects or financial assistance.⁴⁰

In the context of the Canada–Chile Agreement on Labour Cooperation, a number of workshops and conferences were held, involving mainly information sharing and research into the implementation of labour standards. A three-year review of the agreement conducted in 2002 proposed, among other things, to

36. U.S. Department of State Office of the Spokesman, "US Commits Funding For Labor and Environmental Protection for Central America–Dominican Republic Free Trade agreement Countries", Media Note 2008/071 from 30 January 2008. <http://sanjose.usembassy.gov/CAFTADR%20labor%20fact%20sheet%20CLEAN.pdf>. Interestingly, as Doumbia-Henry and Gravel (2006, p. 196) note, the coverage of these activities explicitly comprises gender issues – although gender discrimination is not covered by the "coercive" part of CAFTA's labour provision.

37. U.S. Department of Labor Bureau of International Labor Affairs (2009) "Progress in Implementing Capacity-Building Provisions under the Labor Chapter of the Dominican Republic–Central America–United States Free Trade agreement. First Biennial Report Submitted to Congress Pursuant to Section 403(a)(3) of the Dominican Republic–Central America–United States Free Trade agreement Implementation Act", available at: <http://www.dol.gov/ilab/programs/otla/JeffersonReport.pdf>.

38. The reports are available at: www.oit.or.cr/verificacion.

39. Full text of the submissions available on the ILAB web site at: www.dol.gov/ilab.

40. U.S. Department of Labor Bureau of International Labor Affairs (2009), op. cit.

Box 3.1 The US–Cambodia Textile Agreement: An experience with positive incentives

The approach taken with the US–Cambodia Textile Agreement has been considered innovative for a number of reasons. An important feature was the alignment of government and business interests through the use of positive incentives in the form of increased export quotas for verified compliance with labour standards (Polaski and Vyborny, 2006). Participation in the monitoring programme by the ILO was mandatory and a precondition for obtaining an export licence, which ensured the full participation of all exporting firms in the sector. The ILO was entrusted with carrying out comprehensive monitoring at the firm level and has published its detailed findings on the Internet, thereby providing transparent information on compliance with labour standards to buyers concerned with brand reputation. Also, capacity building activities aimed at strengthening state regulatory capacity and the role of workers' and employers' associations contributed to a more favourable environment for the promotion of labour standards. Some authors have argued that a virtuous cycle was created between improvements in labour conditions, growth of exports and employment creation (Polaski, 2008; Berik and van der Meulen Rodgers, 2007). The number of jobs in the Cambodia apparel sector tripled between 1998 and 2004 (Wells, 2006) and export volumes rose from US\$ 500,000 in 1998 to US\$ 2.8 million in 2004 (Polaski, 2008). While acknowledging some improvements regarding working conditions, other authors have pointed to continued difficulties related to overtime, low wages and resistance by companies to collective bargaining (Wells, 2006; Miller, 2009). A World Bank study found that a market niche had emerged, based on compliance with labour standards, and that the extension of this approach to other sectors might be fruitful (World Bank and International Finance Corporation, 2005).

render the activities more practical and to link them more strongly with the ILO.⁴¹ The Canada–Costa Rica Labour Side Agreement has involved the provision of technical assistance with a view to strengthening the labour inspection and alternative dispute settlement in labour matters and promoting social dialogue in the legislative process.⁴²

The few cases where incentive-based approaches have been applied offer promising potential...

So far, incentive-based labour provisions have been rather scarce, but first evidence on implementation points to relatively positive outcomes.

As for the EU GSP, Orbie and Tortell (forthcoming) show that several countries have ratified ILO Fundamental Conventions in order to be eligible for the additional tariff preferences under the EU GSP incentive-based labour provision. However, the impact of these arrangements on the actual improvement of labour standards in the countries concerned is less clear.⁴³ The US–Cambodia Textile Agreement has received rather positive evaluations regarding its impact (Kolben, 2004; Polaski, 2008) (see Box 3.1).⁴⁴

41. See also the “Ministerial Council Report on the Three-Year Review of the Canada–Chile Agreement on Labour Cooperation”, December 2002, available at: http://www.hrsdc.gc.ca/eng/lp/spila/ialc/2003_2004/02canada_chili_agreement.shtml.

42. See the website of the Canadian government at: http://www.hrsdc.gc.ca/eng/lp/ila/NIIILA/Tech_Ass_CCRALC.shtml.

43. Some countries have been accorded preferences despite being cited by ILO bodies for labour standards violations (Orbie and Tortell, 2009).

44. According to Polaski, this “program (is) arguably the best investment the United States has ever made in promoting international labor rights” (Polaski, 2004, p. 25).

...as well as the use of labour provisions in trade agreements concluded among developing and emerging economies.

Few comprehensive evaluations have been conducted of the impact of promotional labour provisions. An interesting test case is MERCOSUR. Being of a promotional character, the implementation mechanism utilized in MERCOSUR involves tripartite commissions at the national level and the MERCOSUR Social-Labour Commission at the regional level, which sits at least once a year. Its key tasks are the development of programmes and action plans for the promotion of the Social-Labour Declaration, as well as monitoring its implementation (Corries, 2001). Central to its activities are the annual reports that the MERCOSUR member States are required to submit, first to national tripartite commissions and, subsequently, to the regional Social-Labour Commission for comments (Godio, 2004). While progress has so far been rather slow (Motta Veiga and Lengyel, 2006), some authors expect the Social-Labour Declaration to influence the interpretation of national laws by the courts and, in this way, to impact indirectly the national laws of the MERCOSUR countries (Barretto Ghione, 2002). The Social-Labour Declaration has also been used as a platform for social dialogue, at both a national and a regional level (Tokman, 2006). This has, among other things, led to the conclusion of an international framework agreement between the Germany-based transnational company Volkswagen and local trade unions (Godio, 2004).

B. International development finance

The following section discusses the use of labour provisions in the investment policies of DFIs.⁴⁵ The analysis in this section refers to 17 DFIs about which information has been obtained to date. These DFIs comprise those listed in table 3.13 as well as the World Bank. For the purposes of the discussion in this section, labour provisions in DFI policies refer to normative standards which are adopted by these institutions in relation to their investment operations and procedures.

The purpose of DFIs is to provide financial resources to economic actors in regions and sectors where access to capital is limited. There exist global, regional and bilateral DFIs. At the global level, the World Bank Group comprises five financial institutions, three of which operate in the field of development finance.⁴⁶ The main DFIs at the regional level are the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the EU's European Investment Bank and the Inter-American Development Bank. Finally, numerous States have put in place bilateral DFIs.

While multilateral and regional DFIs are owned by their member States, some bilateral DFIs also have private owners, although the main shares usually

45. DFIs provide finance for operations that are typically to be paid back within a predetermined period of time. They are distinct from development agencies, which provide grants that do not have to be repaid.

46. These are the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC). The Multilateral Investment Guarantee Agency (MIGA) focuses on guarantees for foreign investors' projects in developing countries. The last branch of the World Bank Group is the International Centre for the Settlement of Investment Disputes (ICSID).

remain with the national government (Dellacha and te Velde, 2007). The World Bank Group covers both investment in the public sector (IBRD and IDA) and the private sector (International Finance Corporation (IFC)). The same is true for regional banks although the majority of them tend to prioritize the public sector. Bilateral DFIs typically focus on the private sector. The main DFIs disbursed in total US\$ 45 billion in loans, equity and guarantees during 2005, of which just less than half (US\$ 21.3 billion) was directed into the private sector (te Velde and Warner, 2007).

Increasingly, international bodies have called for DFIs to take into account, or at least not hamper, the realization of decent working conditions in their investment operations.⁴⁷ Hence, a context has been created for the introduction of labour concerns into the investment operations of DFIs. In recent years, labour issues have been progressively taken into account in DFI operations. In 2002, the World Bank publicly announced its support for all four CLS.⁴⁸ Similar approaches have been adopted by regional DFIs⁴⁹ and bilateral DFIs.

1. How have labour provisions in international development finance evolved over time?

Labour provisions in DFI policies do not usually address states directly...

Unlike the case of labour provisions in trade arrangements, which refer primarily to states, labour provisions in DFI policies mainly apply to private-sector partners.

There are some exceptions, however:

- The World Bank Group's public arms (IBRD and IDA) include ILO CLS as an aspect of the Country Assistance Strategies, which the Bank prepares in cooperation with the borrowing country concerned. Country Assistance Strategies do not make compliance with the CLS of the borrowing State an eligibility criterion for loans. However, the World Bank seeks to address CLS issues in dialogue with the country concerned, "in cases where non-implementation of one or more core standards negatively impacts the country's prospects for development" (World Bank, 2002).
- A similar policy was recently adopted by the European Bank for Reconstruction and Development (EBRD) (EBRD, 2008).
- Since 1985, the US Overseas Private Investment Corporation (OPIC) policies include labour provisions which are linked to those of the US GSP. This means that investment activities in countries which have lost trade preferences due to a breach of the US GSP's labour provisions are also excluded from OPIC's operations. For countries that do not benefit from the US GSP, an individual assessment is carried out (Clatanoff, 2005).

47. The ECOSOC 2006 Ministerial Declaration called for "cooperation and coordination, in the pursuit of the goals of full and productive employment and decent work for all" in international and bilateral donor agency activities (see paragraph 33 of the document). A similar statement is made by the World Commission on the Social Dimension of Globalization (ILO, 2004, p. 94).

48. World Bank, "Transcript of Town Hall Meeting with NGOs", Washington, January, 2002, cited in Bakvis and McCoy (2008, p. 5).

49. See, for example, the Social Protection Strategy of ADB (ADB, 2003, p. 56 et seq.).

Apart from these exceptions, DFI policies focus mainly on the compliance of companies involved in the respective DFI operations, although these may sometimes, as in the case of EBRD, also cover public enterprises owned by the state.

...but are increasingly included in DFIs' investment policies vis-à-vis private and public companies...

To date, many of the major DFIs have included labour provisions in their policies for their client companies. In this regard a leading role has been played by the IFC. By 1998, the IFC had already adopted a safeguard policy dealing with labour issues (IFC Compliance Advisory Ombudsman, 2003). Following an assessment by the IFC's Ombudsman in 2003 and consultations with a wide array of stakeholders, including the ILO, the "IFC Policy and Performance Standards on Social and Environmental Sustainability" were adopted. Performance Standard 2 contains requirements specifically related to labour issues. The Performance Standards have been applied to all IFC-financed projects since May 2006 (Sims, 2008; Bakvis and McCoy, 2008). The IFC policy contains a comprehensive set of good governance standards, which are systematically incorporated into contracts with its clients, as shown in table 3.12.

In general, the IFC Performance Standards have become a reference for other DFIs in developing integrated labour provisions within their own policies (Sims, 2008). For example, the EBRD's "Performance Requirements", adopted in May 2008, seem to have been inspired by the IFC's Performance Standards (EBRD, 2008). The policies of other financial actors also have been influenced by these Standards. The Multilateral Investment Guarantee Agency (MIGA), which is the investment guarantee arm of the World Bank Group, adopted the Performance Standards in 2007 (MIGA, 2007). In 2003, the leading international private sector banks (known as the "Equator Banks") adopted provisions known as the "Equator Principles". Since their revision in 2006, the Equator Principles contain the social and environmental safeguards of the IFC Performance Standards. Banks that adopt the Equator Principles commit themselves to apply the principles to any project with a minimum value of US\$ 10 million. Adherence to the Equator Principles rose from ten compliant banks in 2003 to more than 60 compliant banks in 2008.⁵⁰ The IFC estimates that the Equator Principles are now applied to 80 per cent of project finance provided by private banks in developing countries (IFC, 2007).

A number of DFIs have included labour provisions in their policies before or in parallel to the IFC. An early example is the US OPIC, which started using such provisions in its investment activities in 1989, requiring clients to respect certain labour standards (OPIC, 2008). From the late 1990s, European DFIs, in particular Denmark's Industrialisation Fund for Developing Countries (IFU), the Netherlands Development Finance Company (FMO) and the German Investment and Development Corporation (DEG), have integrated labour provisions into their investment policies. Numerous regional DFIs and more recent bilateral DFIs, including the Development Bank of Austria (OeEB), established in 2008, have followed suit.

84 50. See at: <http://www.equator-principles.com/>.

Table 3.12 Overview of labour provisions in the IFC Performance Standard 2

Area of labour issues	Requirement applicable to IFC's clients
General issues	Client must adopt a human resource (HR) policy and “document and communicate to their employees” information on their employment and working conditions
Freedom of association	Compliance with national law Where national law prohibits unions: alternative mechanisms for grievance and protection of working conditions must be put in place Clients may not, under any circumstances, discourage workers from, or discriminate against workers for, organizing or bargaining collectively
Non-discrimination	Compliance with national law if it prohibits discrimination No discrimination regarding recruitment, compensation, working conditions, termination of employment training and retirement regarding gender, colour, religion, etc.
Child labour	No child labour that is exploitative or harmful to the child's education, health or development Minimum age: follows applicable national law, no employment of children under 18 in “dangerous work”
Forced labour	No use of work or services “not voluntarily performed” “under threat of force or penalty”
Working conditions	Follow the collective agreement where the client is party to such an agreement Where no collective agreement covers wages, hours of work, overtime arrangements and compensation, sick leave, maternity leave or annual leave, national law will be respected
Occupational safety and health	Client must take steps to minimize, as far as possible, the risks of occupational injury and disease The client must: identify risks, take preventive measures, provide training to workers, document occupational accidents and diseases
Retrenchment	In the event of mass lay-offs, a retrenchment plan is required to mitigate effects of retrenchment in consultation with workers and in a non-discriminatory manner
Grievance mechanism	Possibility for workers to raise concerns with the management in a transparent and expeditious manner
Non-employee workers	Covers contract workers performing core functions for the client for a “substantial duration” All labour provisions apply, except those on HR policy, retrenchment and supply chains
Supply chains	Client must “inquire about and address child labour and forced labour in its supply chain”

Source: IFC Performance Standards

As seen in table 3.13, these DFI policies typically incorporate a wide variety of labour issues. The scope of the labour provisions varies considerably. Some DFI policies, including those of EBRD and DEG, go beyond the IFC's Performance Standards (Rudolph, 2005; EBRD, 2008). Many of these DFIs, including IFC, IDB and most of the European DFIs, also have an exclusion list in place that precludes DFIs from investing in clients that use child labour and forced labour.

Interestingly, twelve of the DFI policies containing labour provisions refer directly to at least some of the ILO Fundamental Conventions. This may be due in part to consultation with the ILO in the design of these policies, as in the case of the IFC and EBRD. That said, the DFI policies do not necessarily embrace all the specific requirements of the relevant ILO Conventions. Usually, the main reference

Table 3.13 Labour provisions in operational policies of major DFIs

Name of DFI	Reference to ILO instruments*	Areas covered by DFI policies**	Labour provisions inserted into contracts with partner companies
International Finance Corporation (IFC)	Fundamental Conventions	Issues related to CLS and other selected labour issues (see table 3.12)	Yes (for investment through financial intermediaries the specific standard applied depends on the risk factor)
Asian Development Bank (ADB)	ILO 1998 Declaration	Issues related to CLS, minimum wage, occupational safety and health	Yes (usually for large infrastructure projects depending on the social assessment)
African Development Bank (AfDB)	Unclear	Issues related to occupational safety and health and gender issues	Yes (in the form of concrete commitments depending on the social assessment)
European Bank for Reconstruction and Development (EBRD)	Fundamental Conventions	Issues related to CLS, occupational safety and health, employment contracts, retrenchment, non-employee workers, minimum conditions of work, respect for collective agreements, EU rules on non-discrimination	Yes
European Investment Bank (EIB)	Fundamental Conventions	Issues related to CLS and occupational safety and health	Yes (in the form of concrete commitments depending on the social assessment)
Inter-American Development Bank (IDB)	Unclear	Issues related to CLS and certain selected areas (for large infrastructure projects)	Yes (primarily national legal requirements – international labour standards are typically aimed at through a specific action plan)
UK Commonwealth Development Corporation (CDC)	Fundamental Conventions	Issues related to CLS, wages, occupational safety and health and other selected areas	Yes
DEG	Fundamental Conventions, Conventions on working time, pay and occupational safety and health	Issues related to CLS, working time, wages and occupational safety and health	Yes
FMO	Fundamental Conventions	Issues related to CLS and other labour issues (identical to the IFC Performance Standards)	Yes
IFU	Fundamental Conventions	Issues related to CLS, weekly rest, working hours, annual leave, wages and occupational safety and health	Yes (primarily national legal requirements – international standards are typically aimed at through a specific action plan)
Norfund (Norway)	Fundamental Conventions	Issues related to CLS and other labour issues (identical to the IFC Performance Standards)	Yes
OeEB	Fundamental Conventions	Issues related to CLS, occupational safety and health and other selected labour issues	Yes (primarily national legal requirements – international standards are typically aimed at through a specific action plan)
OPIC	Unclear	Issues related to CLS except non-discrimination, wages, working hours and occupational safety and health	Yes (primarily national legal requirements – international standards are included where national standards are not sufficient)
Swiss Investment Fund for Emerging Markets (SIFEM)	Fundamental Conventions on child and forced labour	Issues related to child labour and forced labour – other labour issues, including occupational safety and health and minimum working conditions, as far as covered by national law	Yes
Swedfund (Sweden)	Fundamental Conventions	Issues related to CLS and other selected labour issues	Yes

Notes: * Reference to the ILO instruments does not necessarily imply that the policies embrace all the obligations contained in these instruments but may refer to them as a source of inspiration or a benchmark. ** The substance of the labour conditions referred to may be derived from ILO standards or national law or may be established by the DFI policy itself. Some of the bilateral and regional DFIs also refer to the IFC Performance Standards or the IFC policy on occupational safety and health.

Source: Policy documents of the various DFIs.

point for labour provisions in DFI policies is, in the first instance, national law; although, a minimum standard is generally maintained on a number of issues, in particular related to CLS.⁵¹

...and also the public procurement policies of some DFIs now include labour provisions.

Labour concerns have also made inroads into the public procurement policies of various DFIs. Since 2007, the World Bank (IBRD and the IDA) require bidders to comply with the ILO CLS as well as a number of other labour standards.⁵² This policy applies to all contracts exceeding a value of US\$ 10 million dollars (World Bank, 2007). ADB joined the harmonized standard bidding practices in 2005. Also, the AfDB and EBRD have harmonized their public tender practices with that of the World Bank's public arm (EBRD, 2009). In this case, contractors must sign a declaration that they will respect the CLS when carrying out these projects. Some commentators expect other DFIs and development agencies to adopt, at some point, conditions similar to the Standard Bidding Practices of the World Bank's IBRD and IDA (Bakvis and McCoy, 2008).

2. How are DFI labour provisions implemented?

Labour provisions in DFI investment policies often involve comprehensive implementation procedures...

While the details of the DFI policies differ with regard to their implementation, they are typically based on an initial social assessment of the proposed investment. If problems in relation to labour practices are identified, they may be addressed through an action plan.⁵³

One of the most comprehensive procedural frameworks for DFI policies has been developed by the IFC.⁵⁴ First, an initial environmental and social assessment must be conducted by the client company. If potential risks of problems regarding compliance are identified, the client company will develop an action plan designed to avoid, or at least mitigate, the impact on labour conditions. The IFC will take this action plan into account when conducting its own social assessment, which includes consultations with NGOs and unions. Finally, in the event of compliance difficulties, the IFC will (in extreme cases) reject the project or require the company to address these issues, often in combination with technical assistance for the

51. As regards freedom of association, a special approach is often applied. Where national law directly contradicts international standards (for example, by prohibiting workers from forming unions), many DFI policies require their clients to adopt parallel procedures to enable the workers to benefit from international standards as far as possible.

52. To date, the IBRD and IDA have not yet adopted a policy for screening projects with regard to labour issues.

53. In many cases, the DFI policies include a clause requiring clients to comply with the DFI's labour policy in general, as well as specific requirements in the form of an action plan to be met by the client, based on the initial social assessment. Some DFIs, including AfDB and ADB, and EIB focus exclusively on the latter requirement (see for example AfDB (2003) and ADB (2007)).

54. Unlike earlier environmental and social policies, the IFC not only submits its client company to an auditing procedure prior to the investment, but works with the client company to ensure compliance throughout the life of the investment (Warner, 2006).

Box 3.2 Implementation of labour provisions in indirect DFI investments

Investments conducted through financial intermediaries (i.e. another bank) or funds may complicate the application of labour provisions in DFI policies. The link between the DFI and the company concerned, in such circumstances, is more remote than in the context of direct project finance. Here, DFIs usually require their financial intermediary or fund to have a social management system in place to ensure that the projects or companies of their portfolio comply with the specified level of protection in terms of labour standards. The IFC applies a three-tier approach in this regard. The precise standard of protection depends on the initial social assessment. While financial intermediaries with low-risk portfolios only have to apply an exclusion list, portfolios with a medium-risk factor require the financial intermediary additionally to ensure the application of national law. In cases of a high-risk portfolio, financial intermediaries also apply the IFC Performance Standards (IFC, 2009).

Similar approaches are used by the British CDC and the Swiss SIFEM, which engage primarily in fund-of-fund investment. Funds that receive finance from one of these two DFIs are required to ensure that the funds' client companies comply with the DFIs' labour policies, mainly by means of a social management system to be established by the funds. In both cases, fund managers are required to report regularly on specified labour issues concerning their portfolio in annual social and environmental reports. In addition to on-going fund manager monitoring, these DFIs also carry out selective on-site visits.

company. Similar procedures are also followed by the other DFIs, which have integrated labour concerns into their investment policies.

Given that projects often receive finance from more than one DFI, some DFIs have started to coordinate their policies, including the social requirements to be met by the client. Often, DFIs that co-finance a given project agree on joint environmental and social (E&S) requirements. A response to the need for coordination can be seen in the creation, in 1992, of the Association of the European Development Finance Institutions (EDFI), to which 16 bilateral DFIs subscribe at present.⁵⁵ In May 2009, EDFI members signed a declaration on "Principles for Responsible Financing", which commits members to working with client companies in order to progressively realize the standards contained in a number of international instruments, including ILO Fundamental Conventions (EDFI, 2009).⁵⁶ Since 2007, the EDFI has also adopted "Harmonized Environmental, Social, and Governance Standards" (EDFI, 2009). While not harmonizing the content of the labour provisions in DFI policies, these Standards do contain Social Category Definitions, and certain technical standards for social due diligence, social contractual requirements as well as an exclusion list for joint investment projects. Often, DFIs which co-finance a project also coordinate their responses if problems arise regarding the labour provisions. These arrangements can be seen as an important step towards providing some coordination between DFI policies on labour and other social concerns.

...and a number of DFIs provide a review mechanism for labour issues.

A number of DFIs have also put in place specific review mechanisms to protect third parties from potentially harmful consequences of their operations, often in

55. See at: <http://www.edfi.be/>.

56. Other instruments are the UN Declaration of Human Rights, the IFC Performance Standards and the IFC's Environmental and Health & Safety Guidelines (EDFI, 2009).

the context of specific safeguard policies. These policies typically allow the affected parties to bring their concerns before a committee that is formally independent from the operational part of the DFI and reports directly to the DFI's highest body. The review body usually works with both parties to resolve the dispute and may recommend amendments to the DFI's policy or offer redress if problems are identified. Most bodies not only provide a forum for addressing complaints, but may also independently examine whether a DFI has complied with its internal policies and may promote dialogue between the DFI and the affected group.⁵⁷

The first DFI to put a safeguard policy into place was the World Bank in 1994 (Brodnig, 2005). Other DFIs, such as IFC, the EBRD and the EIB, have developed this approach further by also applying safeguards to their labour policies. The AfDB allows for review of gender issues (Rees and Vermijs, 2008). The EIB Complaints Mechanism is particularly comprehensive. Here, individuals may make a submission to the EIB's internal complaints office, but may also have recourse to the European Ombudsman (an independent EU institution) if they consider the reply from the complaints office to be unsatisfactory (EIB, 2008).

While little is known about the application of those policies in practice...

Very little is known about the practical application of labour provisions in the policies of DFIs, as much of the information is confidential and the recent nature of such policies makes it premature to conduct a comprehensive assessment. Among the DFIs, documentation on the application of labour provisions is most advanced in relation to the IFC Performance Standards. Some preliminary insights can, for example, be drawn from the IFC's report on their first three years of implementation of the Performance Standards (IFC, 2009), as well as a trade union assessment of the IFC Performance Standards (Global Unions, 2009).

...some advances seem to have been made regarding the IFC Performance Standards...

Since the IFC Performance Standards entered into force, 21 submissions have been filed by trade unions, involving two requests for information and 19 reports of alleged breaches of IFC Performance Standards. Table 3.14 provides an overview of recent cases dealt with under the Performance Standards between July 2006 and August 2009. The IFC has reacted with enhanced monitoring and capacity building activities for finance recipients and has, in some cases, achieved positive changes through direct interventions. In a few cases, a project was suspended after the circumstances of the complaint were investigated.

In a case concerning a Brazilian airline, the IFC helped to end anti-union activities (Bakvis and McCoy, 2008). In a similar case involving a Ugandan construction union, the IFC's intervention was instrumental in making the company apply a collective agreement (Murie, 2009).

Based on a review of existing cases, a case study in Turkey and one in Uganda, respectively, Bakvis and McCoy (2008), Agtas (2009) and Murie (2009) respectively see potential in the Performance Standard 2 to positively influence the situation of workers. However, the consideration that the IFC relies to a large extent on the borrowers' self-assessment and consultants has led some to argue that the IFC Performance Standards are effective mainly in cases where local unions are

57. See, for example, IFC Compliance Advisory Ombudsman (2007).

Table 3.14 Submissions regarding breaches of the Performance Standards filed with the IFC by trade unions between July 2006 and August 2009

Type of submission	Freedom of association	Child labour	Others	Total*
Total number of cases submitted by trade unions to the IFC				21
Number of requests for information				2
Number of registered complaints	17	3	4	19
Intervention undertaken by IFC				
Additional capacity building or monitoring provided	5	–	–	5
Project suspended or not pursued	2	1	–	2
Correction of alleged violations due to IFC intervention	3	–	1	4
Company bankrupt	2	–	–	2
No breach found by IFC	4	1	1	6
Pending	3	1	1	3

Note: * Due to the complexity of the problems at stake, some of the cases submitted to IFC involve several allegations, which have triggered different interventions by IFC. The total number of the interventions undertaken by IFC does therefore not coincide with the total number of the cases submitted.

Source: Global Unions (2009).

present and are able to monitor the workers' situation (Bakvis and McCoy, 2008). Moreover, when these local unions are linked to global unions, they can further inform the IFC and provide more detailed information regarding implementation (Agtas, 2009). It should be mentioned, however, that trade unions are less involved in the implementation of other DFI policies.

...which may be partially attributed to positive effects arising from capacity building provided by the IFC to its staff...

The IFC has hired staff to implement its environmental and social policy, including a number of labour specialists (IFC, 2009, p. 12), totalling 62 staff members in 2009, and has established a Labour Advisory Group. Also, strong emphasis was put on familiarizing the IFC's own staff with the Performance Requirements. More than 1,600 staff members received face-to-face training on the IFC's Performance Standards, while 192 participated in an online training course on the IFC's E&S management. Furthermore, beyond the initial assessment, 17 projects were subject to a comprehensive labour audit. The IFC also has a number of tools for internal review in place, which seek to assess and gradually improve the IFC's E&S performance, such as an Environmental and Social Review Procedure and a Quality Assurance and Control System (IFC, 2009, p. 7).⁵⁸

These observations reinforce the view that capacity building is an important component in enabling staff to ensure that internal compliance with labour provisions is truly effective and sustainable.

58. Furthermore, a number of DFIs, including EIB, Norfund, and SIFEM have trained their staff on issues related to labour standards in collaboration with the ILO or the ILO's Turin-based International Training Centre.

...and, so far, there is limited evidence of negative economic repercussions of labour provisions in DFI policies.

Aside from the impact of DFI labour policies on workers, the question of their effect on client companies also arises. In an IFC survey, it was found that the Performance Standards are largely acceptable to IFC's clients. According to this survey, while 60 per cent of the respondents believe that costs under the Performance Standards are higher than in the average sector, only 21 per cent of the respondents consider that the Performance Standards might negatively affect their decision to collaborate with the IFC. For IFC investments through financial intermediaries, the number of respondents that share this latter perception is even lower (15 per cent). By contrast, 60 per cent of the financial intermediaries responding to this study consider that the Social and Environmental Management System that the IFC requires them to put in place has positive implications for their brand reputation (IFC, 2009, p. 22).

Insights may also be gained from the Equator Banks, although they are outside the scope of this study. The preliminary evidence regarding the business impact of the Equator Principles indicate that they have not negatively influenced the business relations of the banks adhering to the Principles. As Sims (2008) notes, the number of banks adhering to the Equator Principles continued to grow after the Equator Principles were revised so as to align with the IFC's enhanced Performance Standards in 2006. Further, Scholtens and Dam (2007) find that the adoption of the Equator Principles has not led to negative reactions by the banks' shareholders. However, Sims (2008) observes a drop in the percentage of the proceeds of the DFI project advisers (mandated arrangers) covered by the Equator Principles since 2006. This suggests that adopting the Equator Principles entails certain additional costs (Scholtens and Dam, 2007), which are, however, for a number of banks outweighed by the expected enhanced reputation (IFC, 2007; Sims, 2008).

Conclusion

The potential of labour provisions in trade arrangements and development finance policies to contribute to the social rebalancing of the global economy relies upon how these mechanisms are applied in practice. As yet, relatively limited information is available regarding the implementation of these labour provisions. In general, it would appear that both elements of conditionality and "soft" persuasion and capacity building, have a role to play, depending on the extent to which compliance problems are due mainly to lack of political will or lack of capacity. In the case of trade arrangements, incentive-based clauses in particular offer considerable potential. As regards labour provisions in DFI policies, the cases examined thus far indicate the importance of providing staff, loan recipients and other clients with training, technical guidance and support.

The multiplication of labour provisions has implied that different actors may be subject to a number of standards that differ in part from each other. To address the need for coordination between their different labour provisions and other issues, sixteen European DFIs have created the EDFI. Countries could consider similar mechanisms to coordinate the labour provisions in their trade agreements, particularly in cases where different provisions may be applied simultaneously to

the same affected country. Furthermore, labour provisions in trade arrangements and DFI policies increasingly refer to the ILO Declaration of 1998 (ILO, 1998) and, to a lesser extent, to the ILO Fundamental Conventions. That said, not all of the mechanisms which refer to ILO instruments necessarily incorporate all labour standards contained therein.

Consultation with, and involvement of the social partners and domestic civil society has contributed toward improved design and implementation of these mechanisms in many cases. Such experiences suggest that participation of these social actors in earlier stages of the procedure may contribute toward effective implementation, as well as alleviate concerns regarding a potential lack of transparency in procedures undertaken. A clear procedural framework for dealing with disputes also could further strengthen the implementation process.

The discussion in this chapter has shown that the use of labour provisions has grown and evolved in trade agreements and policies of DFIs. Such measures offer important potential to improve working conditions and worker rights. However, their broader effectiveness can only be assessed on the basis of implementation and impacts. Furthermore, such measures rest upon elements such as credible monitoring and a multi-faceted approach.

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Green policies and jobs: A double dividend?*



Main findings

- According to the international scientific community, climate change induced by rising greenhouse gas emissions represents a major threat to sustainable development and living standards throughout the world. The costs associated with climate change are likely to affect negatively economic growth, especially in developing countries. Environment experts stress that arresting climate change requires a 50 per cent reduction in global CO₂ by 2050.
- The employment challenge associated with the goal of cutting CO₂ emissions is significant. This chapter estimates that employment in high carbon intensive sectors account for about 38 per cent of jobs across the world.
- However, the move to a low-carbon economy also presents major employment opportunities, by opening new markets, and by stimulating eco-innovation and investment in more efficient production techniques. Moreover, “green policies” such as carbon taxes or cap-and-trade schemes would generate government revenues, which could be used to reduce labour taxes, in turn stimulating labour demand.
- The chapter shows that if a price on CO₂ emissions was imposed, and if the resulting revenues were used to cut labour taxes, then employment would rise by 0.5 per cent by 2014. This is equivalent to over 14.3 million net new jobs for the world economy as a whole, which would help meet the employment challenges identified in Chapter 1. These results, which are consistent with evidence from other studies, rest on the assumption that green policies are adopted in a coordinated manner.

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- Importantly, these gains require the right policies to be in place. Jobs and enterprises will be lost in some sectors, and new jobs and business opportunities will emerge in other sectors. Likewise, new skills need to be developed in conjunction with the transition to a low-carbon economy. Furthermore, developing countries require support to address a challenge associated with an environment problem of which they are the innocent victims. Green policies are likely to have adverse effects on inequality, as the rise in the price of energy and of energy-intensive consumption goods may impact disproportionately on low-income households. This is why the Global Jobs Pact, implemented hand-in-hand with green policies, is so crucial.

Introduction

There is growing international awareness of the need to arrest climate change, in order to put the world economy on a more sustainable track. Already, as part of packages to overcome the global crisis, countries have launched infrastructure investments designed to promote transitions to a greener economy. Such efforts would at the same time serve social objectives to the extent that spending on green projects promotes recovery and job creation. They would help reduce the length of the labour market recession as described in Chapter 1.

Beyond stimulus measures, there arises the issue of whether “green” policies can possibly produce a double dividend, in terms of both environmental and social goals. Some argue that world output and employment will be adversely affected by policies that make carbon gas emissions costly. Certain groups may bear the brunt of the adjustment process; and individual countries, when acting in isolation, may face competitiveness constraints. There would thus be, the argument goes, a trade-off between environmental and social goals. However, policies to address climate change also create new opportunities to grow and prosper. Much also depends on the way these policies are designed and implemented (Torres, 2008).

It is therefore important to gauge the pros and cons of the different arguments so as to assess the employment and distributional effects of green policies. This is the purpose of this chapter. It presents a novel attempt to estimate the employment dynamics related to shifting to a low carbon intensive economy and implementing green policies.¹ This analysis is based on an empirical methodology and data developed specifically for the purposes of this *World of Work Report*. The aim is to show how well-designed climate and labour market policies can contribute to realizing a double dividend.

The chapter is organized as follows. Section A provides an attempt to quantify the employment challenge arising from the urgency to curb CO₂ emissions. Section B evaluates the employment impact of different green policy options, making use of a novel analytical tool developed for the purpose of this chapter. Section C concludes and offers further directions for research in this area.

1. Earlier work includes the report *Green jobs: Towards decent work in a sustainable, low-carbon world* (UNEP/ILO/IOE/ITUC, 2008).

A. The employment challenge: Assessing employment in high carbon intensive sectors

This section provides background information on trends in CO₂ emissions. It also assesses the size of the employment challenge that mitigation policies would entail.

By 2050 CO₂ emissions need to be reduced by half compared to 1990 levels²

Economic activity requires the use of energy, which given today's technologies is largely derived from carbon-based fossil fuels which emit CO₂ into the atmosphere during their combustion. Since the onset of industrialization, CO₂ emissions have increased steadily, but the rate of increase has been accelerating since the middle of the twentieth century. Currently, the total global volume of CO₂ emissions is 88 per cent higher than in 1970 and 30 per cent higher than in 1990. CO₂ emissions make up almost 73 per cent of the total greenhouse gas emissions (CAIT, 2009).³ Estimates suggest that the European Union (EU), the United States and, more recently, China are the main emitters, generating altogether over half of world CO₂ emissions.⁴ To address climate change, by 2050 global CO₂ emissions⁵ need to be reduced by half compared to 1990 levels (IPCC, 2007).⁶

Nearly 40 per cent of all jobs worldwide are in high carbon intensive sectors

Figure 4.1 shows that the emission intensity of economic activity has tended to decline over the past two decades. This trend suggests that resources have started to move away from high carbon intensive sectors. But additional efforts are needed to meet the reduction targets for GHG emissions. This will inevitably create an employment challenge as workers will have to move to different jobs, firms or sectors.

To assess the size of this challenge, the incidence of employment in high carbon intensive sectors has been estimated based on an input–output methodology that classifies sectors according to the volume of CO₂ emissions (Appendix A).

2. IPCC, 2007.

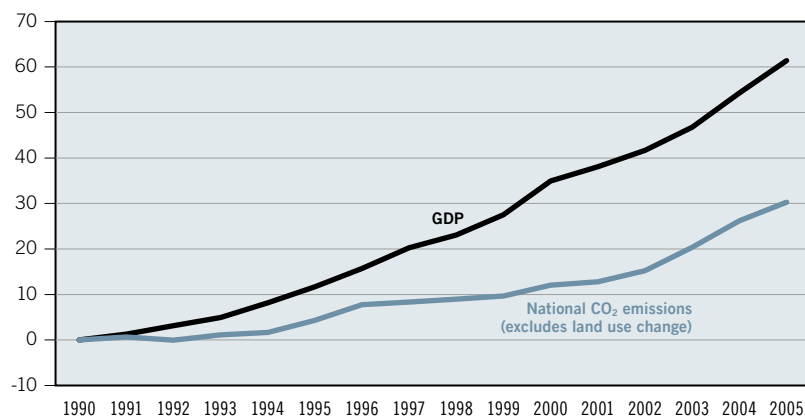
3. Carbon dioxide (CO₂) is not the only GHG, but is by far the most important one. Other GHGs include methane (17 per cent), nitrous oxide (8.7 per cent), perfluorocarbons (0.3 per cent), hydrofluorocarbons (1 per cent) and sulphur hexafluoride (0.2 per cent). Numbers have been rounded.

4. There does not seem to be a correlation between the total emission and the emission intensity for major economies as CO₂ intensity has decreased over time (although this trend does not apply for least developed countries). For instance, in the United States, CO₂ intensity decreased by 23 per cent between 1990 and 2005 while total emissions increased by 20 per cent over the same period. In contrast, in the EU-27, both emission intensity and total emissions have fallen since 1990, by 28 per cent and 2.4 per cent, respectively.

5. The contribution of different types of gases to the effective concentration of greenhouse gases is measured in terms of CO₂-equivalent (CO₂-eq). For instance, methane – arising from organic fermentation among other sources – is considered to contribute less (in absolute terms) to climate change, even though it constitutes the third most important GHG in the atmosphere.

6. By 2020, GHG emissions from developed countries would need to be between 25 per cent and 40 per cent lower than in 1990 in order for the stock of CO₂ in the atmosphere to be stabilized at either a low or an intermediate level. By 2050, emissions from developed countries would need to be cut to between 80 per cent and 95 per cent below 1990 levels. Similarly, by 2050, GHG emissions from developing countries would be allowed to grow. However, emissions must be between 10 per cent and 30 per cent below levels of emissions corresponding to business as usual scenario.

Figure 4.1 World trends of GDP and CO₂ emissions (percentage growth from 1990)



Source: Climate Analysis Indicators Tool, version 6.0 (Washington, DC: World Resources Institute, 2009).

Based on this methodology, it is estimated that about 38 per cent of workers in the world are employed in high carbon intensive sectors, accounting for about 600 million workers (table 4.1). The incidence of employment in high carbon intensive sectors is lower in emerging economies and developing countries than in advanced economies. This difference reflects the fact that the agricultural sector – which accounts for a larger share of total employment in emerging and developing countries than in developed ones – is classified as low carbon intensive compared to other sectors.

Table 4.1 Employment in high carbon intensive industries (2005)

	% of total employment	Number of jobs (millions)
Nine developed countries	56.9	192
Brazil, China and India	32.8	392
Total	38.2	584

Note: The total is the sum of both categories: Brazil, China and India; and nine developed countries (Australia, France, Germany, Hungary, Japan, Republic of Korea, Sweden, the United Kingdom and the United States)

Source: IILS estimates based on input-output tables (see Annex A).

B. The employment potential: Estimating the effects of green policies on jobs

Alternative green policy options

The main policy options for cutting GHG emissions are: more restrictive standards; reduced subsidies for fossil fuels energy consumption; setting a price on CO₂ emissions (via cap-and-trade or carbon taxes); investment in R&D to develop energy-saving or carbon capture and storage technologies. It is often argued that carbon taxes and cap-and-trade schemes are the two main policy levers for the short term. Both policies aim at internalizing the costs of carbon emissions for society within the decision-making processes of enterprises and consumers (see box 4.1).

Box 4.1 Carbon taxes and cap-and-trade schemes

In principle, the environment is a public good with free access. As such, its use is not properly reflected in market prices and it tends to be depleted (the so-called “tragedy of the commons”). To correct this externality, the carbon tax is one possible way of pricing carbon emissions in order to give appropriate market signals that reflect the costs that GHG emissions impose on society. Setting a price for using fossil fuels will change incentives in the economy. Alternatively, tradable emissions permits fix the maximum level of emissions (the “cap”) and issue allowances into the economy that can be freely traded among private polluters. Here, the maximum level of pollution is decided by the government, and then the permits are distributed among firms, redefining their rights to pollute.

Both schemes may counteract the externality generated by GHG emissions by putting a price on carbon, thereby generating incentives to switch to alternative energy sources and adopt green technologies. However, their implementation requires information on emissions, and adequate mechanisms for monitoring and enforcement (Pew Center on Global Climate Change, 2009).

Some economists argue that a carbon tax is preferable to a cap-and-trade scheme (see Nordhaus, 2008; Nell et al., 2009; Uzawa, 2003; Mankiw, 2007; IPCC, 2007). In their view, cap-and-trade schemes come with several shortcomings. Tradable permits require that the actual polluter can be identified, and enforcement of the cap-and-trade scheme is difficult as trading systems have to be set up. In addition, trading of emission certificates is exposed to speculative investments, which can cause high volatility in the carbon price, as the European example shows. According to an estimate by Nell et al. (2009), the volatility of the carbon price, in the case of emission trading, is ten times higher than for stock prices, which are already about seven times more volatile than GDP. Instead, a carbon tax allows for a broader application, including energy supply, major polluting industries, the service sector, the transport system and households. Furthermore, the generated tax revenue can be used to reduce other taxes or to establish tax funds to compensate developing economies, or it can be spent on climate-friendly investments.

From a longer-term perspective, it is crucial to invest in R&D to develop new technologies. As emphasized by the Intergovernmental Panel on Climate Change, policies should gradually shift towards encouraging investment in R&D spending and technology transfer, in particular regarding the development and diffusion of alternative sources of energy, such as solar, tidal and wind power and biomass energy.

So far, green policies in developed countries have concentrated on introducing carbon taxes or implementing cap-and-trade schemes, while some efforts have also been made to prop up R&D spending, subsidize solar panels and other renewable sources of energy, and set new international standards. In developing countries, governments are less advanced in shifting towards green policies, partly due to a lack of investments, resources and technology. But even here, many countries are starting to switch to a greener economy, for instance through recourse to the Clean Development Mechanism (CDM) – an arrangement where developing countries (not included in the main targets associated with the Kyoto Protocol) will benefit from funding from developed countries for green projects. Thus, Argentina, Brazil, China and India use CDMs. In Indonesia, the government proposes a gradual reduction of fossil fuel subsidies, the possible introduction of a carbon tax, better use of the CDM programme and raising consumer awareness.

Earlier evidence suggests that green policies could be either neutral or favourable to employment...

It is sometimes argued that green policies could raise costs of goods, thereby threatening labour demand and living standards. However, green policies can also help to create new markets and unlock the development potential of entire regions and countries. As with any other structural change, the transition to a greener economy will be more or less successful depending on the particular country's characteristics, such as the labour intensity of adversely affected sectors, the matching between workers' skills and the new job requirements, the speed of technology diffusion and the availability of well-designed labour market policies to support workers and businesses in their move to a greener economy.

Advocates of green policies assert that environmental regulation could stimulate eco-innovation and investment in more efficient production techniques and so positively impact on employment. At the moment, enterprises are starting to see the potential of new climate-friendly markets (see, for instance, European Commission, 2005). Empirical studies also seem to confirm that the adverse effects on the economy are probably very limited. Several studies suggest that there is no loss of jobs or decline in output following the introduction of carbon taxes. Some of the studies take into account the scenario in which the revenues from the tax are redistributed, for example through a reduction in labour costs. The development of environmental technology, in and of itself, may have a positive impact on job creation.⁷

Overall, a majority of studies find that the net impact of environmental policies on employment is likely to be neutral or slightly positive. However, the distributional effects of these policies are less clear cut (see Appendix B for an overview of existing studies in this area).

...and this is confirmed in this study: green policies, even without technological change, could raise employment by between 0.5 per cent and 1.1 per cent in a period of five years...

The extent to which green policies affect the labour market also depends on how the additional resources that arise from taxing or pricing carbon emissions are used. In several countries, the additional public revenues generated by these policies have been used to target particular groups, with the aim of generating additional employment and offsetting the initial job destruction associated with sectoral adjustment. Properly designed green policies could help to achieve the double dividend of both lower GHG emissions and higher employment. In particular, policy-makers have two broad options for how best to make use of the additional resources. They could support (i) (low-wage) employment or (ii) specific low-carbon industries. An attempt has been made to quantify the employment effects associated with these two options based on a model for nine countries, specifically developed for the purposes of this chapter. In this model, the effect of putting a price on carbon emissions is modelled. The price can take the form of either a carbon tax or a cap-and-trade scheme. Though there are differences

7. Subsidies also have an important role, but they need to be applied cautiously. For instance, supporting biofuels contributes to energy security and rural employment (De la Torre et al., 2009), but careful cost-benefit assessment is needed given the potential effects of biofuel production on food prices and competition for land and water.

between these two instruments, the model does not examine them in any detail. The results are as follows (see Appendix C for more details).

In order to illustrate the employment impacts of the two different policy options, a baseline scenario – where the revenues arising from carbon taxes or tradable permits are not used for other purposes – is developed. In this baseline scenario, carbon taxes or tradable permits raise the costs for producing high carbon intensive goods and services. Their introduction will affect production in high carbon intensive sectors, thereby creating incentives for a shift of resources to low carbon intensive sectors or the adoption of low carbon intensive technologies.⁸ The baseline scenario considers that: (i) high carbon intensive sectors have to pay the equivalent of 30 euros per ton of carbon emitted for a period of five years (for instance, in the form of a green tax). This payment comes close to the carbon tax level that is typically proposed in current debates and represents the equivalent of 2.5 per cent of the output of high carbon intensive sectors; and (ii) the revenues arising from this measure are kept by government in full (that is, these revenues are not spent in the form of tax reductions for low carbon intensive sectors, cuts in social contributions or other measures). Therefore, the government's primary surplus increases. But, in this baseline scenario, there is no consideration of any macroeconomic implications that this surplus may have. The main result is a decline in both total and sectoral employment in the baseline scenario, reflecting the fact that the policy merely taxes some sectors without any compensatory measures. Note that employment declines even faster in the low carbon intensive sector than in the high carbon intensive sector, which is due to a lag in the adjustment process.

A different employment outcome occurs when the increase in public revenues from taxing the high carbon intensive sector (or from selling pollution rights) is used to promote employment by cutting social contributions, as has been done in Germany and Sweden. In this case, high carbon intensive sectors still face higher production costs. However, in this scenario, the adverse consequences for employment are outweighed by support for labour demand. This is why in this scenario, employment rises in all sectors (table 4.2, second row). More than 1,700,000 jobs are created in the OECD-9 region over a period of five years. Employment gains are three times larger in the low carbon intensive sectors than in the high carbon intensive sectors when revenues are redistributed in the form of employment subsidies. This is probably because the employment content is higher in the low carbon intensive sectors than in the high carbon intensive sectors.

As an alternative, and with the aim of strengthening the incentive to reduce GHG emissions, policy-makers might also think of subsidizing particular low carbon intensive industries. Such industries could be targeted according to their job creation potential. Compared with the previous case, subsidizing green sectors adds a direct incentive to the production of low carbon intensive goods and services. The outcomes of this simulation are shown in table 4.2 (third row). Subsidizing green sectors appears to yield the best results from the point of view of employment. Employment in the low carbon intensive sectors grows by more than 1.8 per cent. Employment in the high carbon-intensive sectors also increases,

8. The simulation assumes that the high carbon intensive sector pays to pollute – either because CO₂ emissions are taxed or because polluters have to obtain pollution rights. Such a simulation differs slightly from standard experiments, where other sectors also have to pay to pollute. In other words, for the purposes of the simulations in this chapter, a “subsistence level” of carbon may be emitted without being subject to payments. This subsistence level applies to all the sectors other than high carbon intensive sectors.

Table 4.2 Estimated impacts of green policies on employment in nine countries (percentage change in employment five years after application of the green policy)

	Employment in high carbon intensive sectors	Total employment
No compensation (baseline scenario)	-0.5	-0.5
Green policy with employment subsidy	0.3	0.5
Green policy with industry subsidy	0.5	1.1

Note: The table presents (i) simulations (based on a vector autoregressive model) of the possible employment effects of different policy options, based on a model for nine countries (Australia, France, Germany, Hungary, Japan, Republic of Korea, Sweden, the United Kingdom and the US); and (ii) projections for developed countries and the world as a whole based on the simulations. See Appendix C.

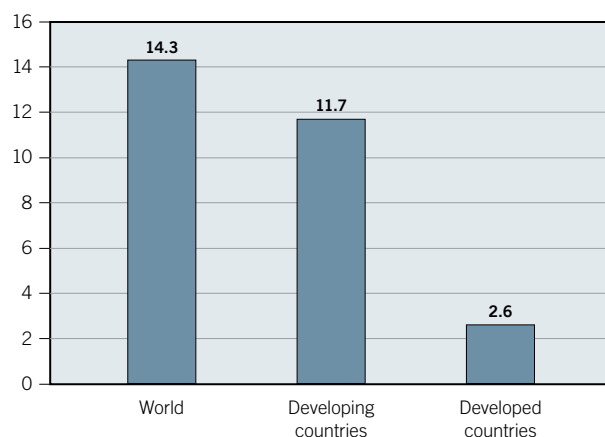
Source: ILS estimates.

by 0.5 per cent, despite the negative impact of the green policy on this sector. A possible explanation is that both sectors are complementary to some extent and that the growth of the low carbon intensive sector has a positive spill over effect on the high carbon intensive sector. Overall, 3.9 million jobs may be created for the nine countries altogether.

...this means that green policies, if combined with job support, could help raise employment by 2.6 million in developed countries and 14.3 million for the world as a whole.

A projection of these results for all OECD countries and for the world economy implies up to 2.6 million and 14.3 millions new jobs, respectively (figure 4.2). These results come close to those of three other major empirical studies, both in terms of CO₂ emission reductions and employment increases (table 4.3). The employment gains arise mainly because the funds raised by environmental policies are used to cut non-wage labour costs, thereby supporting labour demand. More fundamentally, as a result of green policies, relative prices change in a direction that supports employment. Consumers substitute, to a certain degree, low carbon intensive goods for high carbon intensive goods in the face of higher prices for the latter. Similarly, enterprises substitute capital for labour. It is often

Figure 4.2 Well-designed green policies will boost employment (change in net employment, in millions, within five years)



Note: The figure shows the projected impact on employment of green policies combined with lower labour taxes (see text for more explanation). The growth rate of employment estimated for developed countries was extrapolated to total employment worldwide.

Source: ILS estimates.

Table 4.3 Employment effects of green policies with employment subsidies: Outcomes from different studies

	Period of change, years	Increase in employment %
IILS (nine developed countries)	5	0.5
HERMES (EU-6)	8	0.6
QUEST (EU)	20	1.3
PANTA RHEI (Germany)	11	0.6

Note: The QUEST model discusses three different cases depending on which economic instrument bears the higher tax burden. This table presents the outcomes of the third case, in which households pay the carbon tax and accept wage moderation.

Source: IILS estimates for the IILS model; Bossier et al. (1993); Hayden (1999); Bach et al. (2002).

assumed that energy and capital are two complementary factors of production. The rises in energy price mechanically increase the cost of capital relative to the cost of labour.

In the empirical study carried out for this chapter, the simulation corresponds to a decrease in CO₂ emissions by 4.6 per cent for the nine-country sample (table 4.3, entry IILS). The employment effect in the scenario with employment subsidies is an increase of 1.1 per cent when aggregating countries and sectors. This result falls within the range of the estimates produced by other studies (see box 4.2). Assuming a linear effect, our results can be extrapolated to be compared with the results of the other three studies. The results from our study show that a decrease in CO₂ emissions of 2 per cent would produce a 0.5 per cent increase in employment, which is lower than the 0.6 per cent found by the PANTA RHEI model. The employment effect measured in our study is, however, larger than for the HERMES and QUEST models. A 4.4 per cent decrease in CO₂ emissions would produce a 1 per cent increase in employment, whereas the HERMES model predicts a 0.6 per cent increase in employment; and an 8 per cent reduction in CO₂ emissions would produce a 1.9 per cent increase in employment, but the QUEST model predicts a 1.3 per cent increase in employment. Such a comparison must, however, be viewed with caution as the methodologies implemented and the country coverage differ between studies.

And larger gains would arise due to technological change induced by green policies

A final option consists of using the additional public funds, raised by green taxes, to foster technological research, especially in the area of promoting green energy production. Such policies bear the potential to increase growth, for instance by lowering the future price of energy production in comparison with the current mix of energy technologies. Indeed, considering that the price for energy production based on non-renewable energy sources is likely to increase exponentially (the oil price hike observed in 2008 is probably a first indication of potential future price increases), the relative price for green energies can be expected to fall in the future. As mentioned by Tylecote (1997), the scarcity price for non-renewable energies could be reflected by the use of carbon taxes or cap and trade. Similarly, removing subsidies for fossil fuel energy will increase the expected returns from R&D in green technologies (OECD, 2009).

Box 4.2 Employment effects of green policies combined with lower labour taxes: Results from three studies

Three major studies, based on econometric models, have examined the employment effects of green policies and their findings come close to those presented in this chapter.¹ All three models are demand driven and allow for the possibility of unemployment as a result of adjustment processes, and each includes a wide range of sectors. They are therefore particularly useful for examining the inter-sectoral adjustments generated by climate change policies.

The HERMES model includes eight sectors and covers the EU (Bossier et al., 1993). A key finding is that a reduction of CO₂ emissions by 4 per cent via tax instruments increases employment by 0.6 per cent over a period of eight years. The result is driven by factor substitution between labour and capital. Labour demand is supported by both higher energy prices (which increase the cost of capital relative to labour) and lower labour taxes.

The QUEST model assesses the employment effect of reducing CO₂ emissions by 8 per cent between 1990 and 2010 in the EU (Hayden, 1999). QUEST shares similarities with the HERMES model, but there are fewer industries and no energy in the production function. Three scenarios are assessed, based on different sectors bearing the costs of higher energy prices. In the first case, the cost falls on industries. The employment effect is positive but small (+0.1 per cent) and GDP is reduced by 1 per cent. The contraction of output is due to the lower productivity of capital, which brings a contraction of investment. In the second case, the tax burden falls on consumers. The impact on employment is positive, with an increase by 0.9 per cent, and is mainly due to the substitution of capital for labour. The third case assumes a certain degree of wage moderation. The employment effect is the largest, with an increase by 1.3 per cent. Employment is not limited by the rise in wages that takes place in the second case.

The PANTA RHEI model (see Bach et al., 2002) includes 58 industries in Germany. Here as well the revenue from an energy tax is used to reduce labour costs, this time in the form of lower social pension contributions. CO₂ emissions drop by 2 per cent, while employment increases by 0.55 per cent over the period 1999–2010. The substitution effect between capital and labour outweighs the negative employment effect of a contraction in GDP.

¹ See OECD (2004a) for a detailed discussion of the three models.

Existing empirical studies point to the potentially large impact of such an effect. A study by GHK (GHK in association with CE and IEEP, 2007) found that in a scenario of a 10 per cent substitution in electricity generation by renewable energy technologies, the result was an increase of EU-27 output and jobs. The positive impacts are due to the source (sectors) of inputs these new technologies require. However, a global agreement is important due to the uncertainty regarding the profitability of (private) R&D investments. Uncertainty on global commitments will depress R&D investments.

Conclusion

This chapter has argued that the employment challenge arising from green policies might eventually be smaller than critics of such policies argue. Indeed, with the right policy mix and by returning the additional government resources to the economy – ideally in the form of subsidies to low carbon intensive sectors – green policies have the potential to create a double dividend by lowering GHG emissions

and creating employment. This chapter provides a novel attempt to estimate these employment effects. The findings are close to those of other studies – although this chapter is based on a broader range of countries.

The estimated employment gains associated with moving to a greener economy are likely to be a lower bound of the potential benefits of such a policy. Indeed, the estimates presented in this chapter do not take into account the possible technological advancements that might arise from green policies. Technological advancements could bring prices for green energy below those for energy based on fossil fuel combustion, further reinforcing the positive employment spin-offs. More fundamentally, new technology could pave the way for new business and employment opportunities. Further research is needed to assess the potential for green policies to stimulate innovation, new technology and job creation.

More work is needed to improve understanding of the social impacts of different types of green policies. In particular, the international dimensions need to be better understood. The empirical exercise presented in this chapter assumes that green policies are implemented simultaneously across the countries considered. This implies that all the countries implemented green policies at the same time. Therefore, the effects of green policies (with or without offsetting cuts in labour taxes) implemented by one country in isolation have not been assessed. This is a crucial issue. Indeed, there is concern that green policies might be translated into higher prices and a loss of competitiveness, which could result in jobs being reallocated in those countries that do not enforce stringent environmental standards. The issue of whether these concerns are valid, or whether countries can still make employment gains when acting in isolation, requires further analysis.

Also, the distributional consequences of green policies require further analysis. Carbon taxes and energy taxes that raise the cost of high carbon intensive goods are often found to be regressive. Generally speaking, all types of consumption taxes with a flat rate, such as a general sales tax, are regressive since the tax rate applied is not dependent on the income characteristics of the purchaser of the goods. Thus, high-income consumers and low-income consumers both pay the same absolute tax amount for a particular good, which results in lower relative taxation of high-income consumers.

Moreover, it is important to examine in more detail the pros and cons associated with carbon tax and cap-and-trade schemes. In this chapter, the mechanism through which green policies put a price on carbon emissions has not been examined in detail. Further work is important, as carbon tax and cap-and-trade schemes are also likely to have different impacts on growth and employment.

Finally, available research and evidence provide only a very rough picture of the costs of climate change. Estimates of the costs of adaptation to rising world temperature and the consequences this may have for the habitat of people around the world are wildly diverging. Based on current policies and without drastic action, however, one can reasonably expect some climate change to take place over the next few decades. Policy-makers need, therefore, to be able to evaluate these costs in order to make informed choices. This too is an issue requiring further investigation.

Appendix A

Estimating the size of the high carbon intensive sector

Data from German input–output tables for 1995 are used to estimate carbon intensity and employment in 71 sectors. Direct CO₂ intensities (CO₂ in kiloton over output in Euro) are used as a measure for the CO₂ intensities of sectors. Total CO₂ intensities could be used as an alternative criterion for classification. Total CO₂ intensities take into account the CO₂ intensities of inputs used in the production process.⁹ To calculate total intensities, it is necessary to estimate CO₂ intensities of inputs used in the production process through the Leontief inverse, which is complex. This is why part of the analysis is done with the help of direct CO₂ intensities only. A table with the direct and total CO₂ intensities of different sectors is given below (table 4.4).

The 1995 classification has been compared with a classification based on the 2005 data. Even though the average CO₂ intensity fell for the economy (for example, the median of direct intensities fell from 0.051 to 0.043 kilotonnes CO₂ per million Euro), the ranking remains by and large the same. The year 1995 is therefore used as the base year for the classification of sectors into high and low carbon intensive groups.

For the empirical analysis in this chapter, the “high carbon intensive sectors” comprises those industries that emit more CO₂ in comparison with the other sectors. This includes all the sectors in table 4.4 for which the values are greater than one.

The results of this analysis are as follows. The energy sector (electricity, heat and gas) has the highest carbon intensity, followed by energy-intensive manufacturing sectors such as metals, coke, mechanical wood and paper. At the bottom of the table are service-oriented sectors, such as telecommunications, education, real estate, finance and public sector services, and also manufacturing sectors like medical, precision and optical instruments and electrical machinery and apparatus. Among the services, a high carbon intensive sector is air transport. It should be noted that direct intensities differ considerably from the total intensities. For example, the textiles sector is relatively low carbon intensive if we only look at the direct intensities but it is relatively high carbon intensive when looking at total CO₂ intensities.

Finally, it should be noted that the actual intensity numbers for particular sectors probably differ substantially across countries. This is due partly to the different fuel mixes used and partly to the different technologies employed. However, the ranking of the industries in different countries can be expected to be roughly the same, especially since we only make a binary classification into low and high carbon intensive sectors. A recent study by the OECD finds that the ranking of industries according to CO₂ intensity remains the same among different countries (see OECD, 2003). This seems to justify the choice of using the sectoral decomposition for Germany for other countries as well.

108 9. Total CO₂ intensities are based on the Leontief inverse of the input-output tables.

Table A4.1 Classification of industries by CO₂-output intensity

Industries	CO ₂ -Output Intensity (as a ratio to median intensity)	
	Direct	Total
Agriculture	3.1	1.1
Forestry	4.5	1.0
Fishing	2.0	1.1
Mining and quarrying	3.5	2.0
Mining of coal and lignite; extraction of peat	3.7	2.5
Extraction of crude petroleum and natural gas and services	1.2	1.1
Other mining and quarrying	6.7	2.2
Food and beverages	1.8	1.3
Tobacco	0.7	0.9
Textiles	0.7	1.6
Wearing Apparel, Dressing And Dying Of Fur	0.2	1.0
Leather, leather and footwear	0.3	1.0
Wood and of wood and cork	1.0	1.2
Pulp, paper and paper	3.5	4.2
Printing, publishing and reproduction	0.7	0.9
Publishing	0.7	0.6
Printing and reproduction	0.7	1.2
Coke, refined petroleum and nuclear fuel	16.5	4.5
Chemicals and chemical	3.0	2.2
Pharmaceuticals	3.0	2.2
Chemicals excluding pharmaceuticals	3.0	2.2
Rubber and plastics	0.7	1.2
Other non-metallic mineral	9.2	2.6
Basic metals	10.9	5.3
Fabricated metal	1.0	1.6
Machinery, nec	0.5	1.0
Office, accounting and computing machinery	0.2	0.6
Electrical machinery and apparatus, nec	0.5	0.9
Radio, television and communication equipment	0.5	0.8
Medical, precision and optical instruments	0.5	0.7
Motor vehicles, trailers and semi-trailers	0.6	1.1
Other transport equipment	0.7	1.3
Manufacturing nec; recycling	1.0	1.2
Manufacturing nec	0.9	0.9
Recycling	4.5	1.5
Electricity and gas	110.8	14.7
Electricity supply	110.8	14.9
Gas supply	110.8	15.0
Water supply	0.6	1.6
Construction	0.9	0.9
Sale, maintenance and repair of motor vehicles and motorcycles; retail sale of fuel	1.1	0.5
Wholesale trade and commission trade, except of motor vehicles and motorcycles	1.6	0.5
Retail trade, except of motor vehicles and motorcycles; repair of household goods	1.8	0.6
Hotels and restaurants	1.1	0.8
Other Inland transport	5.9	2.3
Other Water transport	2.6	1.0
Other Air transport	17.0	3.1
Other Supporting and auxiliary transport activities; activities of travel agencies	2.4	1.0
Post and telecommunications	0.4	0.3
Financial intermediation, except insurance and pension funding	0.3	0.2
Insurance and pension funding, except compulsory social security	0.3	0.3
Activities related to financial intermediation	0.2	0.2
Real estate activities	0.0	0.1
Renting of machinery and equipment	0.2	0.1
Computer and related activities	0.4	0.2
Research and development	0.8	0.6
Other business activities	0.4	0.2
Public admin and defence; compulsory social security	1.4	0.4
Education	0.8	0.4
Health and social work	1.0	0.5
Sewage and refuse disposal, sanitation and similar activities	1.1	0.4
Activities of membership organizations nec	1.0	0.3
Recreational, cultural and sporting activities	0.5	0.3
Other service activities	0.4	0.3
Private households with employed persons	0.0	0.0

Note: A ratio greater than one means that the corresponding industry is relatively carbon intensive.

Source: ILS estimates based on input-output tables.

Appendix B

Selected empirical results of the distributional effects of green policies

Germany

(Bork, 2006)

Regressive effects for a tax on electricity, gas or heating oil (micro-simulation model). The negative effect is amplified by the reduction in social security contributions, as these reductions mostly favour the middle and upper income classes.

Indonesia

(Yusuf, 2008)

Distributional impacts of a carbon tax are progressive in rural areas and neutral or slightly progressive in urban ones (Computable General Equilibrium model). The reduction of subsidies on fuels for transportation has progressive effects.

Ireland

(Scott and Eakins, 2001)

Regressive impact of a carbon tax based on fuel (analysis based on households' purchases of fuel by income level).

United States studies

(Sutherland, 2006)

Regressive effects for both energy efficiency standards and subsidies for energy-efficient investments.

(Grainger and Kolstad, 2009)

Regressive effect for a carbon price due to differences in consumption baskets between income groups (input–output methodology). Polluting goods represent a relatively large percentage of the consumption basket of low-income households.

(Burtraw et al., 2009)

The allocation of revenue from cap-and-trade scheme leads to progressive distribution outcomes, depending on the compensation policies introduced (model of the electricity sector).

Various countries

(OECD, 2004b)

Carbon taxes are regressive in studies for two countries, while other studies lead to more ambiguous results (literature review).

Appendix C

Assessing the employment effects of green policies in nine countries: A vector autoregression approach

The empirical experiment is conducted by making use of the vector autoregression (VAR) technique. A VAR is a statistical method with which multivariate time series data can be analysed. The VAR describes the dynamic evolution of a number of variables from their common history. All variables in the VAR are treated as endogenous and the VAR allows for an analysis of the data without any theoretical priors: the effects of policies are studied solely on the basis of the characteristics contained in the data.

The VAR model comprises: high carbon intensity output ($Out_{hi,t}$); low carbon intensity output ($Out_{lo,t}$); and employment in the two sectors ($Emp_{hi,t}$ and $Emp_{lo,t}$). All variables in the VAR are specified in terms of annual growth rates (i.e. in log-differences) and collected in a vector y_t , defined by:

$$y_t = \begin{pmatrix} out_{hi,t} \\ out_{lo,t} \\ emp_{hi,t} \\ emp_{lo,t} \end{pmatrix} = \begin{pmatrix} \ln(Out_{hi,t}) - \ln(Out_{hi,t-1}) \\ \ln(Out_{lo,t}) - \ln(Out_{lo,t-1}) \\ \ln(Emp_{hi,t}) - \ln(Emp_{hi,t-1}) \\ \ln(Emp_{lo,t}) - \ln(Emp_{lo,t-1}) \end{pmatrix}$$

The first-order VAR looks as follows:

$$y_t = c + Ay_{t-1} + \varepsilon_t$$

y_{t-1} is the vector of the respective growth rates of the four variables in the previous period, c is a constant and the matrix A contains the coefficients which may be estimated from the collected data. ε_t represents a vector of exogenous random shocks that also have an effect on y_t . This formulation provides a tool to study the statistical influences of the previous periods' growth rates of each of the variables on this period's growth rates of each of the variables. In view of the data limitations, higher than first-order VARs cannot be estimated. However, given that data are annual, a first-order VAR should be sufficient for a broad approximation of the employment–output dynamics.

To investigate dynamic dependencies among the variables and to assess the consequences of policy measures, a impulse response analysis is conducted using the estimated model. Impulse response functions generally indicate how the endogenous variables respond to external influences. In a VAR model, where all variables are endogenous, the only external inputs are the disturbances, which amount to one-step-ahead prediction errors. The specificities of the VAR (all variables are endogenous) implies that errors only arise through shocks. Disturbances are “innovations” or “surprises”, such as “policy shocks”, which cannot be explained by the model and past data.

The details of the VAR and key properties of response functions can be found in the Institute's website at www.ilo.org/inst (see “Background material to the Report”).

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