



International  
Labour  
Office  
Geneva

# INTERNATIONAL JOURNAL OF LABOUR RESEARCH



**Financial crises, deflation  
and trade union responses:  
What are the lessons?**

2010 / VOLUME 2 / ISSUE 1

**International Journal of Labour Research**

**2010**

**Vol. 2**

**Issue 1**

Financial crises,  
deflation and trade  
union responses:  
What are the lessons?

INTERNATIONAL LABOUR OFFICE, GENEVA

Copyright © International Labour Organization 2010  
First published 2010

Publications of the International Labour Office enjoy copyright under Protocol 2 of the Universal Copyright Convention. Nevertheless, short excerpts from them may be reproduced without authorization, on condition that the source is indicated. For rights of reproduction or translation, application should be made to ILO Publications (Rights and Permissions), International Labour Office, CH-1211 Geneva 22, Switzerland, or by email: [pubdroit@ilo.org](mailto:pubdroit@ilo.org). The International Labour Office welcomes such applications.

Libraries, institutions and other users registered with reproduction rights organizations may make copies in accordance with the licences issued to them for this purpose. Visit [www.ifro.org](http://www.ifro.org) to find the reproduction rights organization in your country.

---

*International Journal of Labour Research*  
Geneva, International Labour Office, 2010

ISSN 2076-9806

trade union / international trade union / trade union role / developed countries /  
developing countries.

13.06.3

#### *ILO Cataloguing in Publication Data*

---

The designations employed in ILO publications, which are in conformity with United Nations practice, and the presentation of material therein do not imply the expression of any opinion whatsoever on the part of the International Labour Office concerning the legal status of any country, area or territory or of its authorities, or concerning the delimitation of its frontiers.

The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with their authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them.

Reference to names of firms and commercial products and processes does not imply their endorsement by the International Labour Office, and any failure to mention a particular firm, commercial product or process is not a sign of disapproval.

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

Visit our website: [www.ilo.org/publns](http://www.ilo.org/publns)

# Contents

International  
Journal  
of Labour  
Research

2010  
Vol. 2  
Issue 1

5

*Preface*

Dan Cunliffe

9

*American labour and the Great Depression*

Steve Fraser

25

*Financial crises and organized labour: Sweden 1990–94*

Ingemar Lindberg and Magnus Ryner

43

*The Asian crisis of 1997–98: The case of the Republic of Korea*

Jin Ho Yoon

61

*The Japanese economic crisis of the 1990s*

Naoto Ohmi

79

*The labour market and deflation in Japan*

Hansjörg Herr and Milka Kazandziska

99

*The Great Recession: A turning point for labour?*

Frank Hoffer



# Preface

**Dan Cunliffe**

Director,  
Bureau for Workers' Activities  
International Labour Office

When the financial crisis erupted back in 2008, analysts and policy-makers were quick to look for historical precedents from which to draw policy guidance. As such, they were able to get inspiration from the recent experiences of Sweden, Japan and the Republic of Korea in the 1990s, and even from the Great Depression in the United States, where financial meltdowns led to a variety of economic outcomes. Indeed, many of the policy responses that have been put forward since the beginning of the current crisis or that are still being debated were imported in large part in what was done and not done in those countries.

In January 2010, intent on drawing similar lessons from a labour perspective, the Bureau of Workers' Activities and the Global Union Research Network organized their own workshop on "Labour and the economic crises of yesterday and today: Lessons for a just and sustainable future". This issue of the *International Journal of Labour Research* brings together the various contributions that were made at that event.

Specifically, the authors were asked to examine the cases of the United States in the 1930s and of Sweden, Japan and the Republic of Korea in the 1990s to document the build-up to the financial crisis, its economic and political consequences and, as crucially, how the labour movement responded to the situation. The articles thus offer a range of perspectives that fully reflect the wide diversity of the political and industrial relations systems of the countries studied.

Beyond the recklessness of the leaders of the financial industry, what the stories make clear is the key role played by the deregulation and liberalization of the financial markets in creating a volatile economic environment that either provoked the crises or greatly facilitated their transmission. In each case, the crisis led to an important and painful restructuring of industry, large-scale unemployment, but also – not surprisingly – to intense fiscal pressures on the various governments.

The narratives make a compelling case that matters of international finance, while too often peripheral in the priorities of labour unions, are nonetheless central in their impact on not only macroeconomic policies, but also on the labour market institutions, and consequently on wage determination. If labour has any hope to see improvements in the ability for government to pursue full employment policies and to improve its own capacity to influence wages and working conditions, it can only ignore these matters at its own expense.

As such, the teachings directly inform the global policy priorities set forth in the ILO's Global Jobs Pact of 2009 which calls for "building a stronger, more globally consistent, supervisory and regulatory framework for the financial sector, so that it serves the real economy, promotes sustainable enterprises and decent work and better protects savings and pensions of people".

Conversely, the papers offer a strong policy prescription regarding wage policies in the context of deflation. Indeed, contrary to mainstream economic opinion, in such circumstances, downward nominal wage flexibility, far from helping to cure unemployment, might indeed become part of the problem in so far as it feeds further deflation in the goods market. It is thus suggested that a key part of a global recovery plan is to create a "wage anchor", either through collective bargaining or through minimum wage laws.

Again, this is in line with the prescriptions of the Global Jobs Pact which calls for the avoidance of wage deflation through social dialogue, collective bargaining and/or statutory minimum wages. Unfortunately, the articles reveal that governments, following the crisis, have usually adopted an opposite set of policies further encouraging precarious work through labour law reform in an effort to bolster, among other things, export competitiveness.

The narratives also have something to say about the labour movement's response to the challenges posed by the crisis. They reveal that, at the onset of the crisis, labour generally responded with vigour to the lay-offs and corporate restructuring, the rise of unemployment, as well as attempts by governments to cut into the safety net and weaken labour law.

While trade unions were not wholly successful in each of their battles, in all instances they did secure some gains through mobilization and negotiations with employers and governments, often in the improvement in the social protection programmes or in labour law reform on the right to organize. In some cases, labour proceeded to improve its own organizational strength by attempting to move to industry-wide collective bargaining.

However, labour was also hampered by the difficulty to present an overall and credible alternative to the neo-liberal prescriptions book. The task of articulating such a vision and mobilizing around it constitutes no doubt one of the biggest challenges for the labour movement in this age of globalized capitalism. The cases reviewed in this issue also underline the need for reliable political allies for labour when it comes to putting forward a new economic perspective.

The current economic crisis thus truly represents a moment of both “danger” and “opportunity” for organized labour. Danger that the downturn and the economic restructuring that will ensue will be done at the expense of workers and bring more insecurity in the labour market; danger that the rescue operation of the financial system will induce dramatic cuts in social protection and put further pressure on public sector employees; and danger that the policy response will remain encrypted with the traditional prescriptions for more labour market “flexibility”, most often a euphemism for more precariousness and insecurity for workers all over the world.

All the same, the international nature of the crisis offers labour organizations an opportunity to genuinely work together for global solutions and avoid being trapped in national “competitive austerity” programmes. A global reflation agenda will require a wage-led programme that will hardly be compatible with beggar-thy-neighbour type of policies. In the absence of a globally coordinated strategy, one has to fear that nationally focused policies will generate sub-optimal outcomes that will be worse for all, and have unpredictable and severe consequences for social cohesion.

A window of opportunity is thus at hand for labour and its allies to present their case for a new economic agenda, to move from critique to positive policy prescriptions, to put forward a modern regulatory framework for international capital and coordinated macroeconomic policies that will be more conducive to achieving the objectives of creating decent work for all.





# American labour and the Great Depression

**Steve Fraser**

Research Associate

Joseph Murphy Center for Labor and Community Studies  
Graduate Center of the City University of New York

Editor-at-Large

*New Labor Forum*

*How did organized labour respond to America's Great Depression?  
What was the unions' role in securing the New Deal? And did the New  
Deal work?*

“We are in a new era to which I do not belong.” So confided ex-President Calvin Coolidge to a close friend on a cold December day in 1932. He punctuated that melancholic thought a few weeks later by dying (Schlesinger, 1956, p. 457).

Coolidge's premonition proved to be uncannily accurate. The Great Depression was, except for the Civil War, the most traumatic moment in the history of the United States. Nothing was quite the same after it. In an American culture that normally lives in the windowless room of the current event, the economic devastation of the 1930s and the New Deal which tried to repair it remain to this day deeply imprinted on the national psyche. Indeed, the current global financial meltdown and “Great Recession” are constantly and inevitably compared to what befell the country and the rest of the world 75 years ago.

A watershed event, the Great Depression lives on in memory. The national income was halved in three years beginning with the stock market crash in 1929. One-quarter of the workforce (about 15 million people) was unemployed by 1933 (Leuchtenburg, 1963). Joblessness had tripled in those same three years. In fact, if we leave out of account people employed in one way or another in agriculture, unemployment amounted to an astounding 37 per cent. In industrial cities like Toledo, the number was a surreal 80 per cent. Of the 75 per cent of the national workforce actually employed, one-third could only get part-time work, so in reality only one-half of the active labouring population did so on a full-time basis (Alter, 2006).

The payroll of full-time workers at United States Steel went from 225,000 in 1929 to zero in early 1933. Industrial construction practically evaporated, plunging from US\$949 million to US\$74 million in 1932. Manufacturing output dropped 39 per cent between 1929 and 1933. Thirteen million bales of cotton went unsold in 1932, while food crops rotted in the fields and cattle were slaughtered by the millions (Leuchtenburg, 1963). Five thousand banks had failed by the time Franklin Roosevelt took office in March of 1933. Exports had bottomed out at a level not seen since 1904. The money supply, thanks in part to mass hoarding by ordinary people terrified by the banking crisis, had fallen by one-third between 1929 and 1933, aggravating what was already a crushing price deflation that affected everything from home prices to wages. So, for example, 80 per cent of the stock market's values in 1929 had volatilized into thin air by 1933. Six hundred thousand properties, including not only farms but also urban and rural residences, were in foreclosure. In early 1933, 36 of 40 key economic indicators had arrived at the lowest point they were to reach during the whole 11 grim years of Great Depression (Alter, 2006).

Not until war in Europe stimulated a huge demand in America for war and war-related materials did employment and general economic well-being pick up rapidly. To many people, the depth and the length of the Great Depression suggested that capitalism itself had entered a systemic and perhaps terminal crisis.

Because the breakdown was so severe and total, many looked for underlying problems to explain why everything fell apart. Stark indeed was the presence of plenty amidst poverty. And even starker was the apparent organic connection between the two: poverty not only lived alongside abundance, but it seemed to be caused by it. The output of capitalism's productive machinery had outgrown the capacity of the market to absorb it. Thanks to that insufficient effective demand, the dynamos of industrial and agricultural abundance shut down, only worsening the dilemma.

### The old order called into question

Observation of this grotesque cycle of plenty begetting poverty led to a deeper indictment of the old order. Gross inequalities in the distribution of wealth and income (at levels not matched again until the turn of our own new century) were clearly at fault. Those inequalities were partly the consequence of a tax system favouring the wealthy. More fundamentally, they stemmed from the low wage policy – at least when compared to the dramatic increases in worker productivity of the 1920s – that had characterized American industry since the consolidation of corporate control in the late nineteenth century. Meanwhile, farm income dropped precipitously with the revival of European agriculture after the war. Oligopolistic corporate control of major industrial sectors generated artificially high prices. Capital resources were pooled, coagulated and idled in the hands of an investment banking elite – what, during the Progressive era, had been identified by Louis Brandeis and Woodrow Wilson as the “money trust”. Determined to defend the fictitious paper values associated with its ageing investments, the “trust” locked down access to capital and credit to fund newer, competitive enterprises and new technological innovations, especially in emerging mass consumption-oriented industries. Systemic under-consumption and a dearth of new, productive investment were the twin evils (abetted by the power of a rentier class of speculative coupon clippers) identified by Keynes and others as the prime factors behind the collapse and stagnation.

Government intervention was essential, many critics agreed, and should be diverse. By 1933, who could any longer believe that the free market was self-correcting? With private and local forms of relief exhausted, who could any longer believe the federal government should stand aside? By that time, the most august financiers had been paraded before congressional investigating committees where their helplessness, ignorance and multifarious schemes of self-enrichment had been made public and excoriated.

So too by 1933, the first signs of extra-parliamentary direct action signalled that it might be possible, even necessary to break new ground. Twenty thousand veterans from the First World War gathered on Anacostia Flats in the nation's capital to demand an early instalment of their war service pensions. The "Bonus Army", as it came to be called, only dispersed at the point of federal bayonets ordered into action by President Hoover and commanded by Douglas McArthur. Four thousand farmers occupied the Nebraska state-house and 5,000 people crowded into a Seattle County building demanding government help. Political leaders were chased through the streets by crowds crying, "When do we eat? We want action" (Alter, 2006, p. 18). A demonstration of unemployed marching past Henry Ford's auto plant in Dearborn, Michigan was violently driven away and some demonstrators were killed by the auto tycoon's private police. Coal miners seized food from company stores and on some occasions even seized the closed mines to sell the ore. Some of the jobless who had been cut off by utility companies tapped into gas and electric lines with the help of unemployed workers in those industries; nor would local juries convict them of trespassing or theft when the coal companies sued. The governors of Minnesota and North Dakota declared moratoriums on mortgage foreclosure sales (Leuchtenburg, 1963, pp. 25–26). On city streets, neighbours gathered to forcibly prevent the evictions of their friends. For those who yearned to overthrow the past and directly confront the structural and institutional dilemmas that had run the economy into the ditch, these were promising if also anxiety-producing signs that it just might be possible.

## The New Deal

Looking back at those times there is a popular tendency today to romanticize Roosevelt and the New Deal. Actually, however, he was in some ways a prisoner of the past, at least when he first entered office and continuing through the first two years of his Administration. Some historians have identified that period as the "first New Deal", to distinguish it from the more audacious and social-democratic minded reforms of the "second New Deal". For instance, the President believed in the orthodox wisdom of the balanced budget and never entirely abandoned that faith, even when he was later convinced to depart from it in Keynesian fashion by using deficit spending not only for relief but also to prime the pump of recovery. Roosevelt shared the traditional repugnance for what was then called "the dole" or welfare. Moreover, he feared, as much as Hoover did, parting company with the country's business and financial elite. He tried instead, until it proved unworkable, to forge a partnership with that community in much the same way Hoover had. The two key pieces of recovery legislation passed during the first 100 days – the National Industrial Recovery Act and the Agricultural

Adjustment Act – were premised on the idea of business–government collaboration. Given these conservative-minded philosophical maxims and cautious political calculations, a decisive rupture with the past might have seemed highly unlikely.

Yet that is just what happened. And it had begun to happen even during the legendary first 100 days of the new Administration. The creation of the Tennessee Valley Authority (TVA) was a stunning venture into the realm of economic planning and regional development, which included the government's creation and ownership of a major electrical power-generating facility. Regional electrification was in turn designed to sweep the whole Tennessee Valley into the orbit of a modern mass consumption economy, inspiring satellite industrial and urban settlements, and making the whole region a new market for the output of American industries. The private sector electrical power industry bitterly opposed the TVA, resenting its “unfair” competition. But the TVA prevailed.

Other key pieces of legislation were introduced during those formative days. The Securities Act passed during the first 100 days and the second such Act, introduced a year later, created the Securities and Exchange Commission to regulate the markets. Neither Act called for draconian measures. But the very idea that Wall Street's old guard would be a bit more open to public inspection, and would have to obey rules against insider trading and the like, was obnoxious to an arrogant milieu long grown accustomed to making their own rules and to their own advantage. They embarked on permanent and poisonous opposition to the New Deal and to its presidential architect, whom they thought of as a “traitor to his class”. Even more germane when it came to dismantling the “securities bloc” of older investment banks and infrastructural heavy industry was the passage of the Glass-Steagall Act, another product of Roosevelt's first 100 days. The law separated commercial from investment banking, whose merging had been particularly extensive and rapid during the 1920s and had consolidated the power of the “money trust”.

Finally, it is critical to note that these preliminary days of the New Deal included the first hesitant steps in the direction of what we would today consider Keynesian fiscal innovation, social welfare and labour reform. Legislation included a Public Works Administration whose mission was to undertake large-scale public projects to boost employment and spark capital goods investment. Simultaneously, the government created the Civilian Conservation Corps, a sizeable if limited federal venture into work relief and the precursor of more ambitious undertakings. The Industrial Recovery Act called for wage minimums, hour maximums, and the end of child labour. It also included a provision – one hated by the tycoons of heavy industry – that seemed to place the authority of the government behind the right of workers to form unions and appeared to oblige employers to negotiate with them. Over the next couple of years, it became clear that in fact the government was

not yet ready to enforce its own laws, whether on wage and hour standards or on the right to organize. Nonetheless, it was a premonition of things to come.

## Labour's role

Looking at the lay of the land in 1932, no one could have expected much of anything from the labour movement. Like the rest of the country, it was flat on its back, leading a ghostly existence. Never commanding much of a presence, except in a restricted set of crafts and industries, it had at least represented 12.1 per cent of the labour force in 1920. By 1930, that share had shrunk to 7.4 per cent – even less than it is today (Hirsch and Macpherson, 2003). Most of that membership belonged to the craft unions that dominated the American Federation of Labor (AFL). These institutions hung on by virtue of their leverage, albeit a dwindling one, over the markets for skilled labour. Even here, though, the Depression threw hundreds of thousands of construction trades craftsmen, skilled tool and die makers, mechanics and others onto the breadlines. Where the AFL did enjoy a broader reach over industrial labour generally, as in coal mining, the railroads or the garment and textile industries, mass bankruptcies placed unions like the United Mine Workers and the Amalgamated Clothing Workers on short rations. Not only did they lose numbers in droves as mines and shops closed up, they were also forced to cut back severely on the resources devoted to organizing, internal education and other matters. Whole union locals folded. In the case of the clothing workers, much of their innovative work on negotiating unemployment insurance plans with management ended in insolvency. The United Mine Workers had already lost 80 per cent of its members during the 1920s, a sorry state of things repeated in sectors like meatpacking, textiles and paper-making. Where unions continued to cling to life, wage and hour standards deteriorated irresistibly. When strikes did take place to organize at new sites, as for example in the southern textile industry, to hold on to existing ones or resist wage cuts, they almost invariably failed in the years leading up to Roosevelt's victory. Not surprisingly, between 1929 and 1930, the number of strikers fell by 80 per cent.

Most inauspicious of all was the brute fact that the heart of American industry – steel, auto, glass, rubber, electrical, farm machinery, meatpacking, maritime, and more – was completely unorganized or virtually so. In 1930, 90 per cent of the auto workforce was unorganized. The same was true of rubber, farm equipment, electrical appliances, and other core industries (Zeiger, 1995). And to make matters worse, the craft elite that ran the AFL displayed a real aversion to confronting this world. After all, American heavy industry was deeply hostile to unions, and was armed and ready to use all measures, legal, extra-legal, and violent, to stop their incursion. Just as problematical was the fact that the workers in heavy industry were largely

first- and second-generation immigrants, hailing from south-eastern and eastern Europe. Their ethnic, cultural and religious backgrounds, along with the fact that they performed unskilled and semi-skilled labour, left the native-born, skilled and Protestant milieu in the AFL suspicious and even contemptuous of their abilities, including their ability to organize.

Politically, the labour movement's situation seemed nearly as unpromising at the outset of the New Deal. True, it had enough friends in Congress to pass the Norris-La Guardia Act in 1932 while Hoover was still in office. The law sharply restricted the use of the court-ordered labour injunction to break strikes, an enormously effective weapon in the arsenal of anti-unionism for at least two generations. The provision in the National Industrial Recovery Act (NIRA) proclaiming the right to organize was likened to labour's Emancipation Proclamation. It was deployed by union organizers to convince workers that "the President wants you to join a union". But soon enough, the NIRA became known in labour circles as the "national run around". It was an apt sobriquet, as the Labor Board set up to enforce those good intentions failed to do so. Indeed, less than 10 per cent of the code authorities set up to administer the Act in specific industries even had labour representatives (Rauchway, 2008).

What did change was the reality in the field, beginning with the state of the economy. During Roosevelt's first two terms, the United States economy grew at an annual average rate of 9–10 per cent. Durable goods expenditures and the value of construction rose substantially. Unemployment dropped in each year, except during the calamitous recession of 1937–38, due both to publicly created jobs (about 3.6 million) and an uptick in private manufacturing. Agriculture picked up thanks in part to price supports and crop restrictions. Home foreclosures abated as well, due to the mortgage subsidies made available through the Home Owners Loan Corporation. Stabilization and regulation of the financial system, including the creation of the Federal Deposit Insurance Corporation to guarantee bank deposits, stopped the hoarding and helped open up the arteries of commercial credit. Most of all, the stimulus provided by federal spending, even haltingly applied, seems to have encouraged investment in the private sector.

Consequently, the political and social psychology of the nation shifted seemingly overnight. Common sense might suggest that popular insurgencies arise as a function of mass misery. Often enough, however, the opposite is the case. Many, although certainly not all, of the expressions of resistance and outrage that occurred in the earliest years of the Great Depression were momentary pleas for help without any sustained organizational momentum. By the end of 1934, however, the picture looked entirely different. It is reasonable to think that the economy's improvement gave people the courage, the optimism and the material leverage with which to fight back.

Something was already stirring in 1933 when the number of strikes doubled from the previous year. Then 1.5 million workers went on strike in



1934 (Zeiger, 1995). Some of the most notable of these conflicts had the character of mass strikes; that is, they rapidly spread beyond the borders of a conventional trade union dispute with a particular employer and instead swept into their orbit whole communities. At the same time, other forms of working class based mobilization – rent strikes, demonstrations by leagues of the unemployed, consumer protests, tenant farmer mobilizations – made the air electric with possibility.

### Political impact

This sort of combativeness left its imprint on the political atmosphere, and in turn the heating up of the political environment further encouraged grass-roots militancy and broadened its social aspirations. One might call the relationship symbiotic. At the national level, the mid-term elections of 1934 were a telling case. Not only did the Democratic Party substantially increase its congressional majority but, more importantly, that majority was far readier to contemplate major reform – readier than the President himself – than the one elected in 1932. The edgier and more demanding popular mood had registered. Some measure of that change in the complexion of the legislative branch was undoubtedly due to the gathering challenge to the rule of industrial autocracy in the workplace. By 1936, Roosevelt himself would be condemning “tories of industry” for their selfishness and anti-democratic behaviour. A Senate sub-committee formed that year began a systematic exposure of the lengths to which the country’s leading industrial corporations were willing to go – including the use of spies, heavily armed private police, and the stockpiling of lethal munitions – to crush all attempts at union organizing. Even earlier, by the end of 1934, the National Labor Relations Act – which would create a statutory right to organize and make it the legal obligation of an employer to engage in collective bargaining with the freely chosen representative of his employees – was retrieved from the bottom of the President’s in-box pile and soon enough became a top priority of the Administration.

State and local politics and extra-parliamentary activity, much of it powered by the “labour question”, accelerated this drift to the left. In California, the famous novelist and socialist Upton Sinclair won the Democratic primary in 1934 and campaigned for the governorship under the slogan of “End Poverty in California”. Sinclair’s platform was avowedly anti-capitalist and talked about replacing the older system with one based on production for use. Similar language informed Floyd Olson’s Farmer-Labor Party in Minnesota and Phillip LaFollette’s in Wisconsin and led to their electoral triumphs after earlier defeats in 1932. Down South, the firebrand Senator from Louisiana, Huey Long, inspired a multi-million member populist “Share Our Wealth” outcry. “Share Our Wealth” clubs sprang up all over

the country, calling, among other things, for confiscatory taxes on the super-rich, minimum wages, and government ownership of public utilities. Father Coughlin, the “radio priest” from Royal Oak, Michigan, mesmerized millions of listeners on a weekly basis as he condemned Wall Street speculators and supported the right of workers, particularly his auto worker audience in nearby Detroit, to organize unions. (Only later would Coughlin’s anti-Semitism and Christo-fascism supplant his earlier Catholic corporatism and its criticisms of tooth-and-claw capitalism.)

As the country’s social and political centre of gravity shifted in this way, the labour movement in turn grew bolder, both on the shop-floor and in the political arena. But this new audacity came with a price. Fissures within the upper echelons of the trade union hierarchy had been widening for some time. The labour upsurge of 1934 included hundreds of thousands of workers in heavy industry practically demanding that the old labour federation organize them. Although the AFL established new “federal locals” to accommodate this initial rush, soon enough it began parcelling out members in haphazard fashion into existing craft unions, which then did nothing. The Federation was reluctant, as it always had been, to entertain a new strategy of mass industrial unionism; one aimed at creating universal unions encompassing all the workers in particular industrial sectors. All of its nativist cultural prejudices, its fear of confronting the country’s largest corporations, its nose-in-the air snobbery regarding the unskilled, came into play.

Politically, the craft-dominated Federation adhered to a tradition of voluntarism that also aggravated relations with rising elements of the labour movement, which looked to the state and public policy as a way out of labour’s *cul de sac*. The role of the judiciary in “enjoining” (prohibiting) strikes – a practice stretching well back into the nineteenth century – along with the remarkable frequency with which state and national governments had resorted to armed force to quell labour uprisings, left the AFL wary of any government involvement in labour relations. The Federation at first opposed social security legislation for fear that it would compete with long-established trade union welfare and pension funds and leach away the loyalty of its members. Until 1932, it even opposed government unemployment insurance. This arms-length suspicion of the State ran headlong into the contrary strategy developing within the ranks of industrial unionism, which increasingly came to see the New Deal Administration and its allies in Congress as not only useful, but essential.

And then there was the question of radicalism. The strikes and organizing drives that lit up the industrial landscape beginning in 1934 were not spontaneous eruptions, popular folklore notwithstanding. In virtually every case, they were prepared for and led by a menagerie of radicals: socialists, communists, Trotskyists, remnants of the Industrial Workers of the World (the “Wobblies”), anarcho-syndicalists and others. Moreover, the leadership of the industrial union faction within the AFL often included similarly

mindful people. John L. Lewis of the mineworkers, who became the public face of the new industrial union movement, did not fit this profile; in fact he had been a Republican, never shy about purging his union of radical oppositionists back in the 1920s. But as the movement grew in the mid-1930s, he was more than willing to make use of radicals as key organizers and strategists. Others, like Sidney Hillman of the Amalgamated Clothing Workers and David Dubinsky of the International Ladies Garment Workers Unions, were Russian-immigrant Jewish socialists. The new industrial union movements that began to emerge in auto, rubber and electrical goods, among the West Coast longshoremen, the seafarers, packing house and tobacco workers and the teamsters, were invariably led by political radicals of one variety or another. For these cadres, more was at stake than the creation of effective new institutions of collective bargaining or even than the triumph of industrial unionism as a form more appropriate to modern mass production. They sought to address the "labour question" more broadly and envisioned the Congress of Industrial Organizations (CIO) as a social movement prepared to champion the needs of working people generally, whether members of unions or not, whether black or white, whether skilled or unskilled, whether men or women, whether immigrant or native born.

Simmering divisions within the house of labour finally came to a head with the creation of the Committee on Industrial Organization in 1935, which was soon purged from the ranks of the AFL and emerged as an independent labour organization, the Congress of Industrial Organizations. The CIO immediately embarked on a multi-pronged strategy – simultaneously political and industrial – that not only ended the reign of industrial autocracy in basic industry, but also provided the social energy that made possible the Keynesian social welfare state with which the New Deal is most enduringly identified. In the industrial arena, this meant the pooling of resources (organizers and money first of all) into joint, quite risky campaigns to organize basic industries like steel, meatpacking and textiles. But even as the CIO put together the steel workers' organizing committee and analogous multi-union undertakings, it assiduously pursued its political options.

Senator La Follette's sub-committee not only exposed the intimidating and violence-prone anti-union machinations of companies like General Motors and Republic Steel, its staff also met regularly with CIO organizers to coordinate the release of the committee's most damning revelations with the tactical manoeuvres of the union's campaign. The Wagner Act establishing the National Labor Relations Board (NLRB), which was empowered to enforce the right to organize and the obligation on the part of employers to engage in collective bargaining, had been passed in the spring of 1935. Once the CIO got under way, the NLRB, heavily staffed by sympathizers of the new movement, again and again ruled in its favour, making the CIO-affiliated union the sole bargaining agent and effectively eroding industry's attempt to skirt around the law by setting up multiple or company unions.

Early in 1936, the CIO formed Labor's Non-Partisan League to mobilize for the upcoming presidential election. The League established local offices all over the country in working-class cities and towns. Programmatically, it did not confine itself to union issues narrowly conceived. It depicted Roosevelt and the New Deal as a bulwark against reaction, as a foe of the plutocracy, and as a muscular champion of wide-ranging reform. After all, the years between 1934 and 1937 not only witnessed the enactment of the Wagner Act and Social Security (including government-funded pensions, unemployment insurance and aid to families with dependent children), but also the Wealth Tax Act, the Public Utility Holding Company Act (designed to break up the combines of holding companies that had dominated the power industry and saddled it with enormous, enervating debt), a vast expansion of public works under the auspices of the Works Progress Administration, and a low-income housing programme, among other socially minded innovations. Some of these reforms looked better on paper than they did in practice; the Wealth Tax Act did very little to redistribute income, and the housing programme was severely limited. But to one degree or another they represented ruptures with the self-reliant individualism, gross inequalities and laissez-faire political culture of the past.

Roosevelt, for his part, became increasingly willing to collaborate with and even instigate this transformation in the country's political chemistry. By the middle of 1934, he had little to lose as the old elites had deserted him. For example, the DuPonts, Morgans, and other leading business circles from the "securities bloc" established the American Liberty League whose animus for the New Deal and for Roosevelt personally knew no limits. Class polarization, a rare phenomenon in American political life, increasingly coloured public rhetoric. If in the eyes of the American Liberty League the President was a "communist", he in turn was prepared to identify them as "economic royalists" and to proudly announce that if they hated him, he "welcomed their hatred". Such language was cheered and mimicked by the CIO in the 1936 campaign and thereafter. Meanwhile, the temporary coalescence in the run-up to the 1936 election of the Huey Long movement with Father Coughlin's followers and those of the Francis Townsend movement demanding universal old-age pensions, made Roosevelt wary of losing constituencies to the populist left, a further incentive to realign his campaign against the "captains of industry".

Syncopation of political and industrial initiatives culminated in the path-breaking Flint sit-down strike against General Motors by the fledgling United Auto Workers (UAW) that began hardly more than a month after Roosevelt's landslide re-election. That smashing victory was a real tonic to the CIO, and to millions of working people all over the country. Once the confrontation ended with the company's reluctant recognition of the UAW (at least in certain plants), an epidemic of sit-down strikes erupted all across the country that lasted into the middle of 1937.

Roosevelt's overwhelming triumph of 1936 inspired the high point of CIO strategic ambitions. It was the moment when the New Deal Administration felt most beholden to the labour movement for its contribution to that victory. Together, they embarked on a daring attempt to reconfigure the two-party system, to make it reflect more clearly than the loosely patched together, semi-coherent coalitions that customarily defined the political order, the distinct class interests and outlook that the Great Depression had made so transparent. By American standards it was an audacious undertaking. In the end it turned out to be a fateful failure.

Everything depended on upending the *ancien régime* in the South. While the New Deal faced its natural antagonists in the Republican Party, it was more hobbled internally by the very considerable power of southern Democrats in the Congress. To move ahead with bolder plans of social reform, there needed to be a day of reckoning, one that would confront the political overlords who ran the South and defended its racially inflected political economy resting on low-wage peonage. Ever since the late nineteenth century, the South had been a one-party region. As a result its Democratic Party representatives in Washington enjoyed disproportionate seniority in the power-wielding committees that helped determine the fate of New Deal legislative initiatives. Thanks to its inordinate influence, New Deal provisions were systematically rewired in the South to exclude African-Americans, tenant farmers and sharecroppers. Moreover, so long as the South remained a bastion of low-wage labour, so long as it hardened its hostility to unionization, and so long as it maintained its segregated caste system, it would continue to undermine labour and social welfare standards throughout the country.

Together, New Deal political operatives and the CIO embarked upon a three-pronged strategy to take on the Old South and in the process transform the internal chemistry of the Democratic Party. First of all, beginning in 1937 the CIO launched a major drive to organize the southern textile industry, the site of runaway textile manufacturers since the turn of the century and the region's primary industrial enterprise. The Textile Workers Organizing Committee inundated the South with organizers and money. Complementary efforts by other elements of the CIO made simultaneous forays into the tobacco sheds and steel mills of the Carolinas and Virginia. In many, although not all of these instances, these were racially integrated undertakings and where unions managed to get started they often sustained that flagrant challenge to Southern mores. Secondly, the Roosevelt Administration in close cooperation with the labour movement doggedly campaigned for the passage of a minimum wage/maximum hour law. Although designed to cover the whole country, it was particularly targeted at the South where bare subsistence wages were the rule, even in industry, but especially among agricultural and domestic workers. The third leg of this strategic *démarche* made the unprecedented attempt to purge the Democratic Party of its conservative, mainly Southern elements, during the

primary campaigns leading up to the 1938 off-year elections. This was initiated by the President, but he relied on the CIO to provide the shock troops.

All three undertakings failed to one degree or another. Concerted resistance by the whole Southern oligarchy, including a storm of red- and race-baiting, along with the frailty of what amounted to southern liberalism, doomed the textile organizing campaign. The minimum wage law – the Fair Labor Standards Act (FLSA) – did get passed in 1938. But before it did, it was subject to a thousand amendments, the thrust of which for all intents and purposes exempted much of the Southern labour force – agricultural and domestic workers particularly – from its coverage. And finally, so too did the purge of the party go down to defeat as most of the Democratic Party old guard in the South fought off the primary challenges mounted by the Administration. For this reason, 1938 and the passage of the FLSA marks the end point of the “second New Deal”. After that, and especially as attention shifted to the war in Europe, there would be no more social and economic reform of the sort that we now think of as the heart of the New Deal.

### Did the New Deal work?

How to assess the whole experience? First the question is fairly asked whether the New Deal cured the Great Depression. The answer is yes and no. So long as the Administration kept up its courage and adhered to robust deficit spending, along with other measures designed to shore up demand, there was real recovery. However, because Roosevelt himself was never entirely convinced this was right and proper and because conservative forces within both the Republican and Democratic parties mounted effective opposition to this kind of Keynesianism, the New Deal oscillated between spending and retrenchment. So, for example, the Civil Works Administration set up in 1933 created 4 million public works jobs, but the agency was dissolved less than a year later. The even more ambitious Work Progress Administration created in 1935 suffered serious cutbacks by 1937 (Rauchway, 2008). The latter arguably led to what was called at the time and since “the Roosevelt Recession” of 1937–38, a very severe one that nearly matched the declines of the earlier part of the decade.

In the realm of economic and social reform, the New Deal certainly accomplished much. Financial regulation, labour reform, social security, public works, relief, and regional planning together comprise no mean achievement, especially when measured against an American political tradition that had found most of this repugnant. But arguably more was possible and the failure to extend the reach of the social-democratic welfare state had consequences that haunt America to this day. Although the CIO mounted heroic efforts to confront the racism that impoverished and degraded African-Americans and that divided the working class, the New Deal never really



did. It was too intimidated by its conservative allies in the South and its opponents elsewhere. Moreover, fledgling efforts to extend social insurance to include health care and low-income housing were either abandoned or left on life support. The audacious foray into government ownership and social and economic planning represented by the Tennessee Valley Authority (and the “little TVAs” that sprang up elsewhere in the western United States) would never again make it onto the political agenda. Efforts at major income redistribution through the tax system never proceeded very far even during the height of the “second New Deal”. Anti-trust sentiments clung to life, but as bygone rhetoric that less and less informed public policy. By the end of the decade, the New Deal had run out of gas as a reform movement and had begun mending fences with the old business establishment; a process that would accelerate enormously during the Second World War when the war mobilization apparatus was honeycombed with corporate personnel from what President Eisenhower would later call “the military-industrial complex”.

### Labour’s mixed record

How do we assess the role of the labour movement in this story of triumph and frustration? Without its social and political muscle, it is hard to imagine the New Deal evolving in the direction of social democracy even to the extent that it did. The reign of industrial autocracy that had terrorized workers since the Gilded Age was over. Industrial democracy, however flawed in execution, took its place. Moreover, industrial unionism was an extraordinary accomplishment, not just as a stunning piece of organizational architecture. It required overcoming, at least partially, a multitude of ethno-cultural, religious, racial and gender divisions. In that sense, it brought into life as a self-conscious actor the modern American proletariat, up until then a mere statistical artifice. At a time when race subordination was still an unquestioned axiom of American life, the CIO defied it and sometimes succeeded so that substantial numbers of African-American workers joined its ranks and enjoyed its victories. The labour movement left a lasting imprint on American culture. An ethos of social solidarity, a concern for and appreciation of the role and traditions of the ordinary working person remained a vibrant part of American life until a half century later when the Reagan era ushered in a new age of Mammon-worship.

Nonetheless, in the end the labour movement was never strong or determined enough – either ideologically or politically – to force matters beyond the reformed capitalism that distanced America from the more thoroughgoing social democratic innovations characteristic of post-war western Europe. Whatever real progress the CIO made in overthrowing the racial order could not measure up against the New Deal’s failure to even try, leaving behind, like a ticking time-bomb, the politics of race. It would detonate

in the 1960s and help dismantle the New Deal order and renew deep fissures within the labour movement. The sit-down strikes of the mid-1930s, while inspirational, were also fear-inducing, setting off tremors about the threat to private property that registered with middle-class folk and made the Roosevelt Administration more inhibited about hitching its fate to the new labour movement.

The outcry against the sit-down tactic also led to reservations within the CIO itself as the leadership sensed, at least on this vital matter, its estrangement from popular opinion. And this signalled a deeper problem. True, the CIO was a kind of social miracle in so far as it managed to transcend all the more parochial identities that had crippled the labour movement for so long. But those fractious divisions still carried force. If the leading cadre in many of the new unions was secular radicals willing to imagine real alternatives to capitalism, that was hardly the case throughout the ranks, where old loyalties to the church, ethnic traditions, private property, patriarchal and racial hierarchies, not to mention good old-fashioned American individualism, endured and constrained more daring social and political ambitions.

At the same time, the CIO in particular became so enamoured of, and dependent on, its relationship with a friendly government that it was reluctant, when times changed, to shift gears and rely on itself. The Second World War brought matters to a head. At the outset of the war, the labour movement still exercised real influence within the economic mobilization bureaucracy. It even lobbied for tripartite councils of labour, business and government to run the economy and particular industries. Very soon, however, big business assumed all the major levers of power. Evicted from its more influential enclaves in the war mobilization bureaucracy but afraid to challenge the administration, the CIO found itself enforcing a regimen of patriotic sweating that would increasingly widen the distance between the leadership and the ranks. Dreams of extending the welfare state after the war were scrapped. Friends of labour became scarcer and scarcer within the inner councils of the national government, especially after Roosevelt died.

Social democratic Keynesianism was inexorably supplanted by its commercial variant which left the basic institutions of the free market in a commanding if no longer omnipotent position. In one last spasm of social and political upheaval, the whole industrial labour movement went on strike during 1945–46 (although not all at one time), and made one last heroic effort to organize the South. Simultaneously, it vigorously campaigned for national health insurance, for a widening of what today is called the “social safety net”, for a commitment by the national government to use its fiscal powers to guarantee full employment, and for a national incomes policy to prevent the kind of unequal distribution that had helped cause the Great Depression. Although Truman squeaked to victory in 1948 by mending his damaged relations with the labour movement, by the end of the decade much of the visionary momentum of the movement had dissipated. The Cold War



and domestic anti-communism soon enough took their toll; an intimidated CIO purged its ranks of some of its most militant and socially conscious unions, and the country grew accustomed to thinking of things like racial justice and national health insurance as sneaky forms of communism. After that, the labour movement reconciled itself to defending its bastions of power in the private sector through the mechanisms of collective bargaining and assumed its position as a junior member of the new power elite.

## References

- Alter, J. 2006. *The Defining Moment: FDR's Hundred Days and the Triumph of Hope* (New York, Simon Schuster).
- Hirsch, B.; MacPherson, D. 2003. "Union Membership and Coverage Database from the Current Population Survey Note", in *Industrial Labor Relations Review*, Vol. 56, No. 2, Jan., pp. 349–354.
- Leuchtenburg, W. 1963. *Franklin Roosevelt and the New Deal, 1934–40* (New York, Harper and Row).
- Rauchway, E. 2008. "Learning from the New Deal's Mistakes", in *The American Prospect*, 22 Jan.
- Schlesinger, A., Jr. 1956. *The Crisis of the Old Order* (New York, Houghton Mifflin).
- Zeiger, R. 1995. *The CIO: 1935–1955* (Chapel Hill, University of North Carolina Press).

# Financial crises and organized labour: Sweden 1990–94

## **Ingemar Lindberg**

Former social policy advisor,  
Confederation of Swedish trade Unions (LO)

## **Magnus Ryner**

Professor in International Relations,  
Oxford Brookes University

*The changes in Sweden during the 1990s raise a fundamental question for organized labour: how much priority should go to bread and butter trade unionism, and how much to the broader scheme of things?*

The management of the Swedish financial crisis in 1990–94 has received a lot of good press lately. This stems from the search for historical lessons that might point to solutions to the current global financial crisis. The current fascination focuses on temporary emergency measures to nationalize banks, the creation of a state institution where bad loans were concentrated and managed (Securum), and the subsequent creation of the compulsory stabilization fund (e.g. Dougherty, 2008; Nordstrom, 2010). There are no doubt lessons to be learnt, but existing interpretations are far too nostalgic and narrow in their perspective to be of much use for broader questions concerning organized labour. These interpretations underplay or ignore the immense costs of the crisis. Even when only the narrow balance sheet of the bank rescue is taken into account, a conservative estimate of the overall final cost to the public purse was SEK35 billion, equalling 2 per cent of GDP (Bergström, Englund and Thorell, 2003). But this is only the tip of the iceberg. A more integral social balance sheet would take into account the need to manage the deficit generated by the initial cost of the bailout (SEK67.5 billion, equalling 4 per cent of GDP), and the attendant depressive macro-economic effects. Trade union economists estimated the latter to have wiped out 10 per cent of Swedish productive capacity between 1991 and 1993 (LO, 1992b, pp. 3–6). Account would also need to be taken of the astronomical amounts that the Bank of Sweden paid to defend the exchange rate during the European Exchange Rate Mechanism (ERM) crisis, when the overnight interest rate reached 500 per cent before the Bank gave up. These costs are hard to estimate but they certainly run into hundreds of billions of kronor.

Crucially, the financial crisis constituted a cataclysmic shock for the main historical achievement of Swedish organized labour: a highly developed universal welfare state. Income replacement rates in the social insurance systems were reduced, eligibility criteria were significantly sharpened and employee contributions were increased in the budget consolidation efforts that ensued (and which were applied to instil confidence in global financial markets).<sup>1</sup> To this should be added the effects that financial deregulation had

---

1. For an overview, see Olsson (1993, pp. 349–72). Health and unemployment insurance had replacement rates of 90 per cent of the income of the claimant in 1990. These were reduced to 80 per cent in the first year and 70 per cent thereafter. In addition, for health insurance, the replacement rate during the first three days of illness had already been reduced to 65 per cent in 1990. A five-day waiting period was introduced for unemployment insurance in 1993.

on solidaristic wage policy. All of this was central to halting and reversing trends towards the elimination of inequality and poverty in the decade between the mid-1980s and the mid-1990s (LO, 1997, pp. 57–60). Finally, 15 years on, Swedish financial institutions are once again among those in need of bailouts at high social costs, raising fundamental questions about policy learning and the merits of finance-led capitalism.

All this lends credence to arguments that “free market” finance-led capitalism is not propitious to the interests of organized labour. The magnitude and distribution of costs at crisis points are only the most obvious manifestation of this. In addition, due to the shortening of time horizons in investments and the imperative of maximizing asset yield ratios in the here and now, the importance of securing long-term productivity growth that can underwrite sustained high social wages is discounted in such a system (e.g. Aglietta and Breton, 2001; Aglietta and Rebiéroux, 2005; Grahl, 2001; Watson, 2009). In finance-led capitalism, capital requires a higher return in order to perform its function, at the expense of wage shares. Furthermore, there is a bias in this sort of system against modes of corporate governance that are open to union co-determination (Lipietz, 1997).

One would therefore expect that crisis points in finance-led capitalism that are generated by the bursting of speculative bubbles would give rise to strong political counter-movements of which organized labour would be at the forefront. However, historical evidence suggests that this is an overly functionalist presumption. The possibility can by no means be excluded that such crisis points become opportunities to further advance the financialization of capitalism.

The Swedish financial crisis of 1990–94 is a telling example in this regard. Sweden is a clear case where organized labour, in no little measure because of the strict regulation of the financial sector, succeeded in developing a sophisticated strategy in the post-Second World War period, generating trade union unity, influence, high wage growth and wage compression in a small open economy (Martin, 1983, 1984). The institutional configuration around its Rehn-Meidner model was progressively eroded through a pro-cyclical credit market deregulation during the “Reagan boom” of the world economy and the establishment of the Single Market in Europe. When the bubble of that particular boom burst and generated a set of turbulence effects, also in the politico-economic field (such as the ERM crisis), the comparatively severe effects generated by the Swedish financial crisis might have been expected to provide Swedish organized labour with a window of opportunity to reverse these developments, or at least halt or moderate them. After all, Swedish labour continued to enjoy comparatively strong organizational power resources (a union density rate of over 80 per cent, a strong organizational infrastructure, and still considerable influence over a Social Democratic party that was a shoo-in for the 1994 elections). Furthermore, its economists had developed a sustained and coherent critique of financial market deregulation

and had proposed a range of policy alternatives. But the decade after the financial crisis between the mid-1990s and the mid-2000s became one of further liberalization and financialization of the Swedish economy, culminating in the pension reform of 1999. This set the stage for participation on the roller coaster of the next set of (IT and housing) bubbles in 1995–2007. Despite the critique of financial market deregulation and the experience of the financial crisis that would seem to have validated this critique, there is little evidence of trade union resistance to these developments.

This article seeks to explain this absence. It begins by identifying the international and domestic determinants of the Swedish financial crisis. Then we account for the warnings by trade union economists against the dangers of financial market deregulation in the 1980s, which were articulated as part of an attempt to defend the institutions of the Rehn-Meidner model. In the third section, we explain why trade unions did not challenge but rather accommodated themselves to the deepening of finance-led capitalism.

We do not attribute much significance to suggestions that Swedish trade unions suffered from significant ideational misconceptions. The fact is that trade union economists consistently and forcefully advanced sharp analyses, warning against the dangers of pro-cyclical deregulation in the latter part of the 1980s, suggested plausible (albeit untested) alternatives, and sometimes provided lucid assessments of the global political conditions governing their predicament after the financial crisis. It may also be doubted that Swedish unions were merely passive victims of globalization, although their room for manoeuvre had significantly narrowed and they were aware of that fact. Rather, we argue that the non-fortuitous outcome was significantly mediated by the form of Sweden's State–civil society relations, the manner in which these gave differential power resources to unions in different policy areas, and how this also conditioned practices within the trade union movement itself.

The response of Swedish unions to the financial crisis of the early 1990s must be understood in relation to the potential power of unions in different policy areas. The legitimacy of forceful union pressures on the political system can be strong on issues like employment levels (the demand for full employment) or in areas such as labour law. These are widely recognized as core fields of union political action. The legitimacy is also fairly strong in broader distributional justice issue areas, pertaining to tax policy and social security systems, although here unions are seen as one of several “interest groups”. However, on issues such as credit regulations, foreign exchange policies or borrowing abroad, the link to what is considered to be legitimate union interest is usually regarded as much weaker – including by union members themselves. Union economists may well present their analysis and if their arguments are good they may gain some influence. This had been the case earlier in the post-war period. But by the time of the financial crisis, influence in the macroeconomic field had been eroded to a very large extent.

## Causes and consequences of the Swedish financial crisis

Financial  
crises and  
organized  
labour:  
Sweden  
1990–94

The Swedish financial crisis of 1990–94 consisted of at least three interrelated moments. Initially, it manifested itself as a real estate crisis. Financial intermediaries specializing in the real estate sector had borrowed large sums from Swedish banks, which they in turn had lent as mortgages and for the commercial development of real estate. As the Reagan boom was reaching its limits in 1990, the business plans of commercial developers were shattered as the rate of growth of real estate values faltered, and they began to default on their loans. This generated a chain reaction, whereby the financial intermediaries in the housing sector also defaulted on their loans to the banks.<sup>2</sup> This brought some of the largest Swedish banks to the brink of bankruptcy and beyond. The chain reaction from real estate to banking is generally seen to have been triggered in October 1990, when the real estate intermediary Nyckeln, of the Beijer Group, suspended payments on its bank loans. The immediate cause was the losses generated by a commercial property venture at the Elephant and Castle in London. This suspension of payments eventually caused the collapse of Gota Bank, and seriously compromised the balance sheets of Första Sparbanken and Skandinaviska Enskilda Banken, part of the Wallenberg Group. Nordbanken was suffering from similar arrangements and was also drawn towards bankruptcy. The attendant tightening of credit and collapse of real estate collateral triggered a swift contraction of consumption in favour of net savings in 1991, and the beginning of a severe recession (OECD, 1994, pp. 11–24).

The “slide from difficulty to disaster” (Brown-Humes, 1993) occurred, however, in September 1992 during the ERM crisis. Although Sweden was not a formal member of the European Monetary System (EMS), or indeed the European Community (EC), the Bank of Sweden had unilaterally pegged the krona to a currency basket in which the German mark was the main reference point. This was a cornerstone of its norms-based monetary policy, aiming at price stability. The currency markets severely tested the capacity of European currencies to follow the soaring value of the German mark (caused by a combination of export competitiveness, and post-unification loose fiscal policy but tight monetary policy), breaking the resolve of Italy and the UK on September 16. With an inflation rate that was well over the exceptionally low one of the deutschmark – itself a legacy of overheating in 1986–90 and a wage determination system in stress – the krona was a vulnerable target. Without any formal support by the European Monetary Cooperation Fund, and a composition of liabilities that had been deliberately shaped to consist of mainly short-term and volatile finance, the krona was swept away in the attendant maelstrom. It was in this context that the Bank of Sweden sought to

---

2. See, for instance, Pettersson (1993, pp. 27–93, esp. pp. 60–80). Pettersson was CEO of Första Sparbanken in 1982–91.

demonstrate commitment to its exchange rate norm and increased the overnight rates of the krona to 500 per cent to counter outflows, before it gave up. The exchange rate norm was replaced as the anchor of monetary policy, with an explicit price-stability norm, whereby inflation was not to exceed 2 per cent. The increase in domestic interest rates was the final nail in the coffin of the Swedish banks, which now began to file for bankruptcy one after another.<sup>3</sup>

Facing the prospect of nothing less than the collapse of the financial system, the newly installed neo-liberal centre-right government decided to rescue the banks. Given the astronomical rises in state expenditure, the loss of revenue resulting from GDP contraction, and the precarious status of the krona on the currency markets, the fledgling government invited the ousted Social Democrats to deliberations about cutbacks in social expenditure, in a bid to avert a fiscal crisis and a further loss of confidence amongst foreign investors. This launched the series of austerity packages that seriously re-trenched the welfare state.

Rather than raising questions about the merits of liberalized financial markets, the fiscal crisis provided an opportunity for neo-liberals to move forward on their positions. As many within the Social Democratic party agreed that welfare state developments had gone “too far”, welfare was assigned the blame for the crisis.<sup>4</sup> Given the precarious fiscal situation, even those who wanted to defend the Swedish welfare state – including most trade unionists – accepted that some cutbacks were necessary, thus managing to ward off even deeper cuts.<sup>5</sup>

No doubt this short-term position on crisis management could have been combined with trade union resistance to a deepening of financialization. The burden of adjustment was bound to fall on union members, through a deterioration in social insurance, mass unemployment, lower wages, and higher costs of borrowing. In addition, unions were conscious of, and motivated to resist, neo-liberalization. Swedish trade union economists had some justification for saying “I told you so”, having issued warnings about some of the crucial dynamics that had generated the crisis. To make sense of their warnings and criticisms, it is necessary to investigate in more detail the economic upswing in Sweden in the 1980s that preceded the financial crisis, and the attendant erosion of the Rehn-Meidner model.

---

3. For overviews, see Ryner (2002, pp. 148–58) and Malminen (2005).

4. The policy agenda for this was in no little measure articulated by the conclusion of the so-called Lindbeck Commission (Lindbeck et al., 1994), which was appointed by the Bildt administration in the wake of the 1992 currency crisis.

5. The Social Democratic (SAP) government actually reduced income replacement rates to 75 per cent on January 1996 in its pursuit of budget consolidation. LO mobilized successfully against this, arguing that replacement rates below 80 per cent seriously threatened the very integrity of a welfare state based on universalism and the social protection of labour. Hence, the SAP Party Congress of the same year directed the government to return to replacement rates of 80 per cent.

## The 1980s upswing and the erosion of the Rehn-Meidner model

Financial  
crises and  
organized  
labour:  
Sweden  
1990–94

The Rehn-Meidner model formalized, and gave scientific coherence to, the solidaristic wage policy norms that Sweden's blue-collar trade union confederation, LO, had adopted back in the late 1930s (Simonson, 1988, pp. 20–21, 23–35; Rothstein, 1985, pp. 156–58). Having been initially presented to the 1951 LO Congress, the model was adopted as the broad framework of economic policy-making by the Swedish Social Democratic government in 1957–58 (Pontusson, 1992, p. 65; Ryner, 2002, pp. 86–91). It was produced as a response to demands that unions should subject themselves to state incomes policy in exchange for full employment policies, in order to contain inflation. Rehn and Meidner's response was that it would be contrary to the basic mandate of unions to uphold such incomes policies, as this would entail unions holding back rather than seeking possible wage increases and ultimately they would fail to do so. Hence, unions could not compensate for overly expansionary macroeconomic policies. What unions could do, rather, was to bargain on the basis of the norm of "equal wages for equal work", whereby wages would be "solidaristically" distributed and the relationship between wages and the marginal productivity of individual firms would be severed. This, it was argued, was not only a task well in line with trade union remits, but also potentially a much better method of achieving the non-inflationary full employment objective that incomes policy pursued. Solidaristic wage policy would increase the rate of productivity growth in the economy as low productivity firms would be prematurely forced out of business, releasing factors of production for deployment in high productivity firms that also would enjoy stable and relatively favourable labour costs. This would facilitate growth, wage increases, and wage equality as well as price stability at full employment. Countercyclical macroeconomic policy was still seen as crucial in maintaining full employment. However, it could only do so much. As a supplement, the Rehn-Meidner model prescribed selective labour market policy – retraining, mobility grants and suchlike – to assist the redeployment of labour from low-productivity to high-productivity firms and sectors (LO, 1951).

There was, however, an inherent tension in the Rehn-Meidner model. To maintain wage equality, general wage demands must not be too low. This would retard the structural transformation from low- to high-productivity firms. It would lead to shortages of labour power, overheating and an incentive in some sectors to offer wage increases above the negotiated rate, resulting in wage drift. In other words, overly modest wage demands would lead to wage inequality and ultimately union disunity. They would also be counterproductive from the point of view of productivity growth and price stability. At the same time, there was no guarantee that the wage rate required to contain wage drift was the same as that required to ensure adequate investments for sustainable full employment.



It is with reference to the need to ease this trade-off between the risks of unemployment and wage drift that we can appreciate the extent to which the Rehn-Meidner model was a creature of the post-Second World War era of sturdy controls on money and finance. To ease the trade-off, it was necessary for the interest rate to be an instrument of countercyclical macroeconomic policy and not subject to the vagaries of financial speculation. Hence, integral to the Rehn-Meidner model was a battery of capital controls, including controls on currency exchange, and indeed the entire Bretton Woods range of instruments and agreements.<sup>6</sup> Over time, in efforts to counter effects such as the fragmentation of wage bargaining as a result of the growth of the service sector and white-collar unions (organized by TCO and SACO affiliates), the exhaustion of the Fordist system and the stagflation problems of the 1970s, and the end of the Bretton Woods system where the United States served as the demand locomotive for export-oriented social market economies whilst accepting their credit market controls and policy autonomy (Martin, 1986), the LO economists proposed the deployment of ever more mechanisms intended to ease the trade-off and contain the returns on capital required for productive investments. These proposals included the deployment of pension savings and investment funds, active industrial policy and wage earner funds (Martin, 1984, pp. 219–87).

This is the context behind the reasoning of trade union economists during the Reagan boom of the 1980s. They were writing in the fear that government policy would fall into the precise trap that Rehn-Meidner had warned against: insufficiently countercyclical macroeconomic policy resulting in overheating and excessive demands on unions to restrict wage demands, which would generate wage drift, inequality, union disunity and inflation. The immediate cause of this fear was the 16 per cent devaluation that a new Social Democratic government had completed when it took office in September 1982. LO had acquiesced in a devaluation to restore the cost-competitiveness of Sweden's export industry, as a precondition for the

---

6. Controls included the Investment Fund system, implemented in 1955. It exempted 40 per cent of corporate profits from taxation, if these were set aside in an Investment Fund. However, 46 per cent of these funds had to be deposited in a blocked, interest-free account with the Bank of Sweden. These would then be released counter-cyclically and served as an administrative means to curtail and inject liquidity. Other instruments of control included controls on bond emissions, reserve ratios, and voluntary agreements by financial institutions to buy quota bonds favoured by the Bank of Sweden. The latter were realized against the latent threat of fiat legislation on interest rates. Finally, foreign exchange controls ensured that Swedish interest rates could diverge from international interest rates. As Eric Helleiner has argued, the efficacy of foreign exchange controls was dependent on the mutual multilateral recognition and support of these by the OECD States and above all the United States. In addition, US-led international demand-pull contributed significantly to exported full employment policies in Europe, including Sweden. See inter alia Pontusson, 1992, pp. 70–73; Mjøsset, 1986, p. 131; Notermans, 1993, pp. 140–41; Helleiner, 1994; Ryner, 2002, pp. 89–91, 95–98).

maintenance of full employment and a defence of the Swedish welfare state, and had promised to coordinate wage demands to maintain the cost advantage created by the devaluation. However, LO's understanding of the initial agreement was that the devaluation would not be quite as large, general macroeconomic policy would not be quite so expansionary and selective finance and investment measures – not least the wage earner funds – would play a more prominent role. Hence, in 1985 LO advocated a partial revaluation to counter overheating tendencies and to reassert transformation pressure on Swedish industry (LO, 1985a).<sup>7</sup> But in November 1985 the Bank of Sweden, to approving nods from Ministry of Finance, instead proceeded to dismantle Sweden's system of capital controls, a process completed with the elimination of exchange controls in 1989. LO's fears became acute and a fundamental and open critique of government policy was formulated. A "War of the Roses" broke out, as the critique of financial deregulation became a "constant theme" of LO economists' analysis in the latter part of the 1980s.<sup>8</sup>

LO criticized the lack of democratic procedures behind the decision to liberalize financial markets (1997, p. 89–90). But, above all, LO's critique was substantive, focusing on the macroeconomic implications. The elimination of restrictions on lending by banks and financial intermediaries, in an economy that was already in a robust upswing with high rates of profit, was seen as directly and massively increasing the quantity of money in the economy through an annual credit expansion of 15–20 per cent (LO, 1988, p. 19; 1989, pp. 32–33; 1991, pp. 4–5, 23; 1992b, p. 4). Such an expansionary policy, favouring capital wealth effects over wage increases, was seen as highly questionable from the point of view of distributive justice and as a poor quid pro quo for union wage restraint. The policy was also seen as highly questionable from a macroeconomic point of view. Loans-based consumption would lead to overheating on the home market, generating wage drift and inflationary pressure that would undermine the cost advantage created by the devaluation (LO, 1988, pp. 18–19).

What is more, through these deregulations the government was seen as abdicating all instruments of adjustment, except the one that would inflict the most direct pain on organized labour once the imbalances needed to be addressed. This was the blunt instrument of the interest rate determined by the international markets. Here, the main butt of LO's criticisms was the so-called government borrowing norm (1985b, p. 9; 1986, pp. 5–7; 1988, pp. 20–26; 1992a, pp. 5, 24–25; 1992b, p. 5; 1995), which really amounted

7. The formulation was that LO prescribed a revaluation and a forfeit of employee contribution increases in exchange for coordinated bargaining.

8. Whilst our documentation of trade union critiques draws mainly on sources from the blue collar confederation LO, we are informed that the economists of Sweden's main white collar confederation, TCO, agreed with LO's critique of capital market deregulation (discussion with TCO's Chief Economist at the time, Roland Spänt, Stockholm, 12 Nov. 2009).

to a form of sterilization policy that maximized the sensitivity of Swedish interest rates to global financial markets. Instead of pursuing a policy whereby the government would borrow in order to cover current account deficits, the government would as a principle not borrow abroad, leaving such transactions entirely to the market. Again, the LO economists put forward arguments of distributive justice and of macroeconomics against the policy. From a distributive justice point of view, they argued that a fundamental social democratic and trade union economic aim must be to ensure that the functioning of the economy would be secured at the lowest possible rate of return on capital. Deregulation and the borrowing norm did exactly the opposite by increasing the opportunity cost of productive capital (e.g. LO, 1988, pp. 22–23). Destabilizing macroeconomic effects were the other side of the same coin: high profit rates increased the incentives and capacities of employers to break up coordinated wage bargaining and hence the capacity to coordinate macroeconomic policy and wage policy. To this should be added the highly detrimental differential effects that the interest rate policy had on productive investments in the export sector and on consumption. The former were hit hard by high interest policy, requiring higher profit rates, whilst the latter were hardly affected. This was due to the “monetary illusion” generated by a reduction in the nominal interest rate, in an environment where inflation rates were decreasing, as well as by write-off rules in the tax system. The differential effect would redirect the proceeds of profit towards investments in consumer products and services, generated by the loan-driven wealth effects, eventually generating balance of payments deficits (e.g. 1988, pp. 22–26). As a remedy, LO economists at various times proposed a number of alternatives:

- A temporary return to “some form” of restriction on “free credit” (LO, 1988, p. 22).
- An active state borrowing policy to cover balance of payments deficits. This was a recurring demand whenever the borrowing norm was criticized. In 1995, it was even suggested that an international agreement on such a policy could serve to stabilize currency markets and supplement policies such as the Tobin Tax (LO, 1995).
- Maintaining (whilst foreign exchange controls were still in place) the rule that foreign investments by Swedish companies must be financed by sources from abroad, ensuring that domestic profits and savings are used for domestic investments (LO, 1997, p. 90).
- Broadening the VAT (value added tax) base to include bank, insurance and financial service transactions (LO, 1988, p. 14; 1989, p. 35).
- Tightening tax write-off rules for loans. This was included in the tax reform in the late 1980s, but LO criticized the overall lowering of the tax rate as part of the reform, again from a distributive justice perspective and for its destabilizing pro-cyclical effects (LO, 1989, pp. 34–35).

- Sector-based taxation of wage drift (LO, 1989, pp. 38–39), as a remedy to problems associated with higher profit rates generated by financial liberalization.

In public debate, doubts were cast on the validity of the trade union economists' analysis, at a time when the neo-liberal zeitgeist was holding increasing sway in the epistemic community around economic policy-making in Sweden.<sup>9</sup> However, it is now generally accepted that the asset price bubble as generated by the pro-cyclical effects of credit market deregulation was the source of the crisis (e.g. OECD, 1994, p. 11; Viotti, 2000, p. 7). Yet, after sanitizing the balance sheets of the banks at great expense, and despite questions that could have been raised about the destruction of value resulting from the wage restraint that Swedish wage earners exercised in the 1980s, the Social Democratic government that returned to power in 1994 continued to embark on financial market liberalization amidst a consensus that did not question such liberalization. This culminated in the pension reform of 1999, under which free market finance reached into the everyday savings of Swedish wage earners, not the least through the Premium Reserve System. So by necessity, the wage earners now feed off, and have to participate in, the global casino. In 2007–08, that casino suffered an even more severe financial crisis of global proportions (Belfrage and Ryner, 2009). In the next section, we will consider dynamics internal to Swedish trade unions that make sense of their rather surprising acquiescence in this, at a time when their critique of financial liberalization seemed to have been validated.

### Sweden's financial crisis 1990–94 and trade union strategy

It is one thing to advance a critique. It is quite another to translate that critique into effective advocacy and policy change, and indeed to make the strategic decision to prioritize advocacy in a particular area.

In the general crisis of the early 1990s, the trade unions assigned a very low priority to addressing the financial dimensions. This is perhaps not so surprising. After all, they experienced the crisis most acutely within their core area of activity, where their power resources were strongest: the wage determination system. Structurally, this system was under severe stress, due to the fragmentation of wage negotiations between blue-collar and white-collar sectors as well as between export-oriented and domestic/import-competing sectors. By the 1980s, this development was being actively led by the employers. They were resolved to abandon centralized bargaining in favour of sectoral, and if possible, enterprise-level bargaining (de Geer, 1989). The aforementioned pro-cyclical macroeconomic policies significantly facilitated these

9. Bergström (1993) captures the intellectual atmosphere of the debate of the time.

tendencies (Martin, 1999), and had brought matters to a head even before the Nyckeln default. In the spring of 1990, it was clear that leapfrog bargaining and wage-push inflation would break incomes policy targets, triggering a run on the krona. In increasingly desperate attempts to counter this run on the currency, the Social Democratic government abandoned the policy aim that went to the very heart of the objectives held in common by the labour movement ever since the 1930s. This was the unconditional full employment commitment, which was abandoned in the same breath as the intention to apply for EC membership was announced.

Hence, concurrently to the unfolding of the financial crisis, the trade union priority was to re-establish a norm for wage coordination. As this had to happen in the here and now, such efforts were based on premises that bluntly accepted the “sociological changes” that financial liberalization had made to the macroeconomic framework (LO, 1989, p. 38; also 33). Whatever one may think about foreign exchange deregulations that required profit rates to be determined by the world market and the norms-based monetary policy that increased the minimum rate of return on capital, these now determined the macroeconomic environment of wage bargaining. Any attempt to stretch the scope for wage increases in such an environment would result in unemployment. The priority was now to save whatever could be saved in terms of employment levels, wage solidarity and coordination. Hence a slimmed-down version of wage coordination – the so-called LISA project – was established as a reference point for internal deliberation in the LO secretariat. With LISA, unions accepted that the scope for wage increases was determined by price developments within the EU plus productivity growth. The objective became one of distributing this wage share among the membership.

This prioritization of the areas most directly in the unions’ remit resulted in passivity in debates about financial crisis management. In so far as unions intervened in the broader policy arenas, they advocated (unsuccessfully) a more counter-cyclical and expansionary approach to the recession and (more successfully) resistance to further cuts in social insurance replacement rates as well as labour law.

Possibly as a consequence of this lower priority, whilst trade union economists had put forward critiques of financial liberalization and monetary policy, it is less certain that they had developed a clearly focused and coherent alternative policy concept to which they subscribed with conviction. True, the critiques of the pro-cyclical timing of capital market deregulation and the borrowing norm are clear and consistent enough. However, as the 1990s progressed – also, it should be said, towards a low interest rate environment – these macroeconomic critiques in and of themselves became increasingly irrelevant. On the question of what can and should be done about liberalized credit markets and financialization, and indeed on the in-principle merits of such markets, LO economists are more equivocal. In the Spring 1986 report, there is a clear statement against the merits of following

Denmark's foreign exchange liberalization (LO, 1986, p. 7); the Autumn 1991 report indicts the irresponsible lending practices of the entire deregulated banking sector (LO, 1991, p. 23); and a Supplement to the Spring 1995 Report contains a very interesting analysis with a global perspective on the possibilities for countering turbulence and myopia on global financial markets through active state lending policy (LO, 1995). On the other hand, it is the macroeconomic timing rather than the deregulation as such that is at the forefront of LO's concern. The 1989 report even explicitly states that whilst the timing was wrong, there was nothing wrong with the deregulation of credit and currency markets (LO, 1989, pp. 32–33). Indeed, even the Autumn report of 1991 that indicted bank lending practices is remarkably sanguine about the prospects of financial institutions learning from their mistakes. This seems to indicate that despite their macroeconomic criticisms, LO economists, though by no means unaware of them, still underestimated the systemic risks of finance-led growth models.

Trade union economists who were critical of capital market deregulation had difficulty in being recognized as authoritative voices on this issue, not only by society at large but also by the senior union leadership. The Presidents of LO and TCO as well as of the largest unions (the Metalworkers' and Municipal Workers' Unions) were on the Supervisory Boards of several of the large banks, and hence carried co-responsibility for the decisions that led to the banking crisis. In this particular domain of their activities, they tended not to refer to trade union economists for advice but rather to other economists who were seen as "experts" on finance. The fact that union economists articulated an equivocal perspective on these issues hardly helped matters.

But this stance by LO's economists should not be understood merely as technocrats retreating into their policy domains. Their analysis presented in the 50th Anniversary Edition of *Ekonomiska utsikter* (LO, 1997, pp. 44–49) reveals a rather fatalistic understanding of the social and international balance of power, which was seen as having put organized labour in a less advantageous position, requiring a more defensive posture. The relatively favourable position of organized labour after the Second World War was seen as fundamentally based on Cold War bipolarity, which had created a negotiating space for social democratic trade unions to negotiate advantages on the basis of pre-empting the threat of communist developments in the West. With the collapse of communism and the rise of American unipolarity, that negotiating space had been closed, because the political conditions facilitated a more uncompromisingly capitalist form of development as favoured by the hegemony. This was the political context in which the LO economists put the difficulties of asserting alternatives to capital market deregulation at the national level. From such a point of view, it makes complete sense to retreat from debates over capital markets and focus on areas where some influence can be exerted.

However, a less fatalistic view is also represented in the 1997 Anniversary Edition of *Ekonomiska utsikter*. Following the social analysis of Walter Korpi



(1983), it understood the development as an effect of changes of power resources between social classes, where globalized capital was now able to exert structural power through its transnational mobility. The increased power of neo-liberal ideology, capital market deregulation, retreat from full employment policies and austerity policy should be understood in this context. A counter-strategy would be based on closer transnational trade union cooperation; actions to promote democratization nationally, regionally (the EU) and globally; and ideological struggle against neo-liberalism (LO, 1997, page 71). The LO economists explicitly distanced themselves from this analysis in the introduction and adopted a more fatalistic view based on big power politics.

Furthermore, the less fatalistic view was endorsed by LO's Executive and the 1996 Congress. LO's Executive had taken initiatives to counter the ideological struggle which had been so successfully pursued by Swedish employers and business in the 1980s. Starting with a project focusing on the plight of low-income groups, this initiative grew into an internal social justice commission, culminating in the launch of an LO "debate of ideas" (*idédebatt*) in 1996. The aim was to take back the initiative in the debate about social development, while forging alliances in civil society. Part of this mandate was to explore broader policy frames and strategies, such as the prospects of taking part in struggles about the EU as a "socialist project", which had been a term that the Swedish Social Democratic Party (SAP) had invoked when the decision to join the EC was taken. Considerations included the prospects for the coordination of wage demands across the borders of welfare states in order to counter transnational under-bidding, an international trade union code of practice on pension fund investments, and the prospects for European-level capital controls (LO, 1995b).

Nevertheless, the more defensive posture would prevail as day-to-day short-term issues came to trump long-term strategy. Hence, the fatalistic perspective framed the LISA project, where no explicit connection was made between issues of financial market regulation and the priorities of trade union strategy. By the 1990s, forceful intervention in the debate on financial markets by the trade unions would have been understood as a rather aggressive infringement on a government policy remit in which union interference was seen as questionable and as a radical expansion of trade union practices. At the end of the day, Swedish trade unions were not prepared to undertake the mobilization drive that such a strategy would have required, nor such a radical step away from their "business as usual". Quite telling in this regard is the occasion when the LO *idédebatt* view was represented during the drafting of the LISA project. The reply from the LO economists was: in principle you are correct, but we cannot go out with ambiguous double messages to the membership. In other words, the effort to mobilize rank-and-file support for LISA's EU price/productivity norm could not be reconciled with a politicization of the liberalized capital markets that the LO economists themselves had criticized in the 1980s.

## Conclusions

In hindsight, it may well be argued that credit regulations, foreign borrowing and foreign exchange policies over a longer period of time had a much deeper effect in terms of increased unemployment, and weakened the power resources of Swedish labour more, than did the retrenchment of health insurance entitlements and labour law, which the unions really contested in the aftermath of the financial crisis. One issue to consider is whether the union leaders who were on the boards of banks, insurance companies and pension funds could have represented the interests of workers better if a more consistent trade union knowledge perspective had been developed out of the critique of the credit market deregulation of the 1980s. On the other hand, having been involved in major investment and policy decisions in this area, it would have been difficult for them to distance themselves from the attitudes and ideologies prevailing at this time in the financial sector. This may have contributed to the relative absence of clear-cut, strong resistance against financialization and deregulation on the part of Swedish unions.

By the early 1990s, a lot had changed in the preconditions for this Swedish model – and this is of course even more so the case now. The understanding of what constitutes core union interests needs to be reconsidered today. The Swedish model, like other models of the time, was constructed in a period when productive capital was looking for accommodation with labour, at a time when both labour and finance were scarce and regulated under the auspices of the Bretton Woods system. Present-day globalized capitalism is characterized by massive unemployment and huge financial capital resources, seeking outlets in a highly volatile transnational monetary system. Financial regulations, trade policies, European and global foreign exchange mechanisms but also issues such as global taxes and the regulation of tax havens must be considered serious candidates when core union issues are defined anew.

In order to facilitate rank-and-file mobilization and to gain public legitimacy for union action on issues such as these, the relationship of such issues to the day-to-day situation of workers must be clarified. It is a mistake to think that these policy areas are distant from ordinary union members. The effects of globalized and financialized capitalism are nowadays felt at every single workplace. It may very well be that this is ultimately connected to unipolarity and the dominance of a neo-liberal hegemonic state in the form of the United States. However, such unipolarity is in no little measure exercised through the lack of a transnational counterweight that unions might contribute by creating closer cooperation within the EU and beyond.



## References

- Aglietta, M.; Breton, R. 2001. "Financial Systems, Corporate Control and Capital Accumulation", in *Economy and Society* 30(4), pp. 433–466.
- ; Rebérioux, A. 2005. *Corporate Governance Adrift: A Critique of Shareholder Value* (Aldershot, Edward Elgar).
- Belfrage, C.; Ryner, M. 2009. "The Renegotiation of the Swedish Social Democratic Settlement: From Pension Fund Socialism to Neoliberalization", in *Politics & Society* 37(2), pp. 257–288.
- Bergström, C.; Englund, P.; Thorell, P. 2003. "Securum and the Way Out of the Swedish Banking Crisis", Summary of Report Commissioned by the Center for Business and Policy Studies SNS, May.
- Bergström, V. 1993. *Varför överge den svenska modellen?* (Stockholm, Tiden/FIEF).
- Brown-Humes, C. 1993. "The Slide from Difficulty to Disaster", in *Financial Times*, 19 Feb.
- De Geer, H. 1989. *I vänstervind och högerövåg* (Stockholm, Allmäna Forlaget).
- Dougherty, C. 2008. "Stopping a Financial Crisis, the Swedish Way", in *New York Times*, 22 Sep. Available at: <http://www.nytimes.com/2008/09/23/business/worldbusiness/23krona.html> (accessed 31 Jan. 2010).
- Grahl, J. 2001. "Global Finance: The Challenge to the Euro", in *New Left Review* (new series) 8, pp. 23–47.
- Helleiner, E. 1994. *States and the Re-emergence of Global Finance* (Ithaca, NY, Cornell University Press).
- Korpi, W. 1983. *The Democratic Class Struggle* (Boston, Routledge and Kegan Paul).
- Lindbeck, A. et al. 1994. *Turning Sweden Around* (Cambridge, MA, MIT Press).
- Lipietz, A. 1997. "The Post-Fordist World: Labour Relations, International Hierarchy, and Global Ecology", in *Review of International Political Economy* 4(1), pp. 1–41.
- LO. 1951. *Fackföreningsrörelsen och den fulla sysselsättningen* (Stockholm).
- . 1985a. *Ekonomiska utsiker*, Spring (Stockholm).
- . 1985b. *Ekonomiska utsiker*, Autumn (Stockholm).
- . 1986. *Ekonomiska utsiker*, Spring (Stockholm).
- . 1988. *Ekonomiska utsiker*, Spring (Stockholm).
- . 1989. *Ekonomiska utsiker*, Autumn (Stockholm).
- . 1991. *Ekonomiska utsiker*, Spring (Stockholm).
- . 1992a. *Ekonomiska utsiker*, Spring (Stockholm).
- . 1992b. *Ekonomiska utsiker*, Autumn (Stockholm).
- . 1995a. "Vad styr växelkurs och ränta?", Supplement to *Ekonomiska utsiker*, Spring, pp. 24–32.
- . 1995b. *Rättvisa* (Social Justice), main report to the LO Convention in September 1996.
- . 1997. *Om ekonomi och makt 1947–1997: Ekonomiska utsiker jubileumsskrift* (Stockholm).
- Malminen, J. 2005. *Managing Global Finance: Choices and Constraints in the Swedish Financial Crisis of 1992* (Stockholm, Totalförsvarets Forskningsinstitut, FOI-R-1797-SE).

- Martin, A. 1983. "Is Democratic Control of Capitalist Economies Possible?", in L. Lindberg et al. (eds): *Stress and Contradiction in Modern Capitalism* (Lexington, MA, D.C. Heath), pp. 12–56.
- . 1984. "Trade Unions in Sweden: Strategic Responses to Change and Crisis," in P. Gourevitch et al. (eds): *Unions and Economic Crisis* (London, Allen & Unwin), pp. 190–359.
- . 1986. "The Politics of Employment and Welfare: National Policies and International Interdependence", in K. Banting (ed.): *The State and Economic Interests* (Toronto, University of Toronto Press), pp. 157–242.
- . 1999. "The Politics of Macroeconomic Policy and Wage Negotiations in Sweden", in T. Iversen, J. Pontusson and D. Soskice (eds): *Unions, Employers and Central Banks* (Cambridge, Cambridge University Press), pp. 232–264.
- Mjøset, L. et al. 1986. *Norden dagen derpå* (Oslo, Universitetsforlaget).
- Nordstrom, L. 2010. "Swedish Fund Seen as a Model for Bank Bailouts", in *Boston Globe*, 22 Jan. Available at: [http://www.boston.com/news/world/europe/articles/2010/01/22/swedish\\_fund\\_seen\\_as\\_model\\_for\\_bank\\_bailouts/](http://www.boston.com/news/world/europe/articles/2010/01/22/swedish_fund_seen_as_model_for_bank_bailouts/) (accessed 31 Jan. 2010).
- Notermans, T. 1993. "The Abdication of Policy Autonomy", in *Politics & Society* 21(2).
- OECD. 1994. *Economic Surveys: Sweden* (Paris).
- Olsson, S. E. 1993. *Social Policy and the Welfare State in Sweden* (Lund, Arkiv förlag).
- Pettersson, K.-H. 1993. *Bankkrisen inifrån* (Stockholm, SNS förlag).
- Pontusson, J. 1992. *The Limits of Social Democracy* (Ithaca, NY, Cornell University Press).
- Rothstein, B. 1985. "The Success of Swedish Labour Market Policy: The Organizational Connection to Policy", in *European Journal of Political Research* 13(2), pp. 153–165.
- Ryner, M. 2002. *Capitalist Restructuring, Globalisation and the Third Way: Lessons from the Swedish Model* (London, Routledge).
- Simonson, B. 1988. *Arbetarmakt och näringspolitik*, (Stockholm, Allmänna förlaget).
- Viotti, S. 2000. "Hantering av bankkriser – förslag till nytt regelverk", in *Penning- och valutapolitik* 3, pp. 5–21.
- Watson, M. 2009. "Investigating the Potentially Contradictory Microfoundations of Financialization", in *Economy and Society* 38(2), pp. 255–277.



# The Asian crisis of 1997–98: The case of the Republic of Korea

**Jin Ho Yoon**

Inha University

*What was the Korean trade unions' response to the restructuring and downsizing process that followed the economic crisis of 1997–98? How successful were they in protecting workers' jobs and livelihoods?*

Over a period of more than three decades, the Republic of Korea achieved remarkable economic development, with an average growth rate of more than 8 per cent per year. Per capita income increased from less than US\$100 in 1960 to over US\$20,000 in 2007. The success of the Korean economy has been praised as the “Miracle of the Han River” (Cumings, 1997) and the “East Asian economic model” (Han, 2009).

But at the end of 1997, the Republic of Korea was one of the countries most affected by a dramatic financial crisis. This started in Thailand, with the collapse of the Thai baht, but rapidly spread to other Asian countries. As Korea's foreign reserves decreased rapidly, massive outflows of foreign capital followed. Stock prices and the exchange rate of the Korean won were halved in less than one month. Many firms and financial institutions that had taken out loans in US dollars suddenly found themselves unable to repay their creditors. As these companies became insolvent or were downsized, the financial crisis was quickly followed by the real economic crisis.

Under such circumstances, it was inevitable that the Korean government should seek a bailout from the International Monetary Fund (IMF). In exchange, the IMF demanded a series of economic reforms. In line with these IMF “conditionalities”, the Korean government executed restructuring measures in corporate governance, banking, the public sector and labour markets (Yoon, 2005). This restructuring process had a significant effect on the Korean economy and labour market.

The harsh terms of the IMF conditionalities brought severe austerity, economic stagnation, mass unemployment and rising poverty. Due to the economic crisis and the restructuring process, the unemployment rate jumped to 7.0 per cent in 1998 from 2.6 per cent in 1997. The share of non-standard workers increased to more than half of total waged employment. Social fragmentation also increased. The poverty rate more than doubled after the crisis and indices of inequality increased substantially. Many workers suffered from falling wages and worsening working conditions.

In response to the economic crisis and restructuring of the economy, labour unions needed a new strategy to protect jobs and workers' livelihoods. When the restructuring and mass dismissals started, the first reaction of organized labour was strenuous opposition. Unions called a series of general strikes and mass demonstrations. However, faced with an adverse environment and limited resources, the labour movement was unable to halt the process.

When the government proposed the establishment of a tripartite committee to discuss the restructuring and other reform measures, the unions

decided to participate in this corporatist institution. After much confrontation and long negotiations, the social partners finally came up with the country's first-ever social agreement, in February 1998. According to the agreement, labour laws were revised to ease restrictions on mass lay-offs and allow temporary employment agencies. In return, the unions gained the right to organize teachers and government officials, and other reform policies were promised by the government. However, as the government and the employers refused to halt the restructuring process, the unions later withdrew from the tripartite committee.

Up to now, most trade unions in the Republic of Korea have been enterprise-based, and they usually negotiate with employers individually. The country's union leaders believe that, in order to promote labour's bargaining power, European-style industrial unions and industry-wide collective bargaining are needed. However, the unions' efforts to change the collective bargaining structure have met with strong resistance from management. Although a few industrial unions – metal, hospitals and finance – succeeded in reaching industry-wide collective agreements in 2004, enterprise bargaining is still the dominant form.

This paper sets out to discuss the role of labour unions in the Republic of Korea after the economic crisis of 1997–98. What kind of strategy did the unions adopt in response to the restructuring and downsizing process after the crisis? How successful were the unions in protecting workers' jobs and livelihoods? Which strategies worked and which did not?

### **The cause of the economic crisis and its impact on labour**

Since the economic crisis of 1997–98, the Republic of Korea has become an ideological battleground for mainstream economists and heterodox scholars (Hart-Landsberg and Burkett, 2001; Park, 2001). The “orthodox” view, promoted by the IMF and mainstream Anglo-Saxon economists, attributes the Korean crisis to a “crony capitalism” in which the inefficient and corrupt government over-regulated the economy to protect the interests of the big family-controlled conglomerates known as the *chaebol* (IMF, 1997; Krugman, 1998; Summers, 1998; Kwon and O'Donnell, 1999). According to this view, redundant investments and heavy borrowing from foreign financial markets by the *chaebol* were the foremost cause of the crisis.

The heterodox version, advanced by scholars and activists who are critical of the IMF and international financial capital, is that internal and external liberalization of the financial market brought about the crisis (Wade and Veneroso, 1998; Wade, 1998; Crotty and Lee, 2001; Chang, 1998). They point to the push from international organizations and governments in wealthy countries to institute a worldwide regime of capital mobility.

According to this view, greater openness and deregulation of capital mobility means greater vulnerability to exogenous shocks.

Each argument contains some elements of truth but fails to encapsulate the Korean crisis as a whole (Kim and Cho, 1999). The Korean crisis was a complex phenomenon, including market and government factors as well as external and internal causes.

For the past several decades, the Korean economy has been organized in accordance with the “East Asian economic model”. The government took control of the broad contours of economic life, and more especially focused its development efforts on a small number of *chaebol*, using diverse policy instruments to grant them favours – for example, financial and fiscal assistance, tight protection against imports, and the regulation of wage increases and the labour movement (Crotty and Dymski, 1998; Crotty and Lee, 2001; Park, 2001).

This model was highly successful. From 1961 until 1996, the Korean economy grew by more than 8 per cent a year. In less than 40 years, Korea was transformed from one of the poorest countries in the world to a highly industrialized country.

By the early 1990s, the *chaebol* had expanded their business in the advanced industries, in lines such as autos and semi-conductors. To do so, they needed to borrow a huge sum of money from both domestic and foreign banks. Under the combined pressure of the *chaebol*, of foreign trade partners (especially the United States) and of international institutions such as the IMF, the Korean government rapidly relaxed controls on both domestic financial markets and foreign capital inflows. Believing that the government would rescue them in hard times, the *chaebol* borrowed too much. As a result, the country’s external liabilities rose to over US\$200 billion by the end of 1997 and 58.8 per cent of those loans were short-term, to be repaid within a year (Crotty and Dymski, 1998).

A more fundamental problem was the declining competitiveness of the Korean economy. Cheap export goods from China and other less developed countries took market share from Korea. A slowdown in export growth in 1996, followed by the financial crisis in South-East Asia in mid-1997, squeezed *chaebol* profits and triggered the rapid depreciation of the won, making it impossible for many *chaebol* to pay off the foreign creditors.

To prevent the collapse of the banking system as well as to deal with the insolvency of the *chaebol*, the government asked the IMF for help, and on 3 December 1997 agreement was reached on a US\$58 billion rescue package. The IMF “conditionalities” included budget cuts and high interest rates; the removal of all restrictions on foreign ownership of domestic banks and firms; the elimination of all forms of government control on domestic as well as international capital flows; and deregulation of the labour market to provide employers with the right to dismiss workers (Kwon and O’Donnell, 1999). Accordingly, from 1998 onwards, President Kim Dae-Jung, who was

elected in December 1997, introduced extensive economic restructuring policies. These basically aimed to transform the existing state-dominated economy into a market-driven system by benchmarking the neo-liberal model of Anglo-Saxon countries like the United States and the United Kingdom (Lee and Lee, 2003).

Of the reform measures taken by the government, the most significant from labour's point of view was the promotion of labour market flexibility. The IMF specifically demanded the enactment of labour laws facilitating lay-offs and allowing temporary work agencies.

The economic downturn during the crisis was dramatic. As shown in table 1, the growth rate of real GDP dropped to –5.7 per cent in 1998 from its pre-crisis average of about 7 per cent per year. Only export growth was relatively less affected by the crisis, in contrast to most other components of GDP (Lee and Rhee, 2002).

After the freefall, the Korean economy started to bottom out in the second half of 1998, and the speed of the recovery was no less dramatic. In 1999, it grew at an annual rate of more than 10 per cent. Despite slower growth rates in 2000 and 2001, the “V-shaped” recovery in the Republic of Korea has been faster and broader than in other Asian economies that experienced economic crisis (Lee and Lee, 2008). The Korean economy also recorded a huge trade surplus and a sharp rebound in consumer spending and corporate investment. Some see it as a model for the IMF's free market or neo-liberal prescriptions to other developing countries (Crotty and Lee, 2001). But there are also more pessimistic interpretations. The country faces an unbalanced recovery of questionable durability. The transformation to a

**Table 1. Macroeconomic indicators for the Republic of Korea, 1996–2008**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Growth rate (%)</i>													
Real GDP <sup>1</sup>	7.2	5.8	–5.7	10.7	8.8	4.0	7.2	2.8	4.6	4.0	5.2	5.1	2.2
Consumption <sup>1</sup>	7.3	3.7	–9.9	10.1	7.8	5.5	8.1	0.5	3.7	2.0	3.9	4.8	–0.8
Investment	8.2	–1.5	–22.0	8.7	12.3	0.3	7.1	4.4	2.1	1.9	3.4	4.2	–1.7
Exports	11.6	19.8	12.9	14.4	18.1	–3.4	12.1	14.5	19.7	7.8	11.4	12.6	5.7
Imports	14.7	4.2	–22.0	26.4	22.6	–4.9	14.4	11.1	19.8	9.4	12.9	11.9	4.1
Consumer prices	4.9	4.4	7.5	0.8	2.3	4.1	2.8	3.5	3.6	2.8	2.2	2.5	4.7
<i>Amounts</i>													
Current balance <sup>2</sup>	–23	–8	40	24	12	8	5	12	28	15	5	6	–6
Foreign reserves <sup>2</sup>	33	20	52	74	96	102	121	155	199	210	239	262	201
Won per dollar <sup>3</sup>	805	954	1395	1189	1131	1291	1251	1192	1144	1024	956	929	1103

<sup>1</sup> Real growth rates. <sup>2</sup> Billion US dollars for current account balance and foreign reserves. <sup>3</sup> Won per US dollar is the year average rate

Source: All data are from Korea Statistical Office, <http://kosis.kr/>.



market-driven system has made the Korean economy more vulnerable to outside shocks, and more divided in terms of industrial structure and the labour market.

Many mainstream analysts claim that the restructuring has greatly reduced the Korean economy's vulnerability to instabilities in the international economy. This wishful thinking was proved totally wrong when another international economic crisis broke out in the United States in 2008.

The opening of the Korean economy has made it more and not less vulnerable to outside shocks. Export dependency rose sharply from 32.5 per cent in 1997 to 55.0 per cent in 2008 as a percentage of GNI. The gap between large *chaebol* firms in the export sector and small and medium-sized firms in the domestic sector has been increasing. Fast-growing export industries such as semiconductors and mobile phones rely heavily on imported goods. Thus, export growth does not trigger so much domestic spending (Crotty and Lee, 2005).

The economic crisis severely affected the lives of Koreans, especially the workers. Before the crisis, Korean workers demanded higher wages and better working conditions. Regular workers enjoyed job stability (although non-standard workers did not). The crisis fundamentally changed all these practices (Lee and Na, 2004). The immediate impact of restructuring was mass lay-offs. The number of jobless workers increased significantly from 574,000 in November 1997 to 1.7 million in December 1998 (Koo, 2000). In the public sector, several public companies were privatized and a total of 18 per cent of public workers were dismissed during the 1998–2000 period (Han, 2009). In the financial sector, a total of 25 per cent of workers were laid off in this period. In 1998 alone, the top five *chaebol* laid off more than 80,000 employees (Kwon and O'Donnell, 1999). Such a drastic lay-off was a great shock to many Korean workers, who had previously enjoyed long-term employment.

For the last two decades before the economic crisis, the Republic of Korea enjoyed virtually full employment. The unemployment rates were remarkably low, at less than 3 per cent during the 1990s. However, as shown in table 2, the unemployment rate rose sharply after the crisis, from 2.6 per cent in 1997 to 7.0 per cent in 1998. At its peak, it reached 8.8 per cent in February 1998. Although it has gradually declined since then, it remains at a relatively high level by pre-crisis standards (Lee and Rhee, 2002). The sluggish adjustment of the unemployment rate, compared with the rapid recovery of other macro-economic variables, is the most pessimistic aspect of the Korean economy.

In addition to the officially unemployed workers, many others dropped out of the labour market altogether, particularly women. Others were self-employed workers on very low incomes, such as street vendors. If we add in these factors, real unemployment is more than double the official rate.

Another striking result of economic restructuring on labour was a sharp increase in the number of non-standard workers. Employers were quick to take advantage of their new legal power to dismiss regular workers and employ irregular workers instead. When the Korean economy recovered in

1999, firms hired mostly part-time or temporary workers. The share of irregular workers rose from 46 per cent in 1997 to 52 per cent in 2002, accounting for about 90 per cent of the increase in employment during this period (Cho and Keum, 2009). Wages and working conditions for non-standard workers were much worse than for those with permanent jobs. Thus, overall labour market flexibility was achieved through an increasing degree of duality in the labour market.

Not only employment, but also wages and other working conditions deteriorated after the economic crisis. Wage cuts and other concessions spread throughout the economy. As shown in table 2, real wages dropped by 2.5 per cent in 1998, compared to annual increases of 10 per cent prior to the economic crisis. The share of labour income fell significantly, from 62.6 per cent in 1996 to 58.1 per cent in 2000. The most surprising fact is that unit labour costs dropped by 28 per cent in real terms, due to a combination of wage cuts and productivity rises through employment adjustments (Koo and Kiser,

**Table 2. Labour and social indicators for Korea, 1996–2008**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Employment growth (%)	2.2	1.7	-6.0	1.8	4.3	2.0	2.8	-0.1	1.9	1.3	1.3	1.2	0.6
Unemployment rate (%)	2.0	2.6	7.0	6.3	4.1	3.8	3.1	3.4	3.5	3.5	3.3	3.0	3.0
Share of non-standard workers (%) <sup>1</sup>	43	46	47	52	52	51	52	49	49	48	47	46	44
Real wage increase (%) <sup>2</sup>	11.9	7.0	-2.5	12.0	8.0	5.6	11.6	9.4	6.5	6.4	5.6	5.9	3.2
Share of labour income (%)	62.6	61.4	60.6	59.0	58.1	58.8	58.0	59.2	58.7	60.7	61.3	61.1	60.6
Gini coefficient <sup>3</sup>	.272	.268	.295	.303	.286	.299	.298	.295	.301	.304	.313	.324	.325
Quintile income ratio <sup>4</sup>	4.17	4.09	4.94	5.13	4.58	4.92	4.92	5.06	5.23	5.41	5.72	6.12	6.20
Relative poverty ratio <sup>5</sup>	9.6	9.3	12.2	13.1	10.8	11.8	11.4	12.8	13.7	14.1	14.7	15.6	15.4
Union density (%)	12.1	11.1	11.4	11.7	11.4	11.5	10.8	10.8	10.3	9.9	10.0	10.4	–
Strikes	85	78	129	198	250	235	322	320	462	287	138	115	108
Participants (thousands)	79	44	146	92	178	89	94	137	185	118	131	93	114
Days lost (thousands)	893	445	1452	1366	1894	1083	1580	1299	1199	848	1201	536	809

<sup>1</sup> Share of non-standard workers is a percentage share of temporary and daily workers out of total waged workers. Temporary workers are defined as those whose terms of employment are from one month to one year, while daily workers are defined as those whose terms of employment are less than one month. <sup>2</sup> Real wage increase is for the workers working in non-agriculture establishments that have ten or more employees. <sup>3</sup> All income distribution indicators are for urban households that have two or more family members. <sup>4</sup> Quintile income ratio is the ratio of the income share of the top 20 per cent to that of the bottom 20 per cent. <sup>5</sup> Relative poverty ratio is the share of households whose income is less than 50 per cent of the median income of all households.

Sources: All data excluding industrial relations indicators are from Korea Statistical Office, <http://kosis.kr/>. Data for the industrial relations indicators are from Korea Labor Institute, *KLI Labor Statistics*, 2009.

2001). So the Korean recovery was largely due to the great sacrifices made by workers in terms of both employment and wages.

Social fragmentation also grew. Indices of inequality increased substantially in the aftermath of the crisis. As shown in table 2, the Gini coefficient rose from 0.268 in 1997 to 0.325 in 2008, while the ratio of the income share of the top 20 per cent of urban households to the bottom 20 per cent rose from 4.09 in 1997 to 6.20 in 2008. The relative poverty ratio rose from 9.3 per cent in 1997 to 15.4 per cent in 2008. Still, the welfare system, while improved, remains inadequate to deal with the social problems created by the economic crisis and neo-liberal reform policies (Crotty and Lee, 2005).

### Restructuring and union strategies

The unions tried hard to protect the workers, but organized labour was not strong enough to tackle the economic crisis. Although the labour movement in the Republic of Korea is well known for its militancy, it is still weak, divided and fragmented. Even at its peak, union density was just 18.6 per cent in 1989. By 1997, it had declined to only 11.1 per cent of all wage earners – mostly regular workers in big enterprises. So most SME employees, as well as non-standard workers, were not represented by unions.

There are many reasons for this low union density, but the most important one is the structural weakness of Korean labour unions. Most of them are organized by regular workers within individual enterprises. They bargain separately with their own employers. Although there are industrial federations of enterprise unions, their role is very limited. Key decisions on collective bargaining, collective action and union activities are made at the enterprise level.

Labour unions in the country are not only fragmented but also divided into moderate and militant factions. Before the Great Struggle of 1987, the Korean government permitted only a cooperative national union, which is the Federation of Korean Trade Unions (FKTU). Since 1987, many independent unions have emerged. They refused to join the FKTU and created a new umbrella organization, the Korean Confederation of Trade Unions (KCTU), in 1995.

While the FKTU is more cooperative with management and the government, the KCTU is more militant. While the FKTU is comprised mostly of small and medium-sized unions, the KCTU consists mainly of big unions. This division of the labour movement was clearly one of its weaknesses when trying to deal with the restructuring process.

The initial response of labour to the waves of downsizing and restructuring was to strongly oppose any employment adjustment programmes. But, faced with ever-higher unemployment rates and a hostile government committed to forcing restructuring through, workers became increasingly desperate. To avoid lay-offs, unions suggested various concessions such as wage

freezes, wage cuts, working hours reductions and early retirements. When most of these concessions were refused by employers, unions took direct action against restructuring and mass lay-offs. Local strikes broke out spontaneously around the country. Tens of thousands of workers demanded a halt to restructuring and to wage cuts. Strike activity in 1998, measured in the number of work days lost to strikes, stood at almost three times the 1997 level (Crotty and Lee, 2001). When downsizing was inevitable, unions were usually not involved in the important decisions on the lay-off procedure, the choice of lay-off victims and financial relief for the victims (Jung, 1999). So it seemed inevitable that labour unions should call for “street voting” against mass lay-offs.

However, the FKTU and the KCTU took different positions and different action. The FKTU argued that union goals can be achieved through a policy of constructive engagement with employers and the government (Peetz and Ollett, 2001). They did not take part in the nationwide general strikes. On the other hand, the KCTU believed that mass resistance to the restructuring, including nationwide strikes and large public demonstrations, was necessary. It argued that only such direct action could force the government, the *chaebol* and foreign interests to drop their support for radical restructuring. The KCTU mobilized union members, student activists and the general public and called for a series of general strikes. They demanded reduced working hours as a means of job-sharing, support for non-standard workers and the expansion of social welfare systems.

One of the best-known episodes of this resistance is the case of the Hyundai Motor Company. When Hyundai announced its plan to dismiss more than 8,000 workers in July 1998 because of a large decline in automobile sales, its workers went on strike. More than 5,000 Hyundai workers and their families took over the largest auto factory in the country. Two weeks later, President Kim Dae-Jung ordered 15,000 riot police to encircle the factory and prepare to storm it. Union leaders called on the workers to “fight to the death to defend their jobs”. In the end, negotiators from the union, the government and the company managed to reach agreement on an employment adjustment plan, which included dismissing 277 workers and sending 1,260 others on unpaid leave (Crotty and Dymski, 1998).

### **The Tripartite Commission: Neo-corporatism in the Republic of Korea?**

President Kim proposed the establishment of a Tripartite Commission (TC), in which labour, management and the government would participate and negotiate measures to overcome the economic crisis. This was the first attempt in Korean history to bring labour into the policy-making process. The first TC was launched on 15 January 1998. The Commission was comprised of

11 members drawn from labour unions, management, the government and academics representing public interests.

After much confrontation and negotiation, the three social actors finally came up with a first-ever social agreement on 6 February 1998 (Yoon, 1999). It stipulated that labour laws were to be revised, so as to ease restrictions on dismissals and allow temporary employment agencies. In return for these labour concessions, the government promised to discuss later more than 80 reform measures including the reduction of working hours, legalization of unions for teachers and government officials, lifting the ban on political activities by trade unions, and reforming the social safety net for the unemployed.

However, this “big deal” was too much for the union rank and file to swallow. They, after all, would be the ones directly affected by mass dismissals. When the government and employers refused to stop the restructuring process, leaders of company-level unions affiliated to the KCTU refused to accept the agreement and the KCTU withdrew from negotiations within the TC.

However, the FKTU continued to participate. The KCTU then staged a series of general strikes to halt the restructuring and mass dismissals. Following the general strike by the KCTU-affiliated unions in May 1998, both the government and the KCTU came under so much pressure from public opinion that the KCTU decided to join the TC again in June 1998. The second TC round produced a few reform measures, including recognition of teachers’ right to organize, a reform of social insurance policies, and consultations on the restructuring process (Yoon, 1999). However, the second TC also faced many obstacles, such as mutual mistrust, the labour unions’ opposition to the government-led economic restructuring, and insufficient support from the government. When the government refused to halt the restructuring process, the two labour federations declared their withdrawal from the TC at the end of 1998.

Although a third TC round did begin in August 1999, with the participation of the FKTU only, the TC’s role became very limited. Lacking support from politicians and senior government officials and without the participation of the KCTU, the committee became a symbolic body. Employers remained firm in their opposition to almost all reform measures. Vigorous restructuring efforts in the public sector and the financial sector resulted in continued conflicts between labour and management.

Assessments of the social accord between labour, management and government have been mixed. Some critics argue that the Republic of Korea has no institutional background for neo-corporatist social accords (Leem, 2001). Unlike many European countries, it lacks pro-labour political parties. The government and the *chaebol* had little incentive to continue working with the committee once they had obtained the initial concessions from labour. Labour, on the other hand, lacked the centralized decision-making structure needed both to represent the diverse interests of the affiliated unions and to

impose its decisions on them (Lee and Lee, 2008). Thus, according to these critics, it was a mistake for the KCTU to participate in the TC and sign the agreement, as the TC served only the interests of employers and the government (Leem, 2001).

However, other writers argue not only that the TC contributed to the maintenance of social peace in the early stages of reform, but also that several reform policies were actually realized through the mechanism of the TC (Yoon, 1999). For example, labour unions for teachers and government officials were legalized and political activities by labour unions were authorized. Standard weekly working hours were reduced from 44 to 40. Several social welfare measures – including the national basic living assistance scheme, the unemployment insurance scheme and the national pension scheme – were introduced, and the social welfare budget was increased. Moreover, the TC has served as a channel for the unions to exert some influence on employers and the government.

It is true that the Republic of Korea seems to lack the institutional preconditions for neo-corporatist consultations. There are virtually no political mechanisms to enforce and monitor the rather vague promise of the government and management to undertake reforms and improve the welfare of workers. Low membership, poor representation and internal divisions remain the weak points of the Korean unions. Still, the TC has served as the only channel for the unions to express their views on various labour and social issues. Although in most cases the three social partners could not reach agreement, this does not mean that labour's voice remained totally unheard in the TC. Government policies have been influenced by the discussion in the TC in one way or another, even though the contents of the final policies are not very satisfactory to the unions.

### **Move towards industrial unionism and industry-wide collective bargaining**

Since 1980, the basic structure of labour unions as well as collective bargaining in the Republic of Korea has typically been focused on single companies (Lee and Na, 2004). The Labour Union Law of 1980 allowed workers to organize unions only at the company level. An enterprise union was assumed to bargain with a company on wages and other working conditions. Even a federation of unions within an industry was regarded as a third party in collective bargaining – and third-party involvement was strictly prohibited. This enterprise-level bargaining remained a common practice up to the mid-1990s, even though the restrictions on union structures were removed from the labour laws in 1987 (Bognanno, Budd and Lee, 1994).

Advocates of industrial unionism argued that enterprise unions were organizationally weak and had difficulty in achieving economies of scale, in

terms of operations and budgets (Lee, 2002). Industry-based unions would, they said, also have greater bargaining power in their dealings both with employers and with the government, and would promote solidarity among union members, regardless of whether they were standard or non-standard workers. Enterprise-based trade unionists, they felt, may fail to take account of broader industrial or social concerns, so a shift to industrial unionism is the only way for the labour movement to really tackle restructuring and mass unemployment and protect workers' interests.

Since the 1990s, both the FKTU and the KCTU have put a lot of effort into creating industrial unions by merging company-level unions. A shift towards industrial unions began in several key industries, including the metal, hospital and financial sectors. The economic crisis of 1997 strengthened this trend, due to the need to protect union members from the employment restructuring process.

The transition from enterprise unions to industrial unions is progressing slowly but surely. As shown in table 3, industrial unionists accounted for 47.2 per cent of the total union membership at the end of 2008, which was a big increase from 5.7 per cent in 1998. However, while 76.5 per cent of the KCTU membership belongs to an industrial union, the corresponding figure for the FKTU is only 27.1 per cent.

However, changes in union organizing structures do not mean an immediate change in collective bargaining structures. It is true that enterprise bargaining has decreased since 1997, as shown in table 4. In 1997, over 90 per cent of collective bargaining took place at the company level. By 2002, this

Table 3. Changes in the structure of Korean labour unions, 1998–2008 (%)

	1998	2000	2002	2004	2006	2008
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	100.0
Enterprise union	94.3	87.5	89.6	84.4	60.3	47.1
Occupational/Regional union					3.5	5.7
Industrial union	5.7	12.5	10.4	15.6	36.2	47.2
<i>FKTU</i>					100.0	100.0
Enterprise union					68.3	61.7
Occupational/Regional union					31.7	11.2
Industrial union						27.1
<i>KCTU</i>					100.0	100.0
Enterprise union					45.2	22.4
Occupational/Regional union					54.8	1.1
Industrial union						76.5
<i>Others</i>					100.0	100.0
Enterprise union					79.8	67.2
Occupational/Regional union					20.2	2.2
Industrial union						30.6

Note: All numbers are based on the percentage share of membership.

Source: Ministry of Labour, <http://www.molab.go.kr/>.



**Table 4. Changes in the structure of collective bargaining, 1996–2002 (%)**

	1996	1997	1998	1999	2000	2001	2002
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Enterprise bargaining	88.2	90.8	85.5	86.9	77.1	73.4	60.7
Occupational bargaining		5.0	5.4	5.6	16.5	10.7	
Regional bargaining		2.1	0.4	2.0	1.8	4.0	
Diagonal bargaining		2.1	8.7	5.6	3.7	8.1	
Industry-wide bargaining	11.8 <sup>1</sup>	–	–	–	–	3.8	38.8 <sup>1</sup>
Others	–	–	–	–	–	–	0.5

<sup>1</sup> These figures include all forms of bargaining except enterprise bargaining.

Note: All figures are based on the percentage share of membership.

Source: Ministry of Labour, <http://www.molab.go.kr/>.

figure had dropped to 60.7 per cent. But still, industry-wide bargaining accounted for only 3.8 per cent in 2001.<sup>1</sup>

However, there was a big change in this structure in 2003–04, when labour unions and employers' organizations in key industries, including metal, health-care, and the financial industries, succeeded in concluding centralized industry-wide collective agreements. Their content varied from sector to sector, but usually included the introduction of a 40-hour work week, industry-level minimum wages, measures to protect non-standard workers and the prevention of occupational diseases.

However, there are still many problems and barriers to be overcome before industry-wide collective bargaining can take root in Korea.

First of all, the organization rates of these industrial unions still remain at around 10 per cent in their respective industries, leaving a sea of unorganized workers uncovered by the agreements. In this sense, the “industry-wide” agreements are in fact not genuinely industry-wide.

Second, although most unions in big enterprises have joined industrial unions, they have retained independent decision-making bodies and a large share of union budgets. Most important issues are decided in enterprise-level bargaining (the so-called “supplementary bargaining”) rather than industry-level bargaining. There are huge differences in wage rates between big companies and small and medium-sized companies, so that industry-wide bargaining would potentially undermine the better wages and working conditions of workers in big companies. This is a constant source of conflicts between industrial unions and their locals.

Third and consequently, the contents of the industry-wide agreements are still rudimentary. In the case of the metal sector, for example, there is no mention of determining wages and other working conditions in the

1. Unfortunately, the Ministry of Labour stopped publishing the statistics on the structure of collective bargaining after 2002. However, it is estimated that almost half of trade union members were covered by some form of industrial collective bargaining in 2007, given the fact that 47.2 per cent of the membership were in industrial unions that year.



industry-level agreement. In the case of the hospital sector, only the rate of increase of wages was agreed industry-wide, thus leaving the current wage gap between big hospitals and small and medium-sized ones intact.

Fourth, employers are still very negative about industry-wide bargaining. Initially, they simply refused to engage in it, arguing that it would not allow company-specific factors to be taken into account (Peetz and Ollett, 2001). However, their real concern was that it would increase the bargaining power of unions. After much confrontation, the employers agreed to have industry-wide collective agreements from 2003–04. But they refused industry-level central bargaining again in 2008, when the political situation had shifted in their favor. Most bargaining now takes place at the enterprise level.

## Conclusions

To quote Huzzard, Gregory and Scott (2004), the strategies adopted by the Korean labour unions when faced with the restructuring process can be classified into “boxing” and “dancing”. After a brief period of “boxing”, which was the mass mobilization and strikes in protest at the restructuring and mass lay-offs, two national union centres opted for the “dancing” strategy. They participated in the Tripartite Commission, in which social partners and the government reached agreement on Korea’s first-ever social pact.

However, the FKTU and KCTU took different paths when the government and employers refused to stop the restructuring process and mass lay-offs. The FKTU chose social dialogue with the government and employers within the framework of the TC, while the KCTU withdrew from the TC and took a series of direct actions against the government and employers.

When most of these direct actions failed because of the unfavorable context and the weak mobilizing capacity of labour unions, the KCTU decided that the only way to strengthen labour’s bargaining power was to move from enterprise-based unions to industrial ones.

Since then, organized labour has tried hard to create industrial unions and achieve centralized collective bargaining at the industry level. The majority of the KCTU-affiliated unions became industrial unions, although they have not managed to secure stable industry-wide collective agreements.

It is hard to evaluate the Korean unions’ strategies for overcoming the economic crisis and protecting workers. The impacts of the crisis and the subsequent restructuring process were so strong that unions could not stop either the restructuring or mass dismissals. In that sense, we can say that labour unions “failed” to protect workers. But on the other hand, it is also true that the strong labour struggle against the government as well as the IMF clearly affected the decision-making process. The government proposed the establishment of the TC to defuse the potential conflicts surrounding the restructuring process. Even the IMF had concerns about the social disorder

stemming from the restructuring process, and advised the Korean government to create a social dialogue mechanism and introduce a welfare system. Moreover, in some cases such as the Hyundai Motor Company, unions actually succeeded in reducing the number of dismissals or getting more compensation for the unemployed workers. So the unions' efforts to lessen the impact of the restructuring process were not a total failure.

It is also hard to tell which strategy was more effective in obtaining the desired results: "boxing" or "dancing." As mentioned, the Republic of Korea lacks many of the ingredients of social corporatism, and the TC experience was not a satisfactory one for the unions. In that sense, some commentators criticize the KCTU's initial participation in the TC as a wrong decision. However, the TC has served as the only channel for labour unions to express their views on the various economic and social issues and influence government decision-making. If the TC had not existed, the confrontation between the social partners could have been more serious and some subsequent pro-worker reforms would have taken more time to introduce or would not have been introduced at all. In that sense, the unions' "dancing" strategy may be judged half a success and half a failure.

On the other hand, the unions' "boxing" strategy may also be seen as a mix of success and failure. Given the unfavorable environment and limited mobilizing capacity, it was hard for the unions to achieve the desired result through strikes and demonstrations. But it did put great pressure on the government, the employers and the IMF, influencing their decisions and, in some cases, gaining concessions.

However, the most important strategy of the labour unions after the economic crisis was "self-reinforcement", which was all about changing the structure of the labour movement itself in order to strengthen the unions' bargaining power. A majority of them have succeeded in becoming industrial unions, although it has been a slow process. On the other hand, there are still many barriers to be overcome before genuine industry-level centralized bargaining is achieved.

Thus, labour unions in the Republic of Korea have tried hard to protect workers from the impact of the economic crisis. Although there have been failures as well as successes, the Korean unions not only remain one of the most independent and militant labour movements in the world, they have also transformed themselves into industrial unions so as to bolster their future bargaining power.

## References

- Bognanno, M. F.; Budd, J.; Lee, Y. M. 1994. "Institutional Turmoil and Strike Activity in Korea", in *Journal of Industrial Relations*, Vol. 36, No. 3.
- Chang, H. J. 1998. "Korea: The Misunderstood Crisis", in *World Development*, Vol. 26, No. 8.
- Cho, J.; Keum, J. 2009. "Dualism in Job Stability of the Korea Labour Market: The Impact of the 1997 Financial Crisis", in *Pacific Economic Review*, Vol. 14, No. 1.
- Crotty, J.; Dymski, G. 1998. "Can the Korean Labor Movement Defeat the IMF?", in *Dollars & Sense*, Nov./Dec., No. 220.
- ; Lee, K. K. 2001. "Korea's Neoliberal Restructuring: Miracle or Disaster?", in *Dollars & Sense*, July/Aug., No. 236.
- ; —. 2005. *The Effects of Neoliberal 'Reform' on the Post-Crisis Korean Economy*, Working Paper Series, No. 111, Political Economy Research Institute, University of Massachusetts, Amherst, Sep.
- Cumings, B. 1997. *Korea's Place in the Sun: A Modern History* (New York, London, W. W. Norton & Company).
- Han, C. 2009. *The State and Labor in the Era of Globalization in Korea*, paper presented at the 2009 World Civic Forum, COEX Seoul, 5–8 May.
- Hart-Landsberg, M.; Burkett, P. 2001. "Economic Crisis and Restructuring in South Korea: Beyond the Free Market-Statist Debate", in *Critical Asian Studies*, Vol. 33, No. 3.
- Huzzard, T.; Gregory, D.; Scott, R. (eds). 2004. *Strategic Unionism and Partnership: Boxing or Dancing?* (Houndmills, Hampshire, UK, Palgrave Macmillan).
- International Monetary Fund. 1997. *Request for Stand-By-Arrangement*, (Washington), 3 Dec.
- Jung, E. H. 1999. *Economic Crisis and Industrial Relations in Korea*, Korea Labour and Society Institute and Friedrich Ebert Stiftung (Seoul, Korean Labor and Society Institute Press).
- Kim, S.; Cho, B. 1999. *Korean Economic Crisis: New Interpretation and Alternative Economic Reform*, paper presented to the Annual Conference of Studies in Political Economy, Ottawa, Canada, Jan. 29.
- Koo, H. 2000. "The Dilemmas of Empowered Labor in Korea", in *Asian Survey*, Vol. 40, No. 2.
- Koo, J.; Kiser, S. L. 2001. "Recovery from a Financial Crisis: The Case of South Korea", in *Economic and Financial Review*, Federal Reserve Bank of Dallas, 4th Quarter.
- Krugman, P. 1998. "What Happened to Asia?", MIT Department of Economics, Jan.
- Kwon, S. H., O'Donnell, M. 1999. "Repression and Struggle: the Chaebol and Independent Trade Unions in South Korea", in *Journal of Industrial Relations*, Vol. 41, No. 2.
- Lee, J. H. 2002. *Industrial Union and Change in Collective Bargaining Structure*, paper presented to the International Conference on International Labour Standards and Industrial Relations in Korea, Korea Labor Institute, Seoul.
- Lee, J. W.; Rhee, C. 2002. "Macroeconomic Impacts of the Korean Financial Crisis: Comparison with the Cross-country Patterns", in *World Economy*, Vol. 25, No. 4.

- Lee, K.; Lee, C. H. 2008. “The Miracle to Crisis and the Mirage of the Postcrisis Reform in Korea: Assessment after Ten Years”, in *Journal of Asian Economics*, Vol. 19, No. 5–6.
- Lee, W. D.; Lee, B. H. 2003. “Korean Industrial Relations in the Era of Globalisation”, in *Journal of Industrial Relations*, Vol. 45, No. 4, Dec.
- Lee, Y. M.; Na, I. G. 2004. “How Did Unions Protect Workers’ Rights after the 1997 Economic Crisis in Korea?”, in *The Industrial Relations Research Association Proceedings 2004*.
- Leem, K. H. 2001. “Back to the Future: The Politics of Reform under the Kim Dae-Jung Presidency”, in *Journal of East Asian Studies*, Vol. 1, No. 1.
- Park, B. G. 2001. “Labor Regulation and Economic Change: A View on the Korean Economic Crisis”, in *Geoforum*, Vol. 32, No. 1.
- Peetz, D.; Ollett, N. 2001. “Structural Issues for Union Renewal in Korea After the Financial Crisis”, in *Crossing Borders: Employment, Work, Markets and Social Justice Across Time, Discipline and Place*, The 15th AIRAANZ Conference, Vol. 1, 31 Jan. to 3 Feb., Wollongong, New South Wales.
- Summers, L. 1998. “Opportunities out of Crisis: Lessons from Asia”, in *Treasury News*, 19 Mar.
- Wade, R. 1998. “The Asian Debt-and-Development Crisis of 1997: Causes and Consequences”, in *World Development*, Vol. 26, No. 8.
- ; Veneroso, F. 1998. “The Asian Crisis: the High Debt Model vs. the Wall Street-Treasury-IMF Complex”, in *New Left Review*, 228, Mar.-Apr.
- Yoon, J. H. 1999. “Neo-corporatism in Korea? An Evaluation on the Tripartite Commission”, in *Review of Economics and Business*, Vol. 13, No. 2, Inha University.
- . 2005. *Industrial Relations in Transition: Employers and Employees in an Age of Economic Democracy and Global Competition*, paper presented to the Conference “Korea in the 21st Century: Challenges for a Newly Advanced Economy from a German Perspective”, Dusseldorf, Germany, 1 July.



# The Japanese economic crisis of the 1990s

**Naoto Ohmi**

Assistant General Secretary,  
Japanese Trade Union Confederation (RENGO)

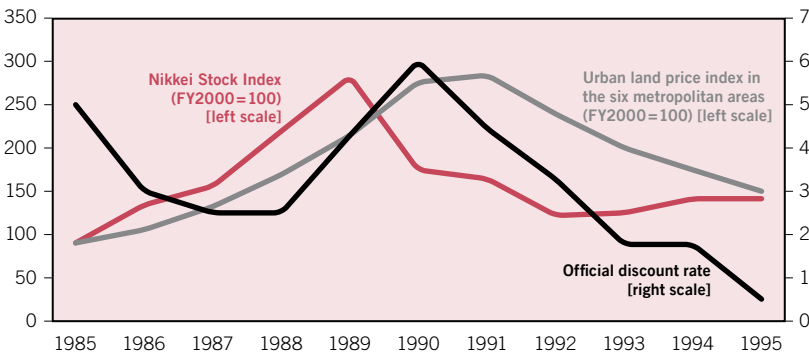
*Why did the Japanese economic crisis last so long? One reason is that the government did not take countermeasures in the right order. Also, weaker redistribution of income hit demand.*

**Growth and collapse of the bubble economy (1985–92)**

Stock and land prices rose significantly in Japan in the latter half of the 1980s. The Nikkei Stock Average hit a peak of ¥38,915 at the end of 1989, and land prices also peaked in 1990, having almost tripled within five years in the big cities (see figure 1). This economic bubble arose because monetary policy did not respond in a timely manner to the significant rise in asset prices. Another reason was that financial liberalization was promoted and financial activity was intensified, without sufficient risk management and application of the principle of self-responsibility. As a result, both financial assets and debts were expanded.

In fact, stock and bond prices and the yen had begun to fall in early 1990. Land prices also began to come down in late 1990. After land prices fell, financial institution loans turned sour and bad loans mounted up. Following the fall in stock and land prices, the prices of so-called financial engineering products, including golf course memberships and quality paintings, also began to drop. Some companies started to go bankrupt around May 1990 because they had failed in the development of golf courses or recreational facilities, which were not their core business. Even then, people were slow to realize what the expansion of bad loans, caused by the collapse of the bubble economy, would bring about.

**Figure 1. Trends in prices, land prices, and the official discount rate, 1985–95**



Source: Bank of Japan (official discount rates); Japan Real Estate Institute (urban land price index in the six metropolitan areas); Nikkei Stock Index calculated on Bloomberg.

## Fiscal and monetary policy in the post-bubble period (1992–97)

The Japanese  
economic crisis  
of the 1990s

Around 1992, it became obvious that the bubble had burst. The mechanism went into reverse and the projected decline in prices curbed speculative demand. Asset prices fell unnecessarily sharply, and bad debts suddenly increased. An emergency economic package implemented in March 1992 included the promotion of public works. Seven further emergency or stimulus packages were adopted by the government up to September 1995. The total amount of funds used for this purpose exceeded ¥60 trillion.

The generation of bad loans in the post-bubble period signalled the breakdown of the financial system. However, it was not until 1996 that public funds were actually injected into the financial system. Though the government repeatedly opted for an expansionist fiscal policy, Japan's long-term debts expanded, and the effect of the economic stimulus policies was limited because of the uncertainty of the financial system.

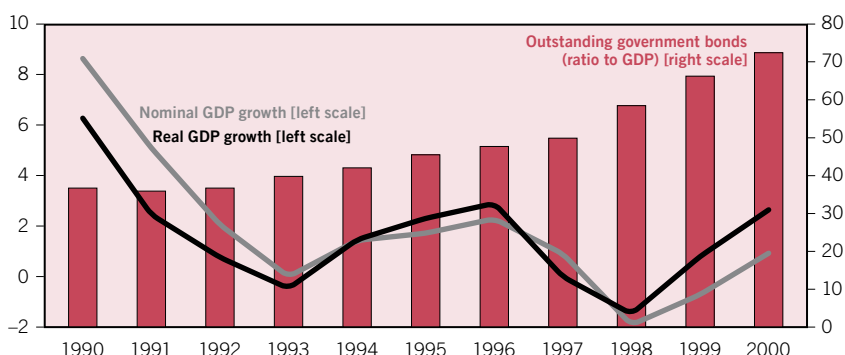
The Tokyo Kyowa Credit Union and Anzen Credit Union had failed in December 1994. These were the first failures in the financial sector in the post-war period. Hyogo Bank later failed, Hanwa Bank suspended business, and housing loan firms failed. This led to the change in government policy and the later injection of public funds. The Cooperative Credit Purchasing Co. (CCPC) was founded by major banks in 1993, mainly to recover collateralized bank credits and to liquidate real estate. The Tokyo Kyodou Bank was then established by major banks and the Bank of Japan to collect the assets of problem institutions. It was reorganized into the Resolution and Collection Bank (RTC) in 1996 to expand its operations.

The Japanese government decided to inject public funds to the tune of ¥685 billion in order to write off the bad loans of housing loan firms. However, this decision was shelved because of objections from opposition parties, who argued that housing loan firms are not banks. At this point, the government should have made up its mind to inject public funds into not only the housing loan firms but also a number of big banks. Instead, the Diet (parliament) approved only the injection of public funds into housing loan firms in 1996. But the confusion led to public criticism of the government and the banks, and the injection of public funds for writing off bad loans became a taboo subject. Therefore, there was no move to use public funds to restructure the financial system until major financial institutions failed.

The post-bubble recession faded in 1996. Real GDP, which had fallen by 0.5 per cent in 1993, rose by 2.3 per cent in 1995 and 2.9 per cent in 1996 (figure 2). The then Hashimoto administration announced six major reforms. Most important was the fiscal structure reform, along with the social welfare reform, especially a rise in the consumption tax in 1996. A 1997 law cut public spending. Included was an annual reduction in the issue of



Figure 2. Annual change in balance of government bonds and real GDP, 1990–2000



deficit-covering government bonds up to 2003. This law not only imposed a ¥9 trillion burden on the Japanese people, but also stirred up anxiety about the future and caused untold damage to the Japanese economy, which had been showing signs of recovery. The fiscal structure reform had a profound influence on the financial system, whose structural bad loan problem had not yet been resolved, and further affected major financial institutions.

### Fiscal and monetary policy (1998–99)

Japan's financial system became unstable in November 1997 when a number of big banks and large and medium-sized securities companies failed in succession. The credit crunch that occurred in the financial market adversely affected the real economy. Small companies had difficulty in gaining access to bank loans. The government finally began to take measures to address the failure of financial institutions.

A massive electoral defeat for the ruling Liberal Democratic Party in July 1998 reversed the balance of power between the ruling and opposition parties. So compromises had to be struck with the opposition parties in order to get stabilization measures adopted. The main measures were:

- *The injection of public funds to recapitalize financial institutions.* ¥30 trillion of public funds were earmarked for stabilizing the financial system. In March 1998, a total of ¥1.8 trillion was injected into 21 major banks, and in March 1999 a further ¥7.5 trillion into 15 major banks.
- *An intensive legislative response to the failure of financial institutions.* Four financial reconstruction laws were passed in October 1998. Of these, the Financial Rehabilitation Law, in force up to the end of March 2001, aimed to deal with failed or insolvent financial institutions. Not only were depositors to be protected but the relevant institutions would be able to continue

to lend money to sound borrowers. Under this law, two major banks came under public management (but were later sold to foreign investors), and several failed regional financial institutions were disposed of.

- *A new framework for financial inspection and supervision.* A policy of prompt corrective action was introduced in April 1998 to enable monetary authorities to carry out early identification of unsound financial institutions through inspection, and prevent them from failing by issuing business improvement orders, etc. The financial inspection and supervision scheme was reviewed in June 1998. The Finance Ministry's role of inspecting and supervising the banking industry was hived off to the newly established Financial Supervisory Agency.

The consumption tax increase in April 1997 and financial system instability in November 1997 had adversely affected the real economy. The Hashimoto administration put through the Fiscal Structure Reform Law, designed to restore fiscal health and to reduce expenditures, but was soon forced to review its policy. In May 1998, the law was revised, postponing by two years the target date for achieving fiscal soundness. The following month a supplementary budget, including a record-breaking economic package (¥16.6 trillion), was passed. However, these measures appear to have come too late. Public criticism of the Hashimoto administration, which had imposed the burden of approximately ¥9 trillion on the people, was strong.

The successor Obuchi cabinet put economic recovery first. The government announced an emergency economic package (¥24 trillion) in November 1998 and economic renewal measures (¥18 trillion) in November 1999. It also suspended the Fiscal Structure Reform Law. Thanks to this series of large-scale economic measures, the economy finally emerged from its critical state. However, many problems remained unsolved, including the slowdown in consumption, the continued deflationary trend, the increase in business failures, and increased unemployment. On the other hand, the issuing of large amounts of deficit-covering government bonds resulted in a growing accumulation of government debt.

### **Policy development toward drastic resolution of the bad loan problem (2001–02)**

In March 2001, the Bank of Japan adopted a so-called “quantitative easing policy” to address worsening deflation. The aim was to shift the focus of money market operations from short-term interest rates (the unsecured call rate) to “the Bank of Japan's current deposit balance”. Quantitative easing was maintained until the Bank of Japan moved to a zero-interest-rate policy in March 2006 (see figure 3).

In October 2002, the government announced a Financial Revitalization Programme designed to reconstruct finance through a radical disposal of the major banks' bad loans. As a result, the proportion of bad loans in the major banks' overall lending portfolios fell from 8.4 per cent in 2001 to 7.2 per cent in 2002 and to 5.2 per cent in 2003. When the percentage fell to 2.9 per cent in 2004, the government stated that it had normalized the major banks' bad loan problems and stressed its success in addressing financial system instability.

In April 2003, the Industrial Revitalization Corporation of Japan (IRCJ) was established through public-private cooperation. The IRCJ's task was to support, financially and otherwise, companies that had excessive debts while holding useful management resources. It had a capitalization of ¥50 billion, all of which was contributed by banks, and the ceiling for government guarantees was set at ¥10 trillion. Ninety per cent of the IRCJ's 160 employees were hired from the private sector. Two employees were from the trade unions. The IRCJ planned to intensively purchase debts for the first two years after its establishment and to sell credited loans by the time of its disbandment five years later, in 2008. In March 2007, however, it completed

Figure 3. Change in policy interest rates and the monetary base, 1991–2006

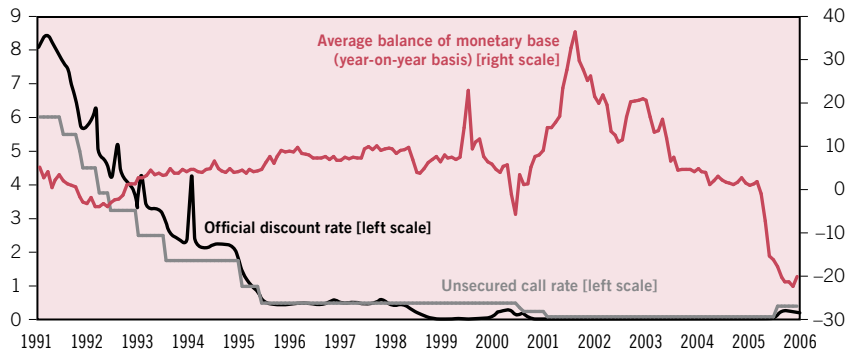
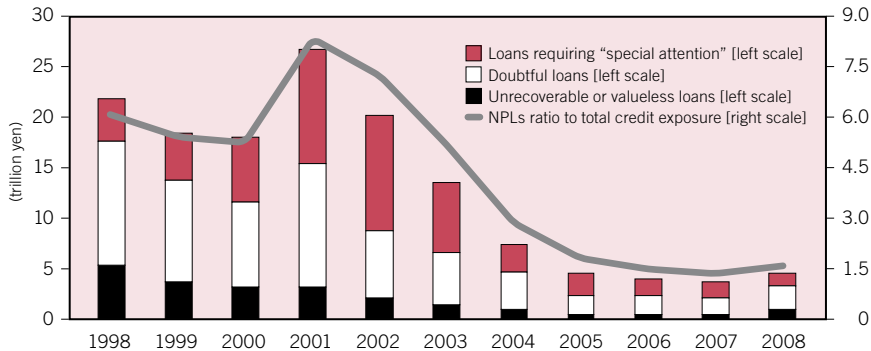


Figure 4. Transition of non-performing loans (major banks), 1998–2008



support for 41 companies and disbanded one year earlier than planned. The total amount of loans held by the supported companies amounted to ¥4 trillion, equivalent to 10 per cent of the bad loans held by banks. The IRCJ paid about ¥31.2 billion in tax during its period of operation, as well as about ¥43.2 billion to the national treasury due to distribution of residual property after disbandment. So no burden was imposed on the people.

During the Diet's deliberations on the Industrial Revitalization Corporation Law, the Japanese Trade Union Confederation (RENGO) recommended that employment stability and trade union involvement should be built into the revitalization process, and these points were reflected in the amendment to the Bill.

### **Towards sound public finance**

After the Koizumi cabinet was formed in 2001, public works were reduced, and the idea of stabilizing the economy through positive fiscal stimulus measures receded. The Japanese economy moved towards recovery for nearly six years, from 2002 to the autumn of 2007, as a result of the increase in exports and the subsequent growth in capital investment. In the meantime, corporate profits grew among large companies, but there was insufficient distribution of this wealth to employees. Labour's share shrank, and the total amount of cash earnings almost consistently declined after fiscal 1998. So workers' lives were not improved and the economy was not able to lift itself onto a self-sustainable recovery track backed by increased consumption. Moreover, neo-liberal policies, focusing on competition and efficiency, caused the solid middle class within Japanese society to collapse. Combined with the weakening of the income redistribution function and the social safety net, this led to the emergence of serious challenges, including income disparities, poverty, and widening gaps between industries, companies and regions.

### **Interim conclusion: Policy errors hindered action to resolve the situation**

After the bubble economy collapsed, it took more than a decade to stabilize Japan's national economy and the financial system. The legacy was a huge budget deficit. One reason for the delay in addressing the post-bubble situation, resulting in the increase in the budget deficit, was that the government did not take fiscal and monetary measures in the correct order. It should have first made efforts to stabilize and restore the financial system, including writing off bad loans held by financial institutions, recapitalizing them, and providing government guarantees for interbank dealings. After that, it should have taken fiscal stimulus measures. In fact, it first implemented a positive

fiscal expansion policy to deal with the economic downturn. It was not until 1998, when major banks and securities companies failed, that the government began to make serious efforts to stabilize the financial system.

There are many theories as to why the government delayed this stabilization drive. Some argue that it disregarded the vicious circle in which the slow disposal of the huge amounts of bad loans would cause a further increase in bad loans, due to the fall in stock and land prices resulting from the economic slowdown. It seems that for some time after the bubble economy collapsed, the government expected that the bad loan problem would be automatically solved when the economy recovered and land prices began to rise. Presumably, insufficient disclosure by financial institutions, including their failure to report the amount of bad loans promptly and accurately, also prevented the government from taking appropriate action immediately.

Others believe that bank managers, monetary regulators and politicians postponed action in order to avoid taking responsibility. RENG0 and trade unions generally took a passive attitude to the economic crisis in the 1990s. This was partly because the reality of the financial crisis was not clear and insufficient information was available. RENG0 policy in the 1990s mainly called for large tax cuts to boost economic recovery and a strengthened safety net for employment. It cannot be said that RENG0 played a positive role in restoring financial soundness and in the disposal of bad loans. From 1998, when the root of the problem became apparent, however, RENG0 recognized the necessity of injecting public funds into financial institutions, expressed concern about the effect of the disposal of bad loans on employment, and called on the government to take measures to revitalize businesses.

### **Changing the bankruptcy laws – Trade union involvement**

In the 1990s, when economic stagnation was prolonged, the legislation was reformed to facilitate the restructuring of business operations. For example, genuine holding companies were approved, and corporate break-up laws were enacted. At the same time, the legislation on business bankruptcies was revised. As bankruptcy laws have a significant impact on employment and working conditions, members elected from trade unions joined the Bankruptcy Legislation Committee to reflect labour views during its deliberations.

In the process of revising the bankruptcy legislation, RENG0 called for greater trade union involvement in bankruptcy procedures, and improvements in the legal treatment of debts owed to the workforce. The author of the present article was involved in measures against corporate bankruptcy while affiliated to an industrial union that covered textile, apparel, food-processing and distribution industries from the late 1990s to the first half

of the 2000s. In his experience, job security was better served by the turnaround of a collapsed company than by corporate bankruptcy. So he argued that the legislative overhaul should make the turnaround-type bankruptcy laws much more user-friendly and strengthen trade union involvement in the turnaround process.

Certain advances were achieved from the viewpoint of worker protection, including the strengthening of labour claim protection and increased trade union involvement in the corporate bankruptcy or turnaround process. However, the reform of business legislation generally helped strengthen the power of shareholders. Thus, it did not contribute to improvements in worker and trade union involvement in terms of corporate governance.

When the relative weight of turnaround-type bankruptcies increases, the main emphasis of worker protection essentially shifts towards job security and away from the securing of labour claims. In this case, many options on the turnaround menu are conceivable, including the transfer of a business, where workers may be asked to accept certain concessions. A multifaceted outlook is required for worker protection. To this end, the involvement of employee representatives is certainly warranted from the corporate governance point of view. However, reforms of corporate governance in Japan are aimed at maximizing shareholder return, whilst engagement with employees, who are important stakeholders, is neglected.

### **Labour market reform by deregulation**

When the Hosokawa cabinet came to power in 1993, the government adopted a bolder deregulation policy, which it saw as a means of encouraging competition and revitalizing the economy. In December 1993, the Workshop on Economic Structural Reform, a private advisory panel to Prime Minister Hosokawa, stated that “economic restrictions should ‘be liberalized as a rule’ and social restrictions should be minimized by adopting ‘self-responsibility’ as the rule”. The panel’s report advocated “a fundamental review of official restrictions”, during which “every field should be reviewed equally without allowing any sanctuaries [...], the same being applicable to welfare, education, labour and financial services”. It also called for “a powerful third-party institution that has its own secretariat and is furnished with the right to advise the government on matters related to deregulation”.

The cabinet endorsed the establishment of the third-party institution in February 1994. In December of the same year, the Administrative Reform Committee was inaugurated, and its Deregulation Subcommittee was set up in April 1995. Since that time, government deregulation policy has been carried forward primarily on the basis of initiatives by the Subcommittee. Its “Regulatory Reform Promotion Plan” was endorsed almost without change by the cabinet, and individual ministries are required to reform the activities

under their control in line with this action programme. The Subcommittee has also supervised progress in implementing the action programme, has revised the plan from time to time and has once again recommended reforms where they have not yet been implemented. As such, the Subcommittee was dissolved in December 1997, but it has continued to operate under other names, and with enhanced status and power, up to March 2010.

With regard to deregulation, RENGO emphasized the need for “a shift in government policy toward a policy that ‘prioritizes ordinary people’ and that would focus on stability and security in people’s lives”. So its position was to engage in active promotion of deregulation that could improve the quality of life. Consequently, RENGO sent representatives to the Workshop on Economic Structural Reform and the successive government committees on deregulation up to 2000. However, differences of opinion between RENGO and the committees on deregulation became increasingly conspicuous in the fields of employment and labour. Partly because of this situation, since the launch of the “Council for Regulatory Reform” in April 2001, RENGO has not been invited to send representatives to the council, nor has it sought to do so.

The Deregulation Subcommittee submitted its first Opinion Paper on the Promotion of Deregulation to the Prime Minister in December 1995. This dealt with the deregulation of fee-charging employment placement and worker dispatch services. It could be said that reform of the labour market had started, aiming at the creation of new growth areas through regulatory reform and by allowing a flexible labour market to assume a complementary role in the growth of these new business areas.

The Worker Dispatch Law was enacted in 1985. Previously prohibited by the Job Stabilization Law, fee-charging job placement was now to be permitted in a range of services covered by a “positive” list. Initially, many sectors were specifically exempted from this deregulation. They included construction, harbour transport, security and other occupations deemed to be unsuitable for dispatched workers. When the law first was enacted, only 13 services were covered by the new system, but by 1996, employment in 26 services had been deregulated in this way.

Further liberalizing measures sought by the Deregulation Subcommittee for the worker dispatch system included adoption of a negative list for the range of services covered, as well as a thorough review of the system, such as the length of the dispatch period and the measures taken for worker protection. These measures were scheduled to be implemented during fiscal 1997, following deliberation at the Central Employment Security Council.

In December 1997, the Central Employment Security Council stated that “In the light of the new international standards provided by ILO Convention No. 181, and from the viewpoint of the necessity for responding to the prevailing economic and social circumstances, assurance of diverse options of working patterns for workers and assurance of job security, the worker dispatch service system should be positioned as a measure related to



the adjustment of temporary and transient workforce supply and demand”<sup>1</sup>. The point at issue here was how to interpret this “adjustment of temporary and transient workforce supply and demand”. In particular, the labour side exercised caution, as they were concerned about the likely outcome if manufacturing industry production lines operated by seasonal, part-time and contract-based workers were opened up to dispatch workers on the plea of “adjustment of temporary and transient workforce supply and demand”. RENGO opposed the Bill to amend the Worker Dispatch Law because it would have allowed rapid replacement of regular employees with dispatched workers. There was concern that “user-friendly” dispatch labour could be locked into the labour market.

The Bill was considered at the 1999 ordinary session of the Diet as part of a package consisting of ratification of ILO Convention No. 181, the Bill to amend the Job Security Law and the Bill to amend the Worker Dispatch Law. The lawmakers accepted requests for amendments from RENGO. These included a one-year limitation on the length of the dispatch period, the protection of personal information, the application of provisions on sexual harassment and maternity protection to workplaces served by dispatched workers, and facilitation of the application of labour and social insurance schemes to dispatched workers.

On 30 June 1999, the Worker Dispatch Law was enacted as amended. Notable changes included the switch from a positive list to a negative one. Among the sectors that continued to be excluded was the manufacturing industry. The length of dispatch period for services, other than the existing services covered by the worker dispatch system, was limited to one year or less. The three-year upper limit to the dispatch period was applied to the so-called 26 specialized services. Business owners violating the law were to be advised to offer regular employment to the affected dispatched workers, if they wished. If the business owner refused to do so, the name of the company in violation could be disclosed. The 1999 amendments caused intense confrontation between labour and management during the deliberation process, as they represented a complete change in thinking on the form that worker dispatch services should take.

The Worker Dispatch Law was revised again in 2003, this time under strong influence from the Council for Regulatory Reform. The member

1. Until the adoption of a Convention related to private placement services at the 85th Session of the International Labour Conference in June 1997, the ILO had adopted a policy, based on Convention No. 96, to opt for the ban on fee-charging job placement services (Part 2) or alternatively restrictions on such services (Part 3). The ILO believed it lagged behind the ongoing changes in the labour market and thus, by adopting Convention No. 181, “allows the operation of private employment service establishments and requires them to protect workers who use this particular service” (Article 2 (3)) targeting all job placement services, worker dispatch services and other services related to jobseeking. The adoption of Convention No. 181 had a significant impact on Japanese labour market policy in subsequent years.



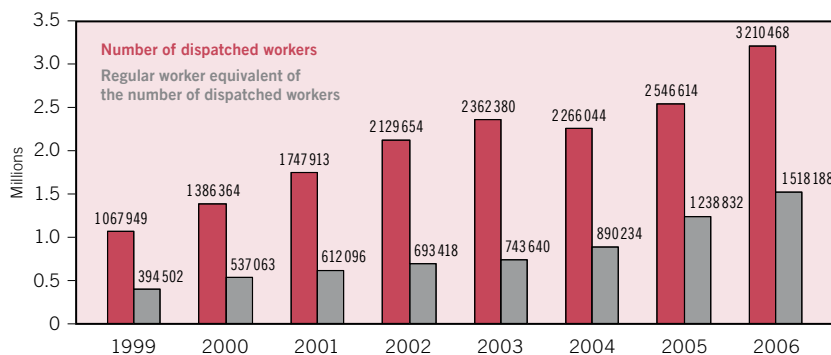
elected by RENGO was excluded from the Council and was replaced by two representatives from the job placement business. The points at issue in the Council were “abolition of the one-year limit to the dispatch period” and “lifting the ban on worker dispatch to goods manufacturing jobs”. In the Central Employment Security Council, labour and management locked horns, but finally the government intervened strongly, and the 2003 amendments to the Worker Dispatch Law were enacted on 6 June 2003. The upper limit to the length of the worker dispatch period was extended to a maximum of three years from the previous one year. Further, on the occasion of extending the worker dispatch period over one year, the business owner was obliged to hear opinions from the majority union in the relevant workplace, and when the business owner intended to hire dispatched workers exceeding the dispatch period, the owner was obliged to offer regular employment to those workers. The limit on the dispatch period for the 26 services (three years) was abolished, and the business owner was obliged to offer regular employment to those dispatched workers who had served over three years, on a priority basis. The goods manufacturing jobs which had been excluded from services covered by the worker dispatch system were opened up to dispatched workers (but as a transitional measure, the one-year limit to the dispatch period remained effective for next the three years). “Introduction dispatch” was institutionalized, meaning that previous prohibitions on the identification of particular workers, such as interviews prior to the dispatch decision and requests for a personal résumé by the business owner, were lifted.

Looking at revisions of the labour laws since the 1990s, the government often followed a format that began with cabinet endorsement of the “regulatory reform promotion plan” and thereby showed the policy direction, the government then soliciting advice from the Central Council. In fact, labour representatives on the Central Employment Security Council were wary of the possibility that deregulation could lead to the advent of a class of “user-friendly and low-cost workers” serving the interests of business owners. Labour therefore repeatedly stressed the need to set up working rules for Council deliberations. However, unfair limits were put on the discussions, as they were bound to follow the cabinet endorsements. Undeniably, the result was a series of labour market reforms directed mainly towards providing a user-friendly workforce.

As a result of the successive measures, the number of worker dispatch businesses and of dispatched workers increased sharply. In fiscal 2006, 3,210,468 dispatched workers were sent into enterprises – a 26.1 per cent increase over the previous year and the equivalent of 1,518,188 regular workers (see figure 5).

Deregulation of the worker dispatch sector has led to a startling increase in the number of low-wage workers. It has caused a widening discrepancy between forms of work and a bipolarization of the workforce.

**Figure 5. Trends in dispatched worker population, 1999–2006**



Note: The “number of dispatched workers” is the total of regular employed workers and registered workers in the general worker dispatch service and regular employed workers in the special worker dispatch service.

Source: Ministry of Health, Labour and Welfare, “Report on Worker Dispatch Service” (2007).

Worker dispatch related to goods manufacturing jobs has been liberalized since 1 March 2004, but on the manufacturing floor, outsourcing through service contracts was practised before the lifting of the ban on worker dispatch. There was therefore concern over whether demarcation between the worker dispatch service and contract-based labour would be clearly maintained or not. That concern has been proved right. Actual cases of disguised contract labour and illegal worker dispatch have come to light one after another, becoming a social issue. Violations committed by day worker dispatch services such as worker dispatch to banned services and double dispatch have also become conspicuous since 2007.

Regarding labour market reform, trade unions took the stance that unions would not oppose the enhancement of job placement functions in the private sector, but certain rules would be necessary for the private placement services. So unions agreed to review the existing Japanese labour market policy by taking advantage of the adoption of ILO Convention No. 181. However, there was substantial disagreement between the position of labour, which sought adequate worker protection, and that of the employers, who sought the expansion of business opportunities.

The members representing labour basically opposed the proposed revisions of the Worker Dispatch Law presented by the Deregulation Subcommittee, but the proposal that came out of the Central Council mostly fell in with the Subcommittee’s demands. However, the Council proposal did include a certain degree of worker protection.

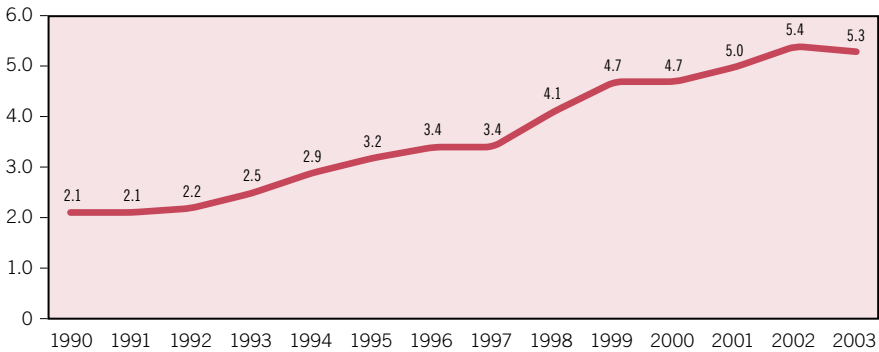
As a result of this series of deregulation measures, the worker dispatch service exploded, but several problems arose concerning worker dispatch. Consequently, in 2009, the government was forced to correct the deregulation policy overshoot of the past several years.

### Changes in employment structure

In 1990, when the Japanese economy was still in its bubble period, Japan's overall unemployment rate stood at 2.1 per cent (see figure 6). The unemployment rate continued to rise throughout the 1990s to top the 4 per cent mark in 1998. At the time, Japan's unemployment rate exceeded that of the United States. The increase continued until 2002. From the latter half of the 1990s onwards, unemployment caused by corporate bankruptcies and the dismissal of workers was on the rise.

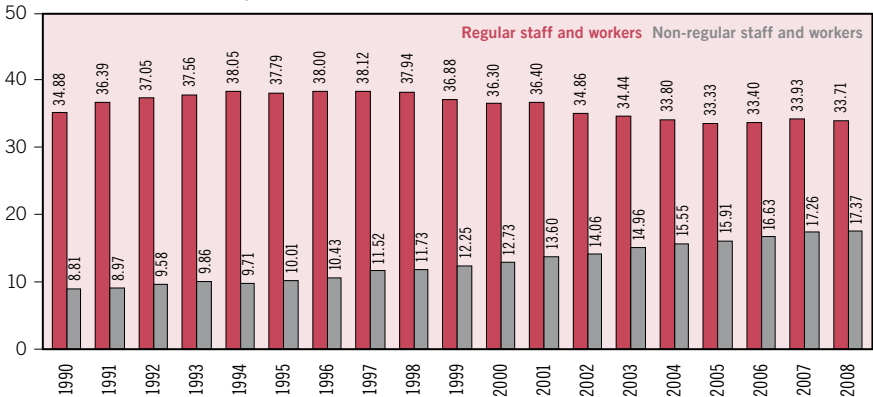
Changes also occurred in Japan's employment structure. As of 2000, the number of regular workers stood at 36.30 million, a decrease of 1.8 million from the peak year of 1997 (see figure 7). Since that time, numbers of regular workers have continued to decline, plummeting to 33.33 million in 2005. In contrast, the number of non-regular workers has grown

Figure 6. Trends in overall unemployment rate, 1990–2003 (percentage)



Source: Ministry of Internal Affairs and Communications, Statistics Bureau, "Labor Force Survey".

Figure 7. Numbers of regular staff and workers vs. non-regular staff and workers, 1990–2008 (millions)



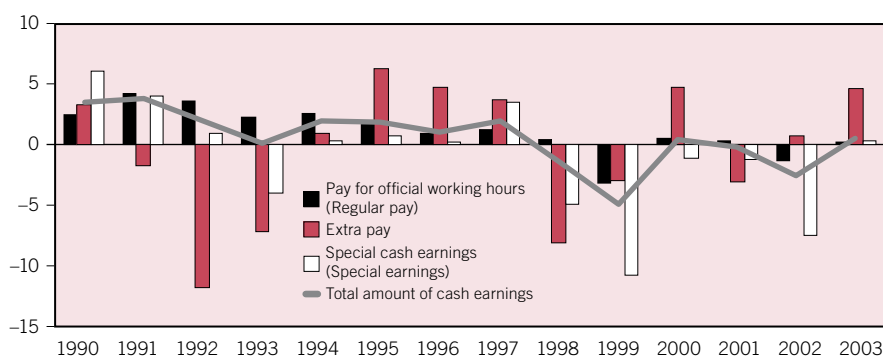
Source: Ministry of Internal Affairs and Communications, Statistics Bureau, "Labor Force Survey".

substantially.<sup>2</sup> Non-regular worker numbers stood at 8.97 million in 1991, whilst in 2000 they grew by 3.8 million to reach 12.73 million. By 2008, there were 17.37 million non-regulars, accounting for more than one-third of the total employed workforce. In Japan, the equal treatment principle for regular and non-regular workers has not yet been established, and employers who hire non-regular workers can make substantial savings on labour costs. In the prolonged depression following the bursting of the bubble economy, businesses engaged in corporate behaviour that pursued short-term profit, and in their employment practices also drastically replaced regular workers with non-regular workers. As a result, Japan's social base, the middle class, collapsed to cause a bipolarization of the workforce, resulting in an increase in workers in the lower-income stratum, with annual incomes of less than ¥2 million.

### Impact of the economic crisis on households

The trend in the total amount of cash earnings from the 1990s through the early years of the 2000s (see figure 8) shows that although earnings had maintained positive growth until 1997, they decreased compared to the previous year in 1998, and in 1999 slumped by a sizeable 5 per cent. In 2000, a slight increase was observed, though in 2002 earnings declined again. Thus, an overall declining trend was observed for employed workers' wages between the latter half of the 1990s and early 2000s.

Figure 8. Wage trends, 1990–2003 (year-to-year change, percentage)



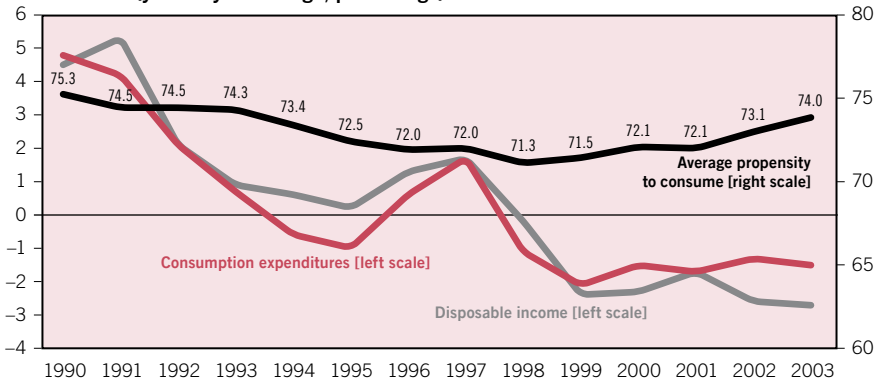
Source: Ministry of Health, Labour and Welfare, "Monthly Labor Statistics".

2. Regular workers are those hired directly, whose period of employment is not fixed, and who work full time. On the contrary, non-regular workers do not meet any of the above criteria. Non-regular workers include dispatch workers (indirect hire), fixed-term workers, part-time workers, etc.

By type of compensation, in 1992, when the total amount of cash earnings increased from the previous year, extra pay for overtime work, such as overtime pay and pay for holiday work, declined by more than 10 per cent from the previous year. This indicates that, at the time, adjustments were made by curbing overtime and holiday work. In 1993, other special cash earnings, including lump-sum bonuses, decreased. Following this, in the years from 1994 to 1997, pay for official working hours, extra pay and special cash earnings all increased from the previous year, but in 1998, when the total amount of cash earnings began to decline from the previous year, extra pay and special cash earnings decreased again, and in 1999, pay for official working hours, which had continued to increase over the previous year, began to decline, and employed workers' household budgets were pushed into tough circumstances. Some improvements were observed in 2000 as pay for official working hours and extra pay increased, but special cash earnings had continued to decline from 1998 through 2002, and worse, pay for official working hours declined again in 2002.

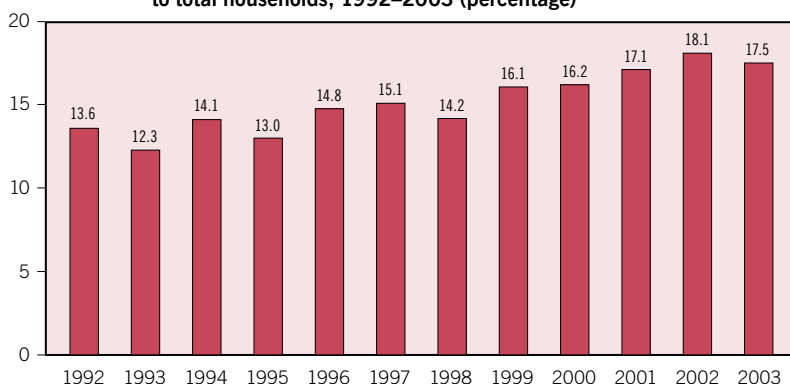
The impact of the decline in wages is seen in the consumption expenditures of workers' households (see figure 9). The average propensity to consume, i.e. the proportion of spending to disposable income, gradually declined from 75.3 per cent in 1990 to 71.3 per cent in 1998, and then again gradually increased till 2003. Composition of households by income bracket (see figure 10) indicates that over the period from 1990 to around 1998, the percentage of households with annual incomes of less than ¥2 million remained at 12 to 15 per cent, while from 1999 through the early years of the 2000s, the percentage of lower-income households increased from 16 to 18 per cent. Such an increase in relatively low-income households seemingly affected the overall contraction of household consumption by working households.

**Figure 9. Disposable incomes and consumption expenditures, 1990–2003**  
(year-to-year change, percentage)



Source: Ministry of Internal Affairs and Communications, Statistics Bureau,  
"Household Budget Survey" (Workers' Households).

**Figure 10. Ratio of households with annual incomes under ¥2 million to total households, 1992–2003 (percentage)**



Source: Ministry of Health, Labour and Welfare, "National Livelihood Survey".

Policy programmes aimed at stimulating household consumption were implemented from 1994. These included several income tax cuts, but the effect of these on consumption was reportedly rather limited.<sup>3</sup> In 1999, municipalities nationwide issued Regional Promotion Coupons, fully funded by the national government. The coupons, worth ¥20,000 per person, were aimed at spurring personal consumption and revitalizing regional economies.<sup>4</sup> However, according to a 1999 survey of the households that qualified for the coupons, the increased consumption attributed to them was estimated to be around 32 per cent of their value. They did help to increase the consumption of mainly semi-durable goods, but the consumption-stimulating effect was attenuated over time.<sup>5</sup>

3. Masahiro Hori and Satoshi Shimizutani: *Micro Data Studies on Japanese Tax Policy and Consumption in the 1990s*, ESRI Discussion Paper Series No. 14, September 2002.

4. Coupon recipients included: (1) Heads of households with children under 15 years of age (born on or after 2 January 1983); (2) Recipients of the senior welfare pension, disability basic pension, survivors' basic pension, mother's pension, quasi-mother's pension, or orphan's pension, as well as recipients of the childcare allowance, disabled child welfare allowance, or special disabled allowance; (3) Welfare recipients, or individuals in custody at a social welfare facility; and (4) Individuals aged 65 or older (born before 1 January 1934) and persons exempt from municipal tax (excluding non-working dependants, in terms of the tax code, of a tax-assessed person).

5. Masahiro Hori, Chang-Tai Hsieh, Keiko Murata and Satoshi Shimizutani: *Did the Shopping Coupon Program Stimulate Consumption? Evidence from Japanese Micro Data*, ESRI Discussion Paper Series No. 12, April 2002.



# The labour market and deflation in Japan

**Hansjörg Herr**

**Milka Kazantziska**

Berlin School of Economics

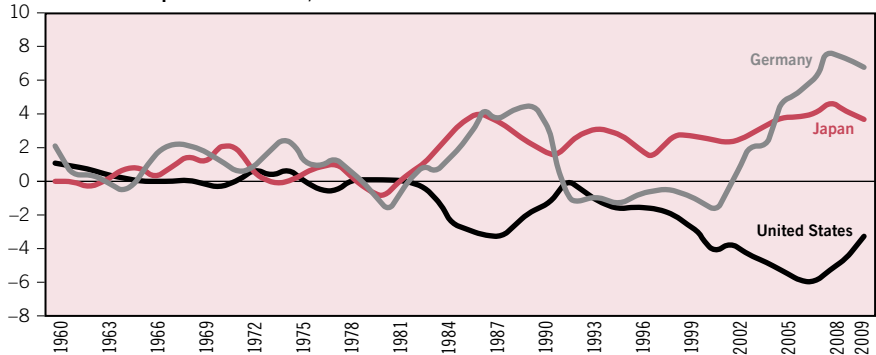


*Why did deflation hit Japan? Wage developments were a key factor. Without far-reaching policy interventions, other industrial countries may head the same way.*

It is widely known that the Great Depression in the 1930s led to goods market deflation and a cumulative collapse of the economy. There is less awareness that the United States suffered from a real estate bubble in the early 1920s, which affected especially Manhattan, Chicago and Florida. This bubble came to an end in 1926. Between 1921 and 1929, the Dow Jones rose from 60 to 400. The end of the stock market bubble came in 1929. Like the subprime crisis, which started in the United States in 2007, the financial crises of the 1920s led to a deep crisis in the real economy. The US economy as well as the economy in most countries in the 1930s fell into a non-prosperity phase, which only came to an end when countries started preparing for the Second World War. The key question is whether the subprime crisis will also lead to a prolonged period of no prosperity combined with high and continuing unemployment.

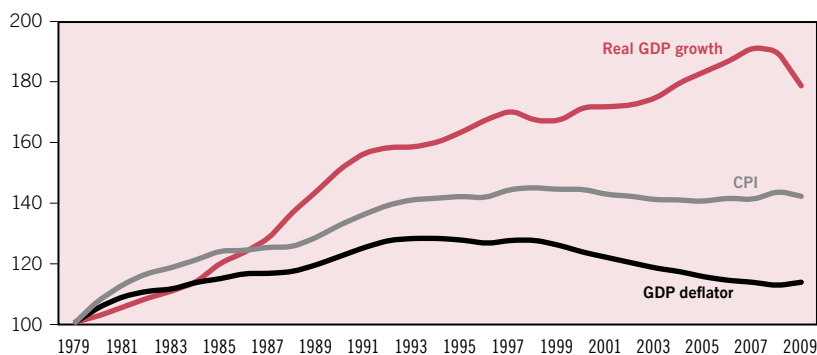
Japan experienced a real estate and stock market bubble in the second half of the 1980s. The implosion of these bubbles in Japan, as in the United States after the end of the bubbles in the 1920s, triggered a long period of low or no growth and increasing unemployment. All private domestic demand components in Japan collapsed after the end of the bubble. Not only did investment demand stagnate, private consumption demand also lost its dynamics and has not recovered so far. Over the whole period, Japan achieved high current account surpluses (figure 1). But the relatively prosperous export-oriented sector was not able to compensate for the lack of domestic private demand. Also, government demand was not sufficient to compensate for the stagnating private domestic demand elements. Even more disturbing

**Figure 1. Current account balances of Germany, Japan and the United States in per cent of GDP, 1960–2009**



Source: International Monetary Fund, *World Economic Outlook 2009*.

**Figure 2. Real GDP, GDP deflator and CPI, 1979–2009 (Index 1979 = 100)**



Source: Authors' calculation based on Ameco.

is that deflation, which was thought to be a phenomenon of the 1930s, returned. In Japan, the consumer price index (CPI) decreased slightly but the GDP deflator decreased substantially (figure 2). Between 1994 and 2008, the GDP deflator decreased by over 12 per cent.<sup>1</sup>

In this paper, we analyse the creation of the bubble in Japan and developments after it came to an end. The question we are particularly interested in analysing is how it was possible for Japan to fall into deflation. We find that the key factor is the development of wages. We are convinced that economists and trade unions can learn from the negative developments in Japan. We go on to analyse briefly how the Japanese bubble was created. We then explore the development of non-performing loans and monetary and fiscal policy reactions. Next, we focus on labour market developments, wages and price levels. Finally, conclusions are drawn.

## The development of the bubble in Japan

The period between the Second World War and the end of the 1980s was a period of high economic growth in Japan, accompanied by low unemployment rates and a relatively equal income distribution. Indeed, until the end of the 1980s, Japan was considered a showcase for prosperous economic development. In the 1950s and 1960s, it had a relatively balanced current account. It fought actively against current account deficits, but did not have high surpluses. This changed at the end of the 1970s, when Japan started to become one of the world's big surplus countries, together with Germany and later China (figure 2). As the biggest portion of the surpluses was vis-à-vis the

1. CPI is more important for the welfare of households, the GDP deflator is more important for the situation in the enterprise sector.

United States, a conflict between the two countries developed. Japan suffered from the heavy appreciation of the US dollar in the first half of the 1980s, including against the yen. Germany was not at the centre of the conflict, as it achieved its surpluses vis-à-vis more countries, and mainly within Europe.

The Plaza Agreement was signed in September 1985, at that time by the G-5 (France, Germany, Japan, the United Kingdom and the United States), to reduce protectionist measures, open up their markets, deregulate their financial markets and – most importantly – to intervene in the currency markets in order to reduce the value of the US dollar. The aim was to help reduce the escalating current account deficit of the United States and the highly appreciated American currency, and at the same time bring down the huge Japanese current account surpluses. The value of the US dollar came down and the yen appreciated. The Japanese current account surplus moderately decreased. As a result of the Plaza Agreement and the appreciation of the yen, Japanese politicians believed a domestic stimulus of the economy was necessary. The US dollar depreciated. But it was not a soft landing, rather a collapse. In February 1987, the Louvre Accord was signed to prevent a further decline of the US dollar. Japan was urged to stimulate the domestic economy even more to promote growth and in this way further reduce the ongoing current account surpluses. In May 1987, Prime Minister Nakasone announced quite exceptional measures taken by the Bank of Japan to boost domestic demand in order to reduce the current account surplus without an appreciation of the yen or a further depreciation of the US dollar (Okina and Shiratsuka, 2001, p. 422). On multiple occasions in this period, the Bank of Japan intervened heavily in the foreign exchange market to prevent an appreciation of the yen.

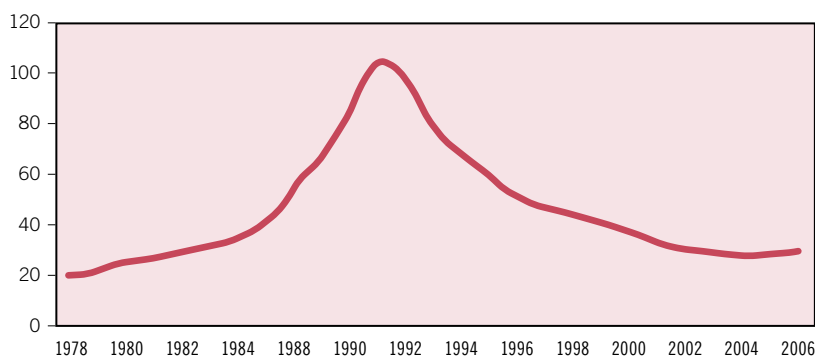
Monetary policy became very expansive and financed credit growth which in turn fuelled an expansion not only of the real economy but also of asset price bubbles. From the Second World War until the 1980s, the main monetary policy instrument used by the Bank of Japan had been the direct control of the credit volume accorded by commercial banks, known as window guidance. Up to the deregulation in the 1980s, the Japanese enterprise sector had no possibility of taking out credit abroad or issuing debt securities, so the window guidance system was very effective in directly controlling the development of the real economy. Looking at the massive increase in the credit volume accorded by commercial banks in the second half of the 1980s, it becomes clear that the Bank of Japan followed an extremely expansionary policy. It virtually pushed the commercial banks into granting more credit (Werner, 2003, p. 133). The Bank of Japan obviously had a strict focus on consumer price inflation and gave in to international pressure. The asset price bubbles, or more precisely the risk of their collapse, were obviously not seen as a danger. The goods market inflation rate was low and the Bank of Japan saw no need to curtail an otherwise healthy GDP growth by fighting against the bubble. It is surprising how naive the monetary policy reaction of the Bank of Japan was. In the theoretical literature, the dangers of asset price

inflation were extensively described by Irving Fisher (1933) and later by economists like Hyman Minsky (1975) and Charles Kindleberger (1978). Not only, it seems, do private agents suffer from irrational exuberance during the build-up of a bubble, institutions like central banks – or governments controlling central banks – do so too.

Financial deregulation seemed to play a crucial role during the development of the bubble in Japan. Since deregulation had started, companies were able to finance themselves for the first time via the capital market in the 1980s. Competitive pressure in the financial sector intensified and resulted in banks increasing their loans to small and medium-sized firms during the 1980s, which went almost unmonitored (Hoshi and Kashyap, 1999, p. 21). Furthermore, it was the change in the behaviour of banks that stimulated the bubble. Legally, the amount of real estate credit was restricted to 70 per cent of the value of the financed object. To circumvent this restriction, banks used the higher anticipated values of real estate to give more credit (Werner, 2003, p. 96).

In the second half of the 1980s, equity and land prices began increasing at spectacular rates. Share prices rose by 240 per cent and property prices by 245 per cent between January 1985 and December 1989 (Werner, 2003, p. 89). The end of the bubble was succeeded by restrictive monetary policy. In order to prevent goods market inflation during the strong boom in the second half of the 1980s, the Bank of Japan increased the money market interest rate five times between May 1989 and August 1990. More importantly, the window guidance system was used to drastically reduce credit expansion. At the end of 1989, there were signs that asset prices would not increase further. The stock market bubble came to an end, as did the real estate bubble about one year later. Up to about 1992, stock prices halved, and they have remained at a low level more or less until today. Real estate prices started to fall over the long period of around 15 years and remained low (figure 3).

**Figure 3. Real estate index in Japan, 1978–2006**



The index covers the following cities: Tokyo, Yokohama, Nagoya, Kyoto, Osaka and Kobe.

Source: Japan Real Estate Institute, 2009.

It is worth noting that real estate bubbles are more dangerous than stock market bubbles. First, in real estate markets a lot of credit is involved. Stock market speculation can also be financed by credit, but the credit volumes compared with real estate markets are low. Second, the ownership of real estate is important for many households. Except in the case of the very rich, it is the most valuable asset that they hold. This means that increases in real estate prices substantially stimulate consumption, and falling real estate prices depress consumer demand.

## Non-performing loans and monetary and fiscal policy after the bubble

### Non-performing loans

The crash in the asset markets led to grave problems in the Japanese banking system and at the same time destroyed the value of collateral and the wealth of creditors and debtors. Speculators had to sell their assets at a great loss to pay back their loans. Firms, for example, had borrowed extensively during the boom phase and had used their real estate holdings as collateral. However, these loans were used in part for speculative investment in shares or real estate, since the latter promised higher profits. With the inclusion of other speculative sectors, Werner (2003, p. 95) arrives at a proportion of 37 per cent of GDP for so-called “Bubble Loans” – loans used for speculation. The development of non-performing loans was unavoidable after such a bubble, financed mainly by credit.

Seen merely as a temporary disturbance due to the fall in asset prices, the non-performing loans did not create much concern in the political sphere. Rescue operations were of two types. First, insolvent institutions were taken over by healthy financial institutions. These rescue mergers were supported by the Deposit Insurance Corporation (DIC) and the Bank of Japan. Second, with the assistance of the DIC, the Bank of Japan and a few private financial institutions, a new bank was formed to take over the bad loans. But problems in the financial sector stubbornly persisted. During 1994–95, three credit cooperatives and one bank failed. During the same period, the problem with the *jusen*, which held large amounts of real estate assets, exploded.<sup>2</sup> The Big Seven were found to have losses worth 6,410 billion yen, an amount that the DIC could not afford to cover. For the first time, the government felt compelled to inject capital to cover non-performing loan losses and the Housing Loan Administration Corporation

---

2. In the 1970s the *jusen* were formed as subsidiaries of banks. They switched to real estate lending in the 1980s as a result of the increased competition and the liberalization of the Japanese financial system.

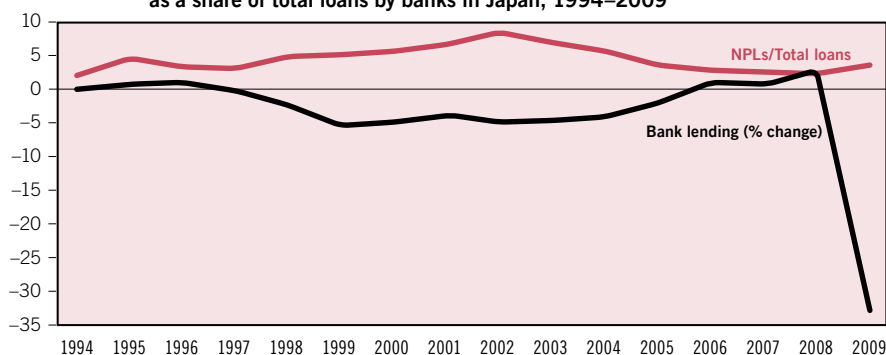
(HLAC) was formed for the disposal of the non-performing loans from the *jusen* (Nakaso, 2001, p. 6).

In 1996, it became clear that the problem of non-performing loans was becoming even larger. The Resolution and Collection Bank (RCB – renamed Resolution and Collection Corporation in 1999) was set up to take over non-performing loans from financial institutions. The government at the same time pushed for reforms in the financial system. In November 1996, Prime Minister Hashimoto announced a programme for the complete liberalization of the financial system by the end of 2001, the so-called “Big Bang”. The aim was to make Tokyo an international financial market as big as London or New York.

The Asian crisis in 1997, followed by the Russian crisis in 1998, was a second deep shock for the Japanese financial system and worsened the situation fundamentally. Japanese financial institutions, which had invested in other Asian countries and in the Russian Federation, had to cope with additional non-performing loans and reacted with a severe restriction of credit expansion (figure 4). In 1997, two major banks (Nippon Credit Bank and the Hokkaido Takushoku Bank) became insolvent. More big bank and insurance company failures followed in 1998. The number of non-performing loans increased from 4.8 per cent in 1998 to 8.4 per cent of total loans in 2002. With government help, it did prove possible to reduce non-performing loans in the years that followed, but the problem did not disappear completely. In 2009, Japan slipped once again into a severe crisis, which will again aggravate the pain of dealing with non-performing loans.

Since the early 1990s, there has been a long period of high non-performing loans in Japan, which has relentlessly prevented its financial system from working properly. Figure 4 reveals that domestic credit expansion after the end of the bubble stagnated or even decreased. A Keynesian or Schumpeterian credit–investment–income mechanism was suppressed in

**Figure 4. Bank lending (annual percentage change) and non-performing loans (NPL) as a share of total loans by banks in Japan, 1994–2009**



Source: Authors' calculation, based on Bank of Japan, Statistical database 2010.

Japan. Without domestic credit expansion financing real activities, of course, a prosperous economic development is not possible.

Several factors explain the existence of non-performing loans over such a long period and the poor credit creation by the Japanese banking system. First, the government did not address the non-performing loan problem quickly and effectively enough. For a long time it believed that the problem could be solved by rescue mergers, but this did not work out. In addition, the public openly opposed the use of taxpayers' money for recapitalizing financial institutions. Second, the goods market deflation added permanently to the non-performing loan problem. Deflation, even in a situation of zero nominal interest rates, increases the real debt burden of all debtors. It is not only the real debt of risky speculators that increases during deflation, but also that of even cautious debtors. In addition, deflation is poisonous for goods market demand. If an investor wants to purchase a machine and expects that his/her competitor will be able to buy the same machine more cheaply one year hence, the former will postpone the investment. Also, consumers will not buy durable goods today if they expect falling prices. Thirdly, the Japanese financial system was hit not only by the end of the bubble in the early 1990s but also by the Asian crises and the subprime crises. Finally, the stricter capital adequacy standards of the Basel Accord had started showing signs of impact on Japanese banks in the early 1990s (Montgomery 2004, p. 25). Overall, a lack of equity, lack of collateral on the part of debtors, fear of their own insolvency and the constant confrontation with bad loans led the banks towards an extremely restrictive credit policy (Baba et al., 2005; Ogawa, 2003, p. 18).

### Monetary policy

The Bank of Japan did not respond quickly enough to counter the asset price deflation and the crisis in the real economy that followed. By 1992 at the latest, the danger of a deep recession had become unequivocal. Given the relatively low inflation at that time and the prospect of a sharp drop in GDP growth, a cut in interest rates would have been appropriate – especially as the window guidance system had been abolished in 1991 and could not be used to stimulate credit expansion. Bernanke and Gertler (2001), Mussa (2003) and Ferguson (2003) all argue correctly that monetary policy was too loose during the development of the bubble and too restrictive after the bubble imploded.

In spite of low GDP growth and very low inflation rates, the Bank of Japan kept interest rates relatively high until the mid-1990s. Only shortly before the Asian crisis (in April 1995) was the interest rate cut to 1 per cent. In view of the increasing deflation problems in 1999, the central bank explicitly declared that it would pursue a zero interest rate policy until deflationary concerns subsided (Bank of Japan, 1999). The economy recovered modestly and the Bank of Japan gave up its zero interest rate policy in August



2000. Recession came back to Japan after the worldwide economic crisis at the end of the internet bubble in 2000–01. In March 2001, the refinancing rate was again reduced to zero and kept at this level until 2006. To give the economy an additional expansionary push, a so-called quantitative easing policy was implemented in 2001. The idea was to increase money supply and pump liquidity into the banking system. Various instruments were used, such as outright purchases of government bonds and purchases of corporate bonds and commercial paper, as well as purchases of stocks by the Bank of Japan and the government (OECD, 2005). After 2005, the situation improved slightly. In 2006, the Bank of Japan lifted its main refinancing rate to 0.4 per cent and 0.75 per cent in 2007. As a response to the subprime financial crisis that started in the United States in 2007, the Bank of Japan reduced the discount rate, in two steps, back down to 0.3 per cent in December 2008. It also reapplied quantitative easing by purchasing corporate and government bonds as well as stocks held by banks, in order to recapitalize banks and increase the stability in the financial system (OECD, 2009a).

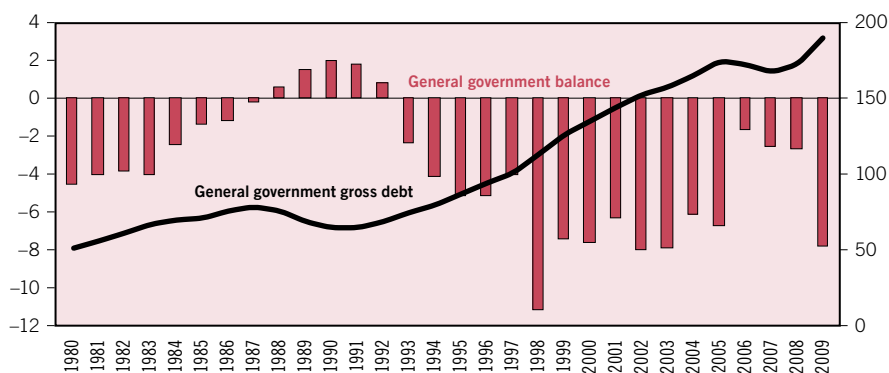
Monetary policy proved to be largely ineffective in Japan. The zero interest rate policy and later the aggressive pumping of liquidity into the economy were not sufficient to stimulate private demand. Because of deflation, real interest rates remained positive and, seemingly more importantly, the distortions in the financial system in the form of non-performing loans, lack of equity and changing behaviour of banks could not be overcome (Baba et al., 2005).

### Fiscal policy

During the boom in the second half of the 1980s, the public budget balance was positive. In late 1991, in the light of the coming recession, fiscal policy took an opposite turn. Japan switched quickly from a budget surplus to a budget deficit. Budget deficits increased dramatically and in many years exceeded 5 per cent of GDP (figure 5). Large parts of the budget deficits were caused by tax reductions aimed at stimulating private consumption, coupled with the increase in government purchases. In 1997, when the Asian crisis hit Japan, the consumption tax was increased from 3 per cent to 5 per cent. This was definitely poor timing (Kuttner and Posen, 2002, p. 9). At that time, the Japanese government thought that the recession had been overcome, and the Fiscal Structural Reform Act was implemented with the aim of reducing the debt-to-GDP ratio to 60 per cent and the budget deficit to 3 per cent of GDP. In 1998, the government took a decisive step to increase spending again. In the following years, it faced the conflicting tasks of stabilizing the economy with fiscal stimuli and consolidating the budget. After 2003, GDP growth recovered moderately and a period of fiscal consolidation got under way. In 2009, fiscal deficits exploded again.



**Figure 5. Budget deficit and public debt in per cent of GDP, 1980–2009**



Source: OECD (2009c).

All in all, the main problem of fiscal policy was that it tried to consolidate the budget whenever there were signs of even a faint recovery. An extremely expansionary fiscal policy, one that would accept double-digit budget deficits for several years, was not tolerated in Japan. Also, direct central bank credits for public expenditures, as a part of the so-called unorthodox monetary policy, were not tried out. Theoretically, this would have been possible. However, in 1998 the Bank of Japan became more independent and such a policy would have implicitly run counter to the government's strategy of establishing a more Western type of financial system. The government debt situation is disturbing. In 2008, the debt to GDP ratio was 172.1 per cent, the second biggest in the world after Zimbabwe (CIA, 2009). Debt to GDP ratios also include the pension contributions paid by the public. If social security revenues were left out of the deficit calculation, public debt would be even higher.

## Wages and deflation in Japan

### Wages and depressions

Sooner or later any bubble bursts, leading to falling asset prices as investors flee to safe liquidity. Distress selling and debt liquidation by the market participants follow. For Irving Fisher (1933), it is of key importance that an asset price deflation leads – via falling asset prices and a distorted financial system – to a lack of demand in the goods market and finally to deflation. Falling goods market prices then lead to an increase in the real debt burden, whereas lack of demand and deflation and increasing real debt reinforce each other until the economic boat capsizes. The driving force for goods market deflation is thus a lack of goods market demand.

John Maynard Keynes (1930) added another important element to the analysis of recessions. He argued that changes in nominal wages, more precisely nominal unit labour costs, are the backbone of inflationary and deflationary processes. Unit labour costs depend on nominal wage increases and productivity increases. If nominal wage increases are identical with productivity increases, there are no changes in wage costs and there is neither wage inflation nor wage deflation. During an economic boom with falling unemployment rates, there is always the danger that demand-driven inflation in the goods market will trigger wage inflation. More importantly in our context, a demand-driven deflation, falling production and increasing unemployment can lead to wage deflation *if* nominal wages do not increase at least in line with productivity. Keynes' wage deflation argument can easily be combined with Fisher's debt deflation model. Then it becomes more understandable that not all asset price deflations lead to disastrous goods market deflation. As long as the nominal wage anchor is upheld even in situations of high unemployment, an asset price deflation and a demand deflation do not lead to a cumulative deflation. Only falling nominal wages open the floodgates to a destructive deflationary process (Herr, 2009).

The wage deflation argument also sheds light on the Great Depression. Bernanke (2000) and others argued that the huge employment losses during the Great Depression were caused by insufficient nominal wage cuts, which led real wages to explode. High real wages, so the argument runs, lead to falling labour demand and high unemployment. The same argument was used for Japan. In the traditional neoclassical and New Keynesian view, after the 1980s real wages in Japan were excessively high and labour markets not flexible enough. Real wages were considered to be too high for full employment. Unions were accused of reacting in an inadequate way and opposing sufficient nominal and real wage cuts (Akerlof, Dickens and Perry, 1996; Baig, 2003; Bigsten, 2005; Takenaka and Yasui, 2005).

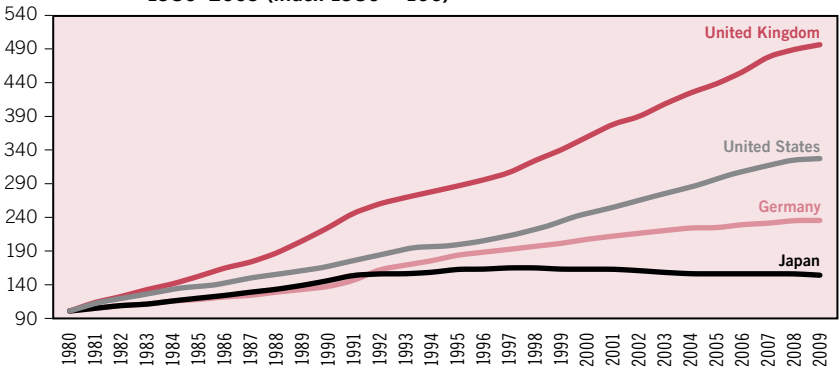
We disagree with these neoclassical arguments. Nominal wage cuts pushed the deflation even further and led to the explosion of the debt burden and the collapse of the economy. A key point is that workers are not even able to reduce real wages by cutting nominal wages. In Keynes' words: "There may exist no expedient by which labour as a whole can reduce its *real* wage to a given figure by making revised *money* bargains with the entrepreneurs" (1936, p. 13). As to wages and the Great Depression, Keynes argues: "It is not very plausible to assert that unemployment in the United States in 1932 was due either to labour obstinately refusing to accept a reduction of money-wages or to its obstinately demanding a real wage beyond what the productivity of the economic machine was capable of furnishing" (ibid., p. 9). As will be seen, in Japan it was also the misguided cut in nominal wages that stimulated deflation, and it did not lead to the real wage cuts sought.

## Wage developments in Japan

After the end of the bubble, nominal wage increases became very low, and they even fell after the shock of the Asian crisis. Only after 2005 did nominal wages stop falling. They have increased only very slightly since then. Figure 6, illustrating nominal wage increases in Japan, Germany, the United Kingdom and the United States, shows that nominal wages in Japan did not increase in such a way as to secure a low positive inflation rate, which is also the target of the Bank of Japan. Figure 6 also indicates that Germany is in a similar position with respect to low nominal wage increases.

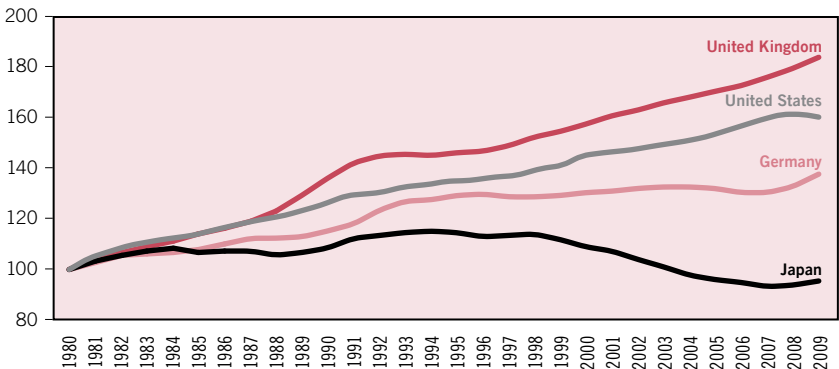
Nominal unit labour costs are the most important factor in the determination of price levels. Unit labour costs depend, as mentioned, on productivity changes and on changes in nominal wages. Trend productivity in Japan increased continuously even after the end of the bubble. Taking nominal wage development into account, it is no surprise that unit labour costs in the second half

**Figure 6. Nominal compensation per employee, total economy, 1980–2009 (index 1980 = 100)**



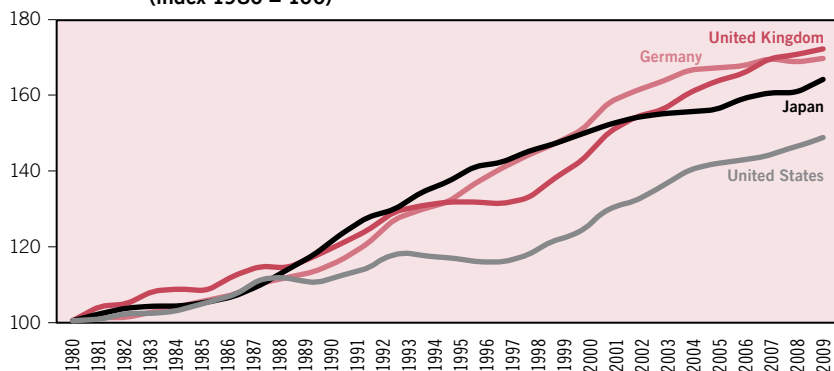
Source: Ameco (2010).

**Figure 7. Nominal unit labour costs, total economy, 1980–2009 (index 1980 = 100)**



Source: Ameco (2010).

**Figure 8. Real average hourly compensation per employee, total economy 1980–2009 (index 1980 = 100)**



Source: Authors' calculation, based on Ameco (2010).

of the 1990s started to decrease substantially in Japan (see figure 7). Overall, the level of nominal unit labour costs in the United Kingdom and the United States increased in a way that led to moderate inflation rates, which were very much in line with the implicit or explicit inflation targets of the central bank. Due to the low nominal wage increases, unit labour costs in Germany stagnated and brought the country close to deflation. Keynes' argument that nominal wages do not determine real wages is fully confirmed in Japan. In spite of falling nominal unit labour costs, real hourly compensation of employees in Japan did not decline. Indeed, it increased, reflecting productivity gains (see figure 8).<sup>3</sup>

Why did the nominal wage anchor in Japan break down and create a dangerous situation, which could have ultimately resulted in a 1930s-style development? The answer lies in the special Japanese labour market situation and the changes it went through.

Official unemployment was around 1 per cent in the 1960s and increased slowly to almost 3 per cent in the mid-1980s, then came down again to 2.1 per cent in 1990, due to economic stabilization. Up to 2003, it increased to nearly 6 per cent, a rate that was reached again in 2009 after a few years of improvement (Ameco, 2010). However, real unemployment figures are higher, as many people who are out of work do not register as unemployed. Furthermore, the development of unemployment has to be seen against the background that the Japanese labour market has a high flexibility in working hours. Freeman and Weitzman (1987, p. 96) see the build-up and reduction of overtime as an important means for Japanese businesses to react to upward and downward swings in economic growth. In the face of low or negative economic growth after the end of the bubble, reducing overtime was quite obviously no longer sufficient to maintain high levels of employment.

3. Real compensation per employee did not increase as much as real hourly compensation per employee (Ameco, 2010). Obviously employees worked fewer hours.

Overall, the increase in unemployment must be considered as a deep shock for Japanese society.

The Japanese labour market has long been divided into regular and non-regular employees. Regular employees used to have lifelong employment guarantees in the company for which they first worked, long-term career prospects, relatively high wages and good fringe benefits. Non-regular employees are short-term contract employees, temporary employees and part-time employees; they earn less than regular employees and it is relatively easy to terminate their employment. Table 1 shows that the number of regular workers dropped from 83 per cent in 1982 to 68 per cent in 2002. The Japanese Ministry of Internal Affairs and Communications reports that in 2008 the percentage of regular workers dropped to below 66 per cent. Female employees are much more affected than male employees. The burden of the Japanese crisis was disproportionately borne by women (Nakata and Miyazaki, 2010). In spite of the increase in non-regular employment, the wage structure (in terms of nominal wages per hour) in Japan did not change much.<sup>4</sup> This group of employees has obviously long served as a buffer against changes in economic growth. The wage income of non-regular employees fluctuates widely according to the volume of employment.

It is also noteworthy that the Japanese wage system is characterized by high bonus payments. Besides the 12 monthly salaries, Japanese employees receive a bonus payment twice a year. This bonus system provides pay flexibility that can be applied at short notice and leads to strongly pro-cyclical wage developments.<sup>5</sup> The bonus system adds to the danger that during periods of low growth, the income of employees will drop substantially.

Of key importance is the wage-bargaining system in Japan and the orientation of labour unions. There are mainly company-level unions that organize more or less only regular employees. Regular employees often automatically become members of the corresponding company-based union. Non-regular employees, on the other hand, are usually excluded from membership by their statutes. Company-level unions are members of national union federations, but wage negotiations *de facto* take part at the company level. Rebeck (2001, p. 136) found that union membership dropped mainly because of the increase in non-regular jobs. Nationwide wage coordination is traditionally

---

4. Comparing average wages from 1995 to 2000 and from 2001 to 2007, the Gini index for wage income in Japan only changed from 29.63 to 28.90. This is a slightly more equal distribution of wages, as inequality increases with the value of the Gini index. Wage inequality in Japan is more or less at the mid-point in the ranking of industrial countries. In the period from 2001 to 2007, for example, Sweden had a value of 23.4, Denmark 23.8, Germany 26.0 and the United Kingdom 34.0 (ILO, 2009, p. 96).

5. For instance, the special cash earnings (in which the biggest share belongs to bonuses) were reduced sharply from an annual average of 107,944.00 yen in 1998 to 60,649.00 yen in 2004. After two years of slight increases, cash earnings were reduced again in 2007 (Ministry of Health, Labour and Welfare, various years).

**Table 1. Composition of employees in the non-agricultural sector, 1982–2002**

	1982	1992	2002
<i>Regular employees</i>	83	78	68
Male	58	54	48
Female	25	25	20
<i>Non-regular employees</i>	17	22	32
Male	5	6	9
Female	12	16	22

Note: All figures in per cent of total employees, without executives of corporations. Some numbers do not add up due to rounding.

Source: Nakata and Miyazaki (2010), p. 193, based on data from the Japanese Ministry of Internal Affairs and Communications.

handled by employer organizations and not by unions. A small number of firms on an industry or multi-industry basis, mainly from the export sector, the government and union federations discuss wages and recommend a certain wage development. Union federations are weak and do not play an important role in this process. Wage recommendations are more or less passively accepted by company-based unions. Employers' organizations, government and union federations have all been following a corporatist mercantile strategy. Wage developments take account of international competitiveness. As the Bank of Japan intervenes in the foreign exchange market, targeted exchange rate movements play an important role in wage developments. "Although exports are a relatively small share of GDP, these discussions are based on the requirements of maintaining as far as possible cost competitiveness. They therefore involve anticipating with government likely exchange rate movements" (Soskice, 1990, p. 41).<sup>6</sup> It is more than accidental that the second industrial country with high current account surpluses, Germany, also has very low wage increases. In Germany too, a mercantilist orientation during wage negotiations can be observed in many cases. However, it is only to be expected that unions in the German export sector, which negotiate with employers' organizations, will be less radical in following mercantilist wage restraint than in the Japanese type of wage coordination, which is organized by a handful of big export-oriented firms. Additionally, in Japan company-level wage negotiations in a situation of a severe economic crisis always tend to lead to wage cuts, as the microeconomic logic of improving the firm's competitiveness by undercutting the costs of other firms becomes overwhelming.

The potential role of minimum wages in preventing a deflationary development was not brought to bear in Japan. During the deflationary periods,

6. Similarly: "The pattern of export sector led coordinated wage moderation in Japan was established in 1975 immediately after the first oil crisis and continued thereafter even during the economic boom of the 1980s" (Hiwatari, 2002, p. 14).

the National Council, which recommends the annual changes, froze minimum wages. Between 1999 and 2006, there were very small changes in minimum wages, if any at all (Nakakubo, 2009, p. 27; Kambayashi, Kawaguchi and Yamada, 2008). On the other hand, looking at the wage structure, we can see that the livelihoods of the poorest workers have improved and that the wage gap between the lowest- and the average-paid workers from the end of 1980s until 2005 actually narrowed. This was especially apparent in the low-wage prefectures (Kawaguchi and Mori, 2009, p. 12). Hence, we can argue that the minimum wage was not used as a mechanism to prevent the deflationary development, but it certainly contributed to preventing the widening of the wage gap and was at least able to protect the lowest-paid from any such widening.

The share of wages in national income has been shrinking throughout the past three decades, from over 70 per cent in the 1970s to 57 per cent in 2008 (Ameco, 2010). This fall is the strongest of any industrial country. The falling wage share is reflected in the trend towards more unequal household income distribution. The Gini coefficient for disposable income increased in Japan from 0.30 in 1985 to 0.35 in 2005. In 2005 this indicator stood at 0.38 for the United States, 0.335 for the United Kingdom, 0.30 for Germany, 0.23 for Sweden and 0.27 for Austria (OECD, 2009b). Higher profit shares on national income reflect the increased power of the financial system and the firm sector in Japan which allowed a higher profit mark-up. The more unequal income distribution also added to the poor demand in domestic goods markets, together with the deflation in goods and asset markets and the increase in the number of people living in precarious working conditions.

### What lessons can be learned?

When the bubble of the second half of the 1980s ended, Japan was all set to slide into a deflationary constellation comparable to developments in so many countries during the 1930s. Overall economic development since the 1980s has been poor. The biggest Japanese mistakes were:

- Japanese economic leaders should never have allowed the asset price bubble to occur. They would still have had the instruments at that time to control credit expansion to the real estate sector. After the implosion of the bubble, interest rates were lowered too hesitantly. Later, when the Bank of Japan was following a zero interest rate policy, all possibility of reducing real interest rates was lost within the context of deflation. The lesson that had already been taught decades before, and which also applies to Japan, is that monetary policy loses its power in a deflationary situation.
- It was a fatal mistake for the government not to clear the balance sheets of non-performing loans quickly and in a comprehensive way. It waited too

long and even then did not solve the problem quickly. Rapid intervention would have helped to revive the distorted credit-investment mechanism. The best strategy would have been to nationalize banks whenever governments had to stabilize them. Later the banks could have been privatized again.

- Fiscal policy was expansion-oriented and prevented a cumulative drop in demand. But fiscal policy was ambiguous, with the government consolidating the budget too early when it thought the crisis had been overcome. Such a policy is understandable, as public debt to GDP exploded. However, it was also demonstrated that in a deflationary situation the government must provide support to the economy to prevent its collapse. Demand could also have been stimulated almost limitlessly through interest-free central bank loans to the government. However, such an unconventional combination of monetary and fiscal policy was not followed.

Looking at monetary policy and the cleaning of non-performing loans from financial institutions' balance sheets in the United States and Europe after the subprime crisis, they seem to have been better handled than they were in Japan. But this did not take away the fear that, after the subprime crisis, at least a medium-term period of low growth might ensue. It is an open question whether fiscal stimuli in Western countries remain at least as expansionary as they did in Japan over such a long period of time.

Wage development in Japan was glaringly dysfunctional. After the bursting of the asset price bubble and half a decade of low growth, the wage anchor started to erode. The example of Japan shows how important labour market institutions are in preventing insufficient wage increases or, even worse, cuts in nominal wages. The misguided wage development can be at least partly interpreted as an element of a mercantile strategy. The Japanese example is also instructive in that it shows that a strong position on world markets does not guarantee successful growth and employment, especially when domestic demand remains weak. Focusing only on stimulating exports is not only harmful for other countries. It can become counterproductive for the mercantilist country itself, as has also been proved in the case of Germany.

However, we should be cautious about assuming that a deflationary wage development as in Japan would not be possible in the United States, Europe or other industrial countries. Deflation in Japan came around five years after the end of the bubble. What will happen in other developed countries after such a long period of low growth as in Japan? There is a high likelihood that many industrial countries will follow the deflationary Japanese development if there are no far-reaching policy interventions. What is needed is a macro-economic policy to stimulate growth, so as to prevent the escalation of unemployment. Nominal wages should increase according to trend productivity and the target inflation rate of the central bank. Minimum wages that are in close contact with the lowest wages paid, and minimum wage increases



that are also in accordance with trend productivity and the target inflation rate, can help to prevent the erosion of the nominal wage anchor (Herr, Kazandziska and Mahnkopf-Praprotnik, 2009). The strengthening of unions and collective wage bargaining mechanisms is necessary in order to help establish such a policy – including in mercantilist-oriented countries like Japan or Germany. This shows that unions in capitalist economies are not only institutions for promoting justice and giving workers a voice. They are needed as stabilizing factors to prevent deflation when monetary policy becomes ineffective.

## References

- Ameco, Economic and Financial Affairs database of the European Commission (various years), available at: [http://ec.europa.eu/economy\\_finance/ameco/user/](http://ec.europa.eu/economy_finance/ameco/user/)
- Akerlof, G.; Dickens, W.; Perry, G. 1996. *The Macroeconomics of Low Inflation*, Brookings Papers on Economic Activity 1, pp. 1–59.
- Baba, N. et al. 2005. *Japan's Deflation, Problems in the Financial System and Monetary Policy*, BIS Working Papers, No. 188.
- Baig, T. 2003. *Understanding the Costs of Deflation in the Japanese Context*, IMF Working Paper 03/215.
- Bank of Japan 1999. *On Recent Monetary Policy*, speech given by Masaru Hayami, 22 June.
- Bernanke, B.S. 2000. *Essays on the Great Depression* (Princeton, NJ, Princeton University Press).
- ; Gertler, M. 2001. “Should Central Banks Respond to Movements in Asset Prices?”, in *American Economic Review*, Vol. 91, pp. 253–257.
- Bigsten, A. 2005. “Can Japan Make a Come-back?”, in *World Economy Paper*, Vol. 28, Issue 4, pp. 595–606.
- CIA. 2009. *The World Factbook* (Washington, DC).
- Ferguson, R. W. 2003. *Uncertain Times: Economic Challenges Facing the United States and Japan*, available at: <http://www.bis.org/review/r030620f.pdf?noframes=1>
- Fisher, I. 1933. “The Debt-Deflation Theory of Great Depressions”, in *Econometrica*, Vol. 1, pp. 337–357.
- Freeman, R., Weitzman, M. 1987. “Bonuses and Employment in Japan”, in *The Japanese Economy*, Part 2, Vol. 6, pp. 221–246.
- Herr, H. 2009. “The Labour Market in a Keynesian Economic Regime: Theoretical Debate and Empirical Findings”, in *Cambridge Journal of Economics*, Vol. 33, pp. 949–965.
- ; Kazandziska, M.; Mahnkopf-Praprotnik, S. 2009. *The Theoretical Debate About Minimum Wages*, Global Labour University Working Papers, No. 6, Feb.
- Hiwatari, N. 2002. *Economic Downturn, Unemployment, and Policy Reform in Germany and Japan: Wage Moderation and Compensation Policies in Coordinated Market Economies*, paper presented at the annual meeting of the American Political Science Association, Boston, MA, 29 Aug.–1 Sep.

- Hoshi, T.; Kashyap, A. 1999. *The Japanese Banking Crisis: Where Did It Come From and How Will It End?*, National Bureau of Economic Research, Working Paper No. 7250.
- ILO. 2009. *Global Wage Report* (Geneva).
- Kambayashi, R.; Kawaguchi, D.; Yamada, K. 2008. *Minimum Wage in Deflationary Economy: Experience of Japan, 1994–2003*, Global COE Hi-Stat Discussion Paper Series (available at: <http://ideas.repec.org/s/hst/ghsdps.html>) gd09-074, Institute of Economic Research, Hitotsubashi University.
- Kawaguchi, D., Mori, Y. 2009. *Is Minimum Wage an Effective Anti-Poverty Policy in Japan?*, RIETI Discussion Paper Series 09-E-032 (available at: <http://www.rieti.go.jp/jp/publications/dp/09e032.pdf>).
- Keynes, J. M. 1930. *A Treatise on Money*, Vol. 1, The Pure Theory of Money (London, MacMillan, Collected Writings, Vol. V).
- . 1936. *The General Theory of Employment, Interest and Money* (London and Basingstoke, MacMillan).
- Kindleberger, C. 1978. *Manias, Panics and Crashes – A History of Financial Crisis* (New York, Basic Books).
- Kuttner, K.; Posen, A. 2002. *Passive Savers and Fiscal Policy Effectiveness in Japan*, Peterson Institute Working Paper 02-2.
- Mussa, M. 2003. “Asset Prices and Monetary Policy”, in W.C. Hunter, G. Kaufman and M. Pomerleano (eds): *Asset Price Bubbles: The Implications for Monetary, Regulatory, and International Policies* (Cambridge, MA, MIT Press), pp. 41–50.
- Ministry of Health, Labour and Welfare, *Report of Monthly Labour Survey, Statistics and Information Department*, various years.
- Minsky, H.P. 1975. *John Maynard Keynes* (New York, Columbia University Press).
- Montgomery, H. 2004. *The Effect of the Basel Accord on Bank Portfolios in Japan* (available at: <http://www.personeel.unimaas.nl/A.Hecq/montgomery.pdf>).
- Nakakubo, H. 2009. “A New Departure in the Japanese Minimum Wage Legislation”, in *Japan Labor Review*, 6 (2), Spring 2009, pp. 22–38.
- Nakaso, H. 2001. *The Financial Crisis in Japan During the 1990s: How the Bank of Japan Responded and the Lessons Learnt*, BIS Papers, No. 6.
- Nakata, Y.F.; Miyazaki, S. 2010. “Increasing Labour Flexibility during the Recession in Japan: The Role of Female Workers in Manufacturing”, in C. Brown, B. Eichengreen and M. Reich (eds): *Labour in the Era of Globalisation* (Cambridge, Cambridge University Press), pp. 191–210.
- OECD. 2005. *Economic Surveys Japan*, Volume 2005/3 (Paris).
- . 2009a. *Economic Surveys Japan*, Volume 2009/18 (Paris).
- . 2009b. *OECD – Society at a Glance 2009* (Paris).
- . 2009c. *OECD Economic Outlook No. 85*, OECD Economic Outlook: Statistics and Projections (database).
- Ogawa, K. 2003. *Financial Distress and Corporate Investment: The Japanese Case in the 90s*, The Institute of Social and Economic Research, Osaka University, Discussion Paper No. 584.
- Okina, K.; Shiratsuka, S. 2001. *Asset Bubbles, Price Stability, and Monetary Policy: Japan’s Experience*, Institute for Monetary and Economic Studies, Bank of Japan, Discussion Paper No. 2001-E-16.

- Rebick, M. 2001. "Japanese Labour Markets: Can We Expect Significant Change?", in M. Blomström, B. Gangnes and S. La Croix (eds): *Japan's New Economy – Continuity and Change in the Twenty-First Century* (New York, Oxford University Press).
- Soskice, D. 1990. "Wage Determination: the Changing Role of Institutions in Advanced Industrial Countries", in *Oxford Review of Economic Policy*, Vol. 6, pp. 36–61.
- Takenaka, S.; Yasui, K. 2005. *Deflation and Nominal Wage Rigidity: Evidence from Japan*, Discussion Paper No. 05-21.
- Werner, R.A. 2003. *Princes of the Yen. Japan's Central Bankers and the Transformation of the Economy* (New York, M.E. Sharpe).

# The Great Recession: A turning point for labour?

**Frank Hoffer**

Senior Research Officer,  
Bureau for Workers' Activities  
International Labour Office  
International coordinator,  
Global Labour University

**M**arkets left to their own devices do not lead to efficient resource allocation and stable equilibria. If there is a lesson to this crisis, it is that free market theonomics is no longer tenable. High volatilities, persistently high levels of unemployment, massive global imbalances, growing inequality and monopolization of productivity gains at the top of the income pyramid have been the most visible dysfunctionalities of finance-led globalization.

Three years into the Great Recession, we have by now grown accustomed to figures that defy the imagination. According to the IMF, financial institutions will write down US\$3.4 trillion between 2007 and 2010 (Davis, 2009). By July 2009 governments had already provided a staggering US\$10 trillion support (Schifferes, 2009) in the form of capital injections (US\$1.1 trillion), purchase of assets (US\$1.9 trillion), guarantees (US\$4.6 trillion), and liquidity provisions (US\$2.5 trillion) to avoid a run on the banking system.

Global stimulus packages were another US\$2 trillion, or roughly 2 per cent of the global GDP in 2009, and 1.6 per cent in 2010 (IMF, 2009). The average fiscal deficit among G20 countries has moved from -1.1 per cent in 2007 to -6.6 per cent in 2010 (IMF, 2009). And yet, despite these extraordinary measures, unemployment skyrocketed, with 10 million jobs lost in high-income countries alone. Globally, the ILO estimates 34 million job losses and a massive reduction of working time. It will take at least 2.5 to 5.5 years to return to the employment levels of 2008 (ILO, 2009a). Toxic assets worth several hundred billion dollars (Palma, 2009) are still circulating in the virtual financial world or are hidden in bank balance sheets. Probably no one knows the scale of the risks that are still out there.

Maintaining the extraordinary levels of government support raises questions of financial sustainability, but winding down state support raises the even more threatening prospect of a double-dip recession. Given the scale of the crisis, the fact that any financial panic has been avoided must be accounted a success in itself. However, whether the massive state and central bank interventions have averted the crisis or just transformed it into a long period of economic stagnation, high unemployment and growing poverty remains an open question.

So far, the bankruptcy of the old economic regime has not resulted in any fundamental policy change. The current "auto-suggestive" recovery talk of officials and official experts creates a misleading atmosphere of confidence and complacency. Even in the third year of recession, nothing has been done to address the structural deficiencies of the system. As the root causes of the crisis are not being tackled, there is good reason to expect continuous instability, more bubbles, inefficient allocation of resources, disastrous financial implosions, and of course hardship.

## Threat and opportunity for labour

The Great Recession:  
A turning point for labour?

A crisis constitutes a threat as well as an opportunity. A threat because hard-won achievements in wages and working conditions are easily eroded, and an opportunity because powerful vested interests and fundamental flaws in the economic system can often be overcome in the response to a systemic crisis.

No other crisis since 1929 has posed such a challenge to labour in industrialized countries, its traditional stronghold. Its deep and widespread character is reshaping the global economic order, with unpredictable consequences. The stakes are high. Will the crisis further deepen inequality within and among nations? Will employers' hostility to workers' rights increase? Will private capital succeed in socializing the costs of the crisis? Will massive deleveraging lead to deflation and stagnation, or will continued deficit spending lead to inflation? Are there lost decades ahead for the industrialized countries, just like the last 20 years in Japan? Will the welfare state as we know it survive the crisis? Will the United States maintain its global dominance? Can the euro survive? Will authoritarian state-led capitalism *à la chinoise* demonstrate a superior capacity to respond to the crisis than democratic capitalism? Is the multilateral system strong enough to provide the space for cooperative solutions or will we see a re-nationalization of international policies? Will the G20 replace the United Nations as the real forum for global governance? Or is a sustainable recovery on its way, with strong economic and productivity growth which will allow countries to grow out of their high debt levels and cause the job market to rebound soon?

A labour agenda cannot ignore this bigger picture. The immediate needs of workers push trade unions towards a defensive "bread and butter" agenda of protecting jobs, often through wage concessions. However, if universally applied, this will trigger a downward deflationary spiral, and with hindsight it may also be seen as having led labour down the path of being reasonable, but irrelevant.

The depth of this crisis makes it a virtual certainty that it will be a defining moment for labour, one way or another. The current regime favours global finance and big corporations. It rewards irresponsibility and high risk, distributes the gains of technical progress and economic growth extremely unevenly, erodes the bargaining power of labour and results in frequent financial crises with huge costs for societies. A continuation of this economic disorder will further weaken organized labour and reduce the ability of governments to pursue progressive social and economic policies. Years of sluggish growth and high unemployment (IMF, 2010) will most likely provide fertile ground for employers to erode social standards and increase non-standard forms of employment. In such an environment, further decline of trade union membership and influence is highly likely.

The crisis is worsening the economic bargaining position of labour, but it might also open up a political opportunity to reverse the trend of decline

and mobilize for an alternative agenda of fair globalization and inclusive societies. Such an agenda implies limiting the economic power of the few in order to extend the freedom, democracy and opportunity of the many. The ability of societies to protect themselves against state or market dictatorship depends on the political institutions and public discourses in society. Trade unions are – next to religious organizations – the largest non-governmental organizations in most societies. Their role is vital in building more inclusive societies. To fulfil this role will require a combination of defensive strength, immediate crisis relief measures and a more fundamental agenda for change. This is highly ambitious, but it seems to be the most promising option to reverse decades of decline.

The experience of recent financial market crisis in the Republic of Korea, Sweden and Japan shows that labour was not able to exploit the failures of the economic system to its advantage. Indeed, in all cases it led to an erosion of labour rights, a relative decline in employment and wages and a massive rise in precarious employment (IMF, 2010).

Furthermore, all of the countries tried to surmount the crisis – some with more success than others – through export-led strategies based on currency devaluation and cost-cutting. These strategies were supported by the international financial institutions, favoured by employers, but costly for workers. These recovery plans were only possible to the extent they were adopted in a few countries and that their trade partners were willing to accept trade deficits.

But the financial crisis of 2007 is different. As in the Great Depression, this crisis affects a huge number of industrial countries simultaneously. Its global character therefore makes the standard export-led solution of devaluation and wage cuts both conflictual and unrealistic.

The crisis of 1929 quickly became a political crisis of legitimacy for capitalism. In this sense, no other economic crisis has changed the world as fundamentally as the Great Depression. Notably, it ushered in the proud labour movements of continental Europe (Sturmthal, 1944). However, the social democratic party of the day largely failed to find an answer to the crisis. Instead, the collapse of the liberal market economy paved the way to authoritarian regimes throughout Central and Eastern Europe. Fascism became the new social movement whose rise to power appeared unstoppable and culminated in the Second World War. On the other side of the Atlantic, the New Deal transformed the United States of America.

Today, many associate the Great Depression with Roosevelt's New Deal, but it should not be forgotten that the crisis was first and foremost a terrible economic breakdown with incredible social hardship.

The important lesson of the Great Depression was the understanding that unregulated markets could lead to disastrous social and economic outcomes and that, in turn, state intervention in the economy was not only possible but necessary to reduce the fallouts from economic cycles. A broad

consensus emerged that the costs of leaving crisis resolution to the market was prohibitively high and an ultimate threat to the social fabric of societies.

Only at the end of the last century, when the bitter experience of the Great Depression and its historical lessons disappeared from the collective memory, were free marketers able to dismantle the regulatory legacies of the 1930s and set the ground for the Great Recession of 2007.

### Crisis, what crisis?

So far, the Great Recession has been a financial, social and economic crisis, but not a political one. Protest, anger and action are limited to television talk shows, a number of well-organized mass demonstrations, a few cases of symbolic bossnapping and a debate about banker bonuses which, first and foremost, shows the unbroken strength of the financial sector. By and large, the political fallout from the crisis has been limited. Broadly speaking, the overall legitimacy of the economic order is not being questioned.

In the first phase of “putting the fire out” – as in a war economy – costs did not matter: survival was the order of the day. Readers might remember Henry Paulson, the Treasury Secretary of the United States, sending a three-page document asking Congress for US\$700 billion (Stanglin, 2008). Most welfare recipients have to do more paperwork than that to claim social assistance. Astronomical sums were mobilized while the decision about who would foot the bill was postponed.

After getting a bailout largely on their own terms, financial institutions have now turned their attention to shifting the burden of its cost as well as to resisting any major change to the neo-liberal globalization order. The immediate huge deficit spending prevented a great depression, but it also allowed the financial sector to regroup and engineer a formidable defence of the old regime. Despite bringing the global economy to the verge of collapse, the financial sector has so far been able to block any substantial regulatory change.

It is ironic that the same financial institutions that were begging governments to take on huge debts to save the banking system are now running speculative attacks against those same governments, because of unsustainable public debt levels. Governments are now paying the price for saving the banks, but not taking away “their financial weapons of mass destruction” (Buffet, 2002). The blood transfusion from the State to the banking sector has led to a quick recovery by the moribund patient who, once recovered, shows no signs of gratitude but turns his speculative energy against weakened governments.

Insufficiently regulated financial markets make capital flight and tax evasion easy and enable speculative attacks on currencies. Through these channels, they create a structural pressure to reduce public debt by cutting public expenditures on health, pensions, education, infrastructure and public



services instead of raising capital and wealth taxes as well as continuing to engage in productivity-enhancing public expenditures.

The list of countries that are going through this painful process is getting longer by the day: Iceland, Ireland, Latvia, Lithuania, Ukraine, Hungary and Greece are already being forced to make brutal cuts in wages and welfare provision while their economies are contracting. Portugal, the United Kingdom, Spain and Italy are probably the next in line.

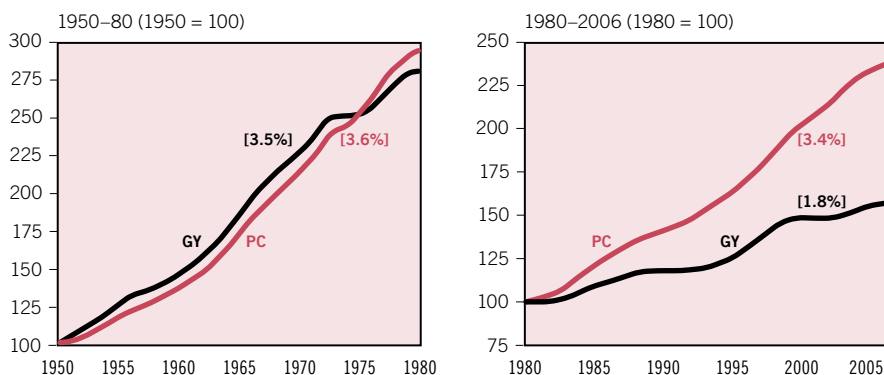
In an Orwellian manner, every attempt by governments to liberate their societies from the straitjacket of blind market forces is called an attack on freedom, and a speculative attack on an entire country, such as Greece, is interpreted as fair discipline against an irresponsible government. The work of speculators is thus once again presented as impartial justice executed by an anonymous market.

### Inequality and wage slide – or why regulatory changes here and there are not a sustainable response to the crisis

The global economic regime based on excessive profits and unsustainable private debt has collapsed. The fundamental reason is not some regulatory deficiencies here and there. Final aggregate demand cannot be indefinitely based on growing consumer debt. Rather, it needs to be based on the real income of the broad population, which was the case in the United States until the late 1970s.

An oversized financial industry has exploited the opportunities presented by global capital mobility, to the detriment of societies. In recent decades, wages and transfer incomes have not grown in line with productivity

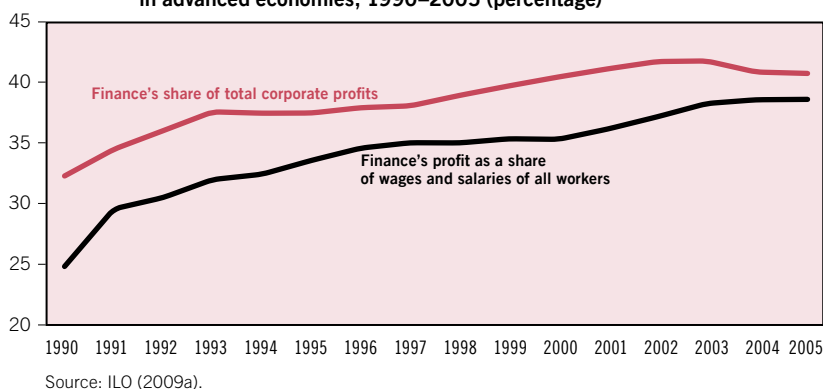
**Figure 1. Disjunction between income and consumption in the United States**



Note: **GY** = gross income of the bottom 90 per cent. **PC** = personal consumption expenditure. 3-year moving averages. Percentages are average annual rates of growth in respective periods.

Source: US Census Bureau (2008) as quoted in Palma (2009).

**Figure 2. The rising incidence of profits of the financial sector in advanced economies, 1990–2005 (percentage)**



in most countries. In fact, institutional and legal capital and labour market changes, combined with aggressive, short-term profit maximization strategies have enabled the owners of private enterprises and financial capital to appropriate most of society's productivity gains.

Moreover, threats of relocation or disinvestment have resulted in labour market deregulation and casualization of employment. Such global capital mobility led to the rise of tax havens, transfer pricing and tax competition, reducing the ability of governments to tax capital, thus driving down tax rates and regulation levels. Meanwhile, the high profit rate in the financial industry put pressure on the real economy to produce similar results for shareholders. Thus, the profits of the financial bubble economy became the benchmark for the real economy.

In sum, while income differentials have widened, the tax burden has shifted to employees and consumers, further reducing the purchasing power of the people. Throughout the world, "indecent", precarious and informal employment is increasing. In many countries, open capital markets overly constrain governments' ability to pursue an expansionary fiscal policy, as any increase in inflation would trigger capital outflows and ultimately risk a currency crisis. These capital market constraints, combined with the declining ability to tax, have reduced governments' room for public expenditure, while low wages have limited private consumer demand. Nevertheless, overall demand has stayed high, as rapidly growing private deficit spending backed by asset bubbles has disguised the long-term unsustainability of growing imbalances in distribution and trade. It has created the illusion that consumption can rise despite a declining wage share, and that wage increases below productivity growth are "only" a problem of social justice, not an economic policy issue.

As long as asset prices are going up, a bubble looks like a free lunch from which everybody gains. However, the bubble, like any pyramid scheme, can only continue if more and more people join in. The bubble itself creates a

need to loosen credit criteria further: as the ratio between actual income and asset prices grows, credit conditions need to be softened to draw new entrants into the (real estate) market. Financial irresponsibility has to grow.

The financial industry massively increased its share of corporate profits. However, this increase in profits did not translate into real investment.

Indeed, a reverse process took place. The huge profits in the financial industry were crowding out private investment. A larger and larger proportion of capital is constantly circulating in the virtual world of financial “products”. Productive capitalism is increasingly being replaced by *rentier* capitalism.

When the bubble burst, it did not just affect the bubble economies; countries with an export surplus-led strategy, priding themselves on their solid financial policies, also saw their “beggar-thy-neighbour” policies collapse. They could no longer offset their lack of internal demand through ever-growing export surpluses. The export machines came to a standstill. The export champions realized that they had exchanged real goods against fancy

Figure 3. Investment/operating surplus, selected countries, 1970–2002

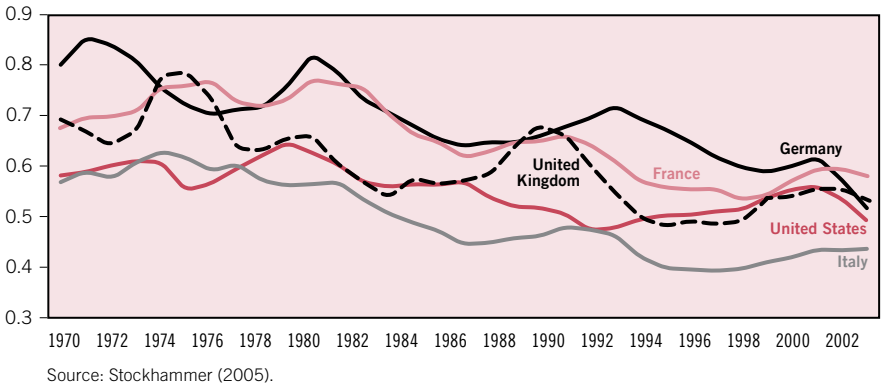
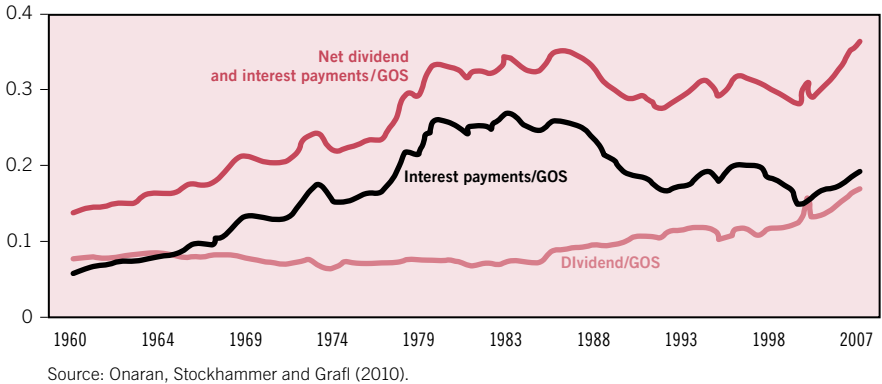


Figure 4. Net dividend and interest payments/gross operating surplus (GOS), United States, 1960–2007



but toxic pieces of paper. Productivity gains, instead of being shared fairly, had been wasted.

Wage, tax and social policies that share productivity gains fairly are crucial for a sustainable growth pattern based on final aggregate demand that does not rely on either beggar-thy-neighbour policies or ever-rising private or public debt.

## Labour facing a dual crisis

Trade unions today are facing not only an economic crisis, but an organizational crisis of declining membership and influence.

During the post-war period of high growth and relative stability, productivity gains were widely shared in society, as a powerful trade union and labour movement improved working and living conditions through collective bargaining and redistributive social policies.

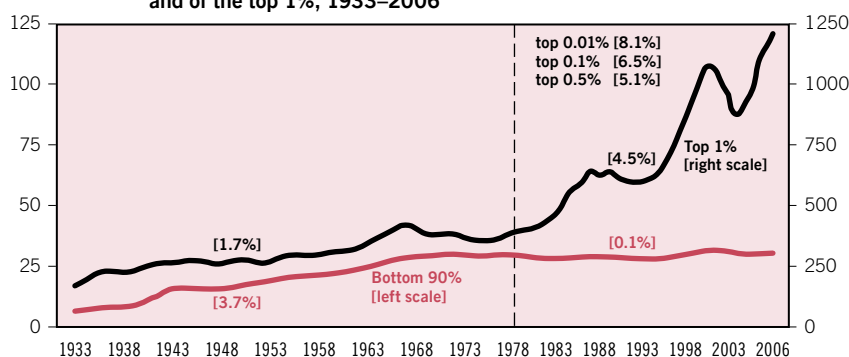
During that period, trade unions became institutionalized in society. Governments recognized organized labour as the legitimate voice of workers, and employers by and large had to accept unionized workplaces, as they could no longer rely on anti-union state policies to fight organized labour. Class compromises replaced class war. Institutional power reduced the need for mobilizing power. Trade unions became less of a social movement and more of a respected, influential and professional institution.

This “harmonious cold war” period, including as it did an influential role for organized labour as part of corporatist capitalism, became unstable in the early 1970s. Socially, the success of the welfare state reduced the need for direct solidarity and mutual support within the labour movement. Culturally, the student protests of the 1960s and growing individualism also challenged the authoritarian and patriarchal world of the traditional labour movement. Workers were less willing to play an active role in the movement and the organizations relied more on professional staff and institutional strength to serve their members. Both processes mutually reinforced each other.

But most significant was the end of Bretton Woods, which limited the scope for national macroeconomic policies. Labour could, to a lesser extent, supplement collective bargaining with redistributive, adequate social and economic policies at the national level. Business liberated itself increasingly from national regulations by going global. Capital achieved the comfortable position of being able to blackmail governments and workers into conceding ever more advantageous conditions. Tax reductions and wage cuts, instead of technical productivity increases, became a major competition factor. However, while the latter contribute to wealth creation, the former merely redistribute wealth from labour to capital.

Trade unions were not able to resist these changes, and their influence started to decline. The fall of the Berlin Wall sped up the process of

**Figure 5. United States: Average income of the bottom 90% and of the top 1%, 1933–2006**



Note: Percentages are average annual rates of growth between 1933–78 and 1978–2006. Includes capital gains. 3-year moving averages.

Source: Palma (2009), based on Piketty and Sáez (2003).

de-nationalizing the economies and opened up large, de facto union-free countries for capital investment.

The well-described processes of labour market deregulation, high unemployment globalization, outsourcing, precarious employment, small government, declining public services, and so on, undermined traditional workplace organizing and collective bargaining capacities. Manufacturing jobs were moved into union-free regions or countries. The post-war consensus of sharing productivity gains largely disappeared.

Changing the balance of power was not an inevitable by-product of a neutral globalization process, but rather a policy strategy that abolished the rules and regulations that had limited the freedom of capital and had provided protection for workers. Not surprisingly, these changes made it more difficult for trade unions to organize workers and to bargain collectively. Furthermore, the more collective bargaining moves to the enterprise level, the more the logic of competitiveness determines the bargaining outcomes, rather than the logic of solidarity.

Labour has been struggling to find answers to these changes. Under the conditions of global capital mobility, the effectiveness of national Keynesianism declined. Labour no longer focused on comprehensive alternative policies but on arguments for social policies within the neo-liberal paradigm.

However, alternatives within the logically closed system of neo-liberalism always suffer from the distinct disadvantage that they look somehow illogical. Interference in the market, apart from in a few exceptional cases, necessarily involves, in the neo-classical model, a trade-off between efficiency and desired political outcomes. And those desired outcomes inevitably end up looking unaffordable and irresponsible in the context of global competition.

The ascendancy of New Labour as a philosophy meant that large sections of the social democratic partners accepted the neo-liberal rules of the

game. There were no longer alternative visions of societies and development. The end of history meant that in the mind of a vast majority – left and right – competitive capitalism was the only show in town. Ironically, the neo-liberal right and the anti-globalization left somehow seemed to agree that the structural forces of global capitalism had destroyed the policy space for social democratic policy.

Trade unions try to maintain the institutions for national and international social dialogue. But it takes two to tango. Even where social dialogue survives, the employers show little enthusiasm for any substantial regulations. Employers today are probably not more or less hostile towards trade unions than in the past. However, they have better legal and economic opportunities, a more favourable political and societal environment to circumvent trade unions through outsourcing, relocation, contract labour, precarious employment, etc.

In short, the crisis encountered a trade union movement that has been on the defensive for 30 years, a movement that has lost members and political influence in most countries, and whose traditional social democratic political allies have converted wholeheartedly, cautiously or with resignation to neo-liberal globalization.

It is this weakness of the left that explains to some extent the arrogance and confidence of those who have just ruined our economies. Feeling no threat, the casino is in full swing again. Thanks to government bailouts and cheap central bank money, stock markets have reached pre-crisis levels again despite the recession. These windfall profits are again translating into obscene bonuses for brokers, dealers and bankers.

### **Labour in crisis: Sharing the pain, shaping the future?**

Given the scale of the crisis and the fear of a massive social and employment catastrophe, trade unions were invited to engage in crisis mitigation efforts. After the years during which trade unions were accused of being part of the problem, they have now become part of the solution. In many countries, trade unions of the particularly hard-hit traditional manufacturing industries are actively engaged in managing the fallout of the crisis. In Germany, for example, the system of industry-wide collective bargaining and highly institutionalized co-determination has displayed its full strength. Pragmatic and highly competent crisis management and adjustment policies and a smooth interaction between state labour market instruments and negotiated flexibility at the enterprise level have yielded impressive results. Despite a massive decline in production, there has been virtually no rise in open unemployment. The interplay of enterprises that wanted to keep their skilled workforce, trade unions that gave priority to maintaining high levels

of employment, and an extremely quick and flexible system of short-time working arrangements (*Kurzarbeit*) facilitated broader-based burden-sharing.

At the international level, trade unions successfully lobbied to meet with many heads of State before the G20 meeting. At the ILO, they managed to negotiate a global jobs pact that made far-reaching proposals for an income-led recovery strategy. However, the main focus of trade union activities was dealing with the employment and wage consequences of the crisis.

It is certainly a policy success that the short-term social costs of the crisis have been severe but not dramatic. Automatic stabilizers, stimulus packages, and negotiated flexible work arrangements have all contributed to mitigating the impact of the crisis.

However, the longer an employment crisis continues, the further the balance of power will shift in favour of capital. Production capacities are under-utilized, unemployment goes up, pressure on wages grows, union membership and union collective bargaining power decline. Employers will use this to push their agenda of labour market deregulation further. Economic pressure at enterprise level and high levels of unemployment force and enable employers to demand and get major concessions from the workers. Even in cases where trade unions are able to mobilize and display defensive strength, the downsizing and restructuring of industries will result in substantive membership losses in their strongholds and reduce the organizational and financial abilities of the unions. This will further weaken their bargaining and institutional power.

The largely unchanged structural forces of the current globalization regime will continue to weaken labour. As long as the main features of the neo-liberal regime, such as global capital mobility, free trade, global tax competition, flexible labour markets, small government, precarious employment and decentralized wage fixing are in place, labour will inevitably be forced to agree to competitive solutions or, in plain language, to orderly cuts in employment, wages, social protection and public services.

Trade unionists at the enterprise level face the dilemma that what is macroeconomically desirable seems to be microeconomically impossible. Traditional industrial relations and collective bargaining can be helpful in sharing the pain among workers, but are insufficient to change the economic paradigm. A downward wage spiral would push economies into deflation; however, the logic of enterprise survival means that without regulations at the macro level, it will be impossible to maintain wage levels. Wage levels within the enterprise can be maintained only if aggregate levels of demand can be maintained. As private demand and private investment go down, a macroeconomic wage policy needs to be complemented with a state-led investment policy. Unless the crisis is "politicized", a further and perhaps terminal decline awaits the labour movement.

## A change agenda versus concession bargaining or radical impotence

The Great Recession:  
A turning point for labour?

Trade unions are facing a dilemma. Participating in the crisis management offers the opportunity to avoid the worst, and members expect their unions to protect them as much as possible in the current crisis. However, avoiding the worst will not create confidence in the organization and among the membership to mobilize for more far-reaching change. It will also mean that most of labour's energy will go into defensive action. But although concession bargaining is structurally demoralizing, not engaging is not an option either.

At the policy level, trade unions are demanding "a place at the table" to influence the decision-making process. However, such a place comes at a price. An institution is only invited if it is regarded either as "reasonable" or as too powerful to be ignored. Given the current balance of forces in societies, "reasonable" unfortunately means mostly business as usual. It might be an "institutional" success to be invited, but it is not necessarily a "political" one. Indeed, those who sit at the table also share the responsibility for what is decided in the end and, incidentally, also for what is not decided.

If trade unions want to achieve more substantial change, they must not only ask for a place at the table, but also show that they are sufficiently powerful to present an agenda for change that cannot be easily ignored. Being part of the process and being the proponent of far-reaching change is impossible without mobilizing people. Otherwise, bold statements will look like empty threats.

If history is any guide, capital cannot be expected to subordinate its drive for profit to the needs of the national or international common good. Cooperative solutions have to be imposed on enterprises. The competitive logic of the market makes voluntary cooperation under crisis conditions highly unlikely.

Responding to this global crisis through competitive cost-cutting implies an extremely painful deflationary process. Such a deflationary race to the bottom will ultimately also solve the problem, after a huge amount of capital has been destroyed and millions of jobs have vanished. The winners will then rise, phoenix-like, from the ashes.

Labour and the progressive forces in societies face the fundamental challenge of either putting forward a comprehensive agenda for realistic change or accepting that the cost of this crisis will be rolled over onto ordinary citizens.

Trade unions have unique workplace knowledge, they are recognized as a centre of competence for social and labour policies, they are deeply anchored in the real economy. But the policy space in the area of their core competency is increasingly defined by what happens in other areas. It is the regulation of financial markets, the modernization of the tax system, the management of exchange rates, the control of banks that are key to reining in the power of footloose capital. Here, trade unions have little institutional



power and only limited expertise. They do not speak as an authoritative voice in this field and have a hard time mobilizing members around those issues.

This authority can only be achieved through a broad alliance of progressive forces in society. The main partner for a genuine reform agenda will not be the employers, but a broad coalition of the vast majority of the population who benefited little from the old regime and are now expected to cough up billions of dollars for more of the same. In recent decades, the tax burden of financing the welfare state has shifted disproportionately to the middle-income earners as the rich have become increasingly successful at avoiding taxation. The populist right is exploiting the understandable frustration over this and is mobilizing the middle class against the poor recipients of government transfers. Without effective progressive taxation of the top echelons of income and wealth, it will be impossible to recreate an overall spirit of solidarity and fair burden-sharing in societies.

### A labour agenda for change

The economy is too important to be left to economists – particularly mainstream economists... The neo-liberal theonomics of the last decades has paved the way for an unfair and irresponsible economic system that serves the interests of the few at the expense of the vast majority of the world's population. Inequality has reached unprecedented levels and is economically dysfunctional.

The lack of end demand cannot be forever sidestepped by means of either debt-financed consumption or export surpluses. Wages need to grow in line with the long-term productivity trend in societies. A sustainable market economy requires a State that supports a wage-led recovery strategy, provides social protection and comprehensive public services to its citizens, controls global capital markets, and is able to ensure a solid financial base for its activities through progressive taxation.

What is required to make our economies fairer and more inclusive? At the Global Jobs Summit, the ILO suggested a Global Jobs Pact and an income-led recovery strategy (ILO, 2009b). The Pact recognizes the fact that without fundamental change in the overall economic and financial systems social justice, decent work and living wages cannot be achieved.

Saving the financial system by bailing out irresponsible banks is insufficient to address the underlying imbalances and to increase aggregate demand. During the economic downturn, private investment will remain sluggish. Over-indebted consumers cannot continue to spend beyond their means. There is no alternative to continued substantial counter-cyclical monetary and fiscal state intervention.

But state intervention can only be successful in the long run if accompanied by policy measures to correct the dysfunctional wage developments of

the past decades, to build a genuinely fair and progressive tax base and change the dysfunctional global capital markets.

The Great Recession:  
A turning point for labour?

## A Decent Work response

In a global economy, coordinated global responses are the optimal solution. This requires national and international rules for capital and labour markets. The Global Jobs Pact offers a policy framework to meet these needs.

### Investing in the future, creating employment and increasing the social wage

Under the conditions of a slump, public investment has a higher employment intensity than tax cuts. The provision of universal quality public services and infrastructure is key to reducing inequality, building inclusive societies and increasing opportunities for the poor. Universal quality education, health services, affordable housing and other freely accessible public services reduce the need for individual savings and increase the proportion of people's disposable income. Public investment in education and research is the best way to achieve high future levels of technical progress and productivity growth as the ultimate foundation of wealth creation. Investment in public transport, new energies, urban development, and quality housing is a huge social and environmental need that can create millions of high-quality jobs.

### Preventing wage deflation and promoting wage-led recovery

Increased public investment must be complemented by institutional measures to avoid wage deflation, reduce wage inequality and see to it that productivity gains translate into higher wages, thus ensuring a sustainable consumption pattern. Combining centralized or coordinated collective bargaining with minimum wage legislation is the most suitable way of establishing a wage floor and compressing wage differentials. Increasing the wage share and strengthening the wages of low-income workers in particular will lead to an increase in overall consumption, as poor households spend a higher share of their income. Simultaneously, precarious employment relationships must be limited, as they have been used to circumvent labour rights and collective bargaining agreements. Labour clauses in public contracts must require contractors and subcontractors to pay the prevailing collective bargaining wage rate. Moreover, public sector employment must be increased and public sector wage levels must be maintained to serve as an additional wage anchor.

The State has to combat employers' aggressive tactics aimed at preventing workers from joining a trade union. It needs to level the playing field through legal mechanisms that extend collective bargaining coverage and worker representation at the workplace. Any bailout or state subsidies must hinge on worker participation in the restructuring through collective bargaining processes and agreements.

### Maintaining and extending social protection

Social security systems are the fastest and most efficient way to provide income replacement for workers in a crisis situation. Comprehensive social security systems act as automatic stabilizers and must be extended during an economic downturn, in order to stabilize income levels and overall consumer demand. They are also the most powerful instrument for reducing inequality and poverty.

In developing countries without comprehensive social security systems, a social floor that includes a basic pension, child benefits, access to health care and temporary employment guarantee schemes or cash transfers for the unemployed and underemployed is urgently needed to lift millions of people out of poverty. It contributes to increasing demand and is a necessary complement to any effective minimum wage legislation.

Finally, governments must protect retirement savings. Pay-as-you-go systems are clearly the best option at a time of capital market volatility. Any pension scheme – private or public – should be legally obliged to guarantee at least a minimum rate of return equivalent to government bonds.

### Making the necessary global structural changes

The suggested measures will be difficult to implement and impossible to sustain without restructuring the global financial system that has propelled the failed economic regime.

### Regaining the ability to tax capital

Tax havens must be shut down. To solve this issue, banks that work in tax havens, either directly or through subsidiaries, or that engage in other tax theft operations, should be barred from major US or EU financial centres. Multinationals should be required to report their global profits and pay a unitary tax. All the business that is done under one ownership should be treated as one unit, then the proportion of income earned in a specific country should be estimated and its national tax should be applied to that income. This would make transfer pricing and financial delocalization less attractive.

Wealth and inheritance taxes and marginal tax rates on high income must be increased to rebalance the tax burden in society and increase the purchasing power of ordinary citizens. Property taxes on high-value real estate would be a first step that could be introduced relatively easily even at the national level. In industrialized countries today, tax levels are between 30 and 50 per cent of GDP. High tax levels are compatible with highly productive economies. Compared to highly successful Scandinavian countries, most countries have substantial policy space to increase taxes. Taxing global wealth is not technically impossible. It is a question of political power and political will. Given that 40 per cent of global wealth is owned by 1 per cent of the population, a highly progressive wealth tax should be able to generate substantial revenues without increasing the tax burden on the vast majority of people. In most countries, the top 10 per cent of the population own more than 60 per cent of the total wealth. Real estate and land are a big part of this wealth and are comparatively easy to tax. Indeed, as Winston Churchill pointed out a hundred years ago, land owners normally gain huge windfall profits from public infrastructure development and should be taxed accordingly: “Roads are made, streets are made, services are improved ... To not one of those improvements does the land monopolist, as a land monopolist contribute, and yet by every one of them the value of his land is enhanced ... he contributes nothing to the process from which his own enrichment is derived” (Churchill, 1909).

### Downsizing speculative and high-risk activities of the financial industry

The financial sector has been very innovative and good at doing what is bad for development. Financialization of our economies has channelled resources into wasteful investment. Casino capitalism has diverted capital from real investment. The so-called product innovations of the financial industry have made traders and brokers rich but, unlike other kinds of product innovation, they have not increased the wealth of our societies. In other words, banking has to become boring again.

A financial transaction tax on stock market transactions would reduce unproductive financial market speculation based on minimal margins and high leverage. A high capital gains tax on short-term profits would reduce incentives for speculative trade in financial markets. Higher reserve requirements for banks and more conservative rules for mortgages reduce the probability of asset bubbles. Banks can only be allowed to operate as private enterprises if they bear the risks of their investment and never become too big to fail. A diverse banking system – incorporating state-guaranteed savings banks, clearly mandated public development banks and private banks – is needed to reduce the institutional lobby and blackmail power of the financial

industry. Rating agencies that are fully independent from the financial industry must be available to ensure better risk assessment. Investor protection against toxic products must be provided through compulsory state certification of all financial products. Risk-taking by pension funds needs to be limited by insisting on a guaranteed minimum rate of return.

Implementing a comprehensive agenda for change is a task that goes way beyond traditional industrial relations and collective bargaining. However, it will be impossible to defend, let alone advance, the living conditions of workers, if the rules of the game are not changed. Trade unions might win a number of battles through organizing and campaigning, but they will lose the war, if they do not become a key partner in a political alliance for change.

Cohorts of think tanks, journalists and experts have been incredibly successful at suggesting that there is no alternative to the full subordination of our lives under the law of the market. A democratic alternative has the opposite point of departure: there are always policy choices and there is no structural economic determinism that makes social justice and fairness impossible.

## References

- Buffet, W. 2002. Berkshire Hathaway Inc. Shareholder Letter 2002, Omaha (available at: [www.berkshirehathaway.com/letters/2002pdf.pdf](http://www.berkshirehathaway.com/letters/2002pdf.pdf)).
- Churchill, W. 1909. "On Land Monopoly", speech made to the House of Commons on 4 May 1909 (available at: [www.grundskyld.dk/pdf/Winston-Churchill-Land-Monopoly.pdf](http://www.grundskyld.dk/pdf/Winston-Churchill-Land-Monopoly.pdf)).
- Davis, B. 2009. "Plenty More Bank Losses Expected Globally", in *Wall Street Journal*, 1 Oct. (available at: [/online.wsj.com/article/SB125427067994651171.html](http://online.wsj.com/article/SB125427067994651171.html)).
- ILO. 2009a. *World of Work Report 2009: The Global Jobs Crisis and Beyond* (Geneva) (available at: <http://www.ilo.org/public/english/bureau/inst/>).
- . 2009b. *Recovering from the crisis: A Global Jobs Pact* (Geneva) (available at: [www.ilo.org/jobspace/lang-en/index.htm](http://www.ilo.org/jobspace/lang-en/index.htm)).
- IMF. 2009. *The State of Public Finances: A cross-country fiscal monitor* (Washington, DC) (available at: [www.imf.org/external/pubs/ft/spn/2009/spn0921.pdf](http://www.imf.org/external/pubs/ft/spn/2009/spn0921.pdf)).
- . 2010. *Unemployment dynamics during recessions and recoveries: Okun's law and beyond* (Washington, DC) (available at: [www.imf.org/external/pubs/ft/weo/2010/01/pdf/c3.pdf](http://www.imf.org/external/pubs/ft/weo/2010/01/pdf/c3.pdf)).
- Onaran, Ö.; Stockhammer, E.; Grafl, L. 2010. *Financialization, income distribution and aggregate demand in the USA*, Discussion paper (London, Middlesex University, Department of Economics and Statistics).
- Palma, J.G. 2009. "The revenge of the market on the rentiers. Why neo-liberal reports of the end of history turned out to be premature", in *Cambridge Journal of Economics*, No. 33, pp. 829–869.
- Schifferes S. 2009. "\$10 trillion' credit crunch cost", BBC news, 31 July (available at: [news.bbc.co.uk/2/hi/business/8177814.stm](http://news.bbc.co.uk/2/hi/business/8177814.stm)).

- Stanglin, D. 2008. "Paulson: Financial rescue plan can't wait", in *USA Today*, 21 Sep. (available at: [www.usatoday.com/news/washington/2008-09-21-financial-rescue\\_N.htm](http://www.usatoday.com/news/washington/2008-09-21-financial-rescue_N.htm)).
- Stockhammer, E. 2005. *Arbeitsmarktrigiditäten oder Nachfragerigiditäten oder Nachfragemangel? Die Ursachen der Arbeitslosigkeit in Europa*, Vienna (available at: [www.wu.ac.at/inst/vw1/gee/papers/geewp45.pdf](http://www.wu.ac.at/inst/vw1/gee/papers/geewp45.pdf)).
- Sturmthal, A. 1944. *The Tragedy of European Labour 1918–1939* (London, Victor Gollancz Ltd).







