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**Escaping stagnation and restoring
shared prosperity: A macroeconomic
policy framework for job-rich growth**

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Employment and
Labour Market
Policies Branch

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Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization*,¹ and which has now been widely adopted by the international community.

The comprehensive and integrated perspective to achieve this goal are embedded in the Employment Policy Convention, 1964 (No. 122), in the Global Employment Agenda (2003) and, in response to the 2008 global economic crisis, in the Global Jobs Pact (2009) and in the Conclusions of the recurrent discussion on Employment (2010).

The Employment Policy Department (EMPLOYMENT) is fully engaged in global advocacy and in supporting countries placing more and better jobs at the centre of economic and social policies and of inclusive growth and development strategies.

Policy research, knowledge generation and dissemination are an essential component of the Employment Policy Department's action. The publications include books, monographs, working papers, country policy reviews and policy briefs.²

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¹ See http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf

² See <http://www.ilo.org/employment>.

Foreword

In this succinct piece, the author makes a compelling case for ‘structural Keynesianism’ as a way of responding to the current mix of unsatisfactory growth and uneven progress in reducing unemployment at the global level. Traditional or ‘cyclical’ Keynesianism is, according to the author, good at dealing with short-run shortfalls in aggregate demand, but less able to cope with the structural dimensions of slow growth and slack labour market conditions.

The author suggests that current orthodoxy with its focus on fiscal austerity and structural reforms has run out of ideas on how to revive global growth and reduce labour market distress. The alternative to this orthodoxy is to adopt a comprehensive agenda with the following elements: (1) engaging in substantial, smart and sustained fiscal stimulus, such as public investment in infrastructure; (2) prioritizing full employment in monetary policy; (3) rebuilding the wage-productivity growth link; (4) restoring tax progressivity; (4) using the financial sector to serve and support the real economy; (5) reshaping globalization by ensuring that trade agreements are sensitive to labour and environmental standards as well as country-specific circumstances, key exchange rates are coordinated, and capital controls are prudently applied. Perhaps the most controversial, but bold, proposal to refashion globalization is to implement a global minimum wage system. The author is aware that what he proposes is a rather ambitious agenda, but he is resolute in his conviction that there is a collective obligation on the part of progressive scholars and activists to propose a fair and workable alternative to current economic orthodoxy.

Iyanatul Islam
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1 Goodbye Keynesianism, hello structural Keynesianism

In the immediate aftermath of the financial crisis of 2008 there was widespread speculation that the rebound would be quick and sharp. This was expressed in talk of a “V-shaped” recovery, epitomized by Federal Reserve Chairman Ben Bernanke’s reference to the “green shoots” of recovery in March 2009. That has not happened. Instead, more than five years after the onset of the crisis, the global economy is stuck in a slow growth-high unemployment trap.

The current situation is the product of a mix of cyclical and structural problems, reflecting the fact that there is both a cyclical and structural shortage of demand. The identification of both cyclical and structural demand issues is consistent with a “structural” Keynesian perspective, in contrast to “conventional” Keynesian analysis which only identifies cyclical demand issues.

Escaping the trap requires both a cyclical and structural policy response. One without the other will not succeed. Cyclical policy alone will produce temporary relief that soon evaporates. Structural policy alone will fail to produce the escape velocity necessary to escape the pull of stagnation with low growth and high unemployment.

From a public policy standpoint, the challenge is twofold. There is a need, firstly, to design an effective policy mix and secondly, to create political space for those policies. That means rebutting neoliberal arguments that push fiscal austerity and doubling down on the same policies that produced the financial crisis and subsequent incomplete recovery in the first place. However, it also means breaking with conventional Keynesian analysis which is silent on the problem of structural failure. The critique of conventional Keynesian analysis is not that it is all wrong, but rather that it is not sufficient.

2 The gloomy state of the global economy

Today's gloomy state of the global economy is captured in Tables 1 and 2. Table 1 shows unemployment rates for selected advanced countries and regions in 2007 and 2013. It shows a sharp jump in the unemployment rate across the board, peaking in 2009. Subsequently, the greatest fall in the unemployment rate occurred in the U.S.. However, there are concerns that the U.S. labour market recovery is significantly overstated owing to labour force exit that is evidenced by a sharply reduced employment to population ratio. Table 2 shows real GDP growth rates for selected countries and regions over the period 2007-2013, showing a three-speed global economic recovery since the Great Recession of 2009. Emerging market and developing economies are growing faster than the advanced economies (defined as OECD member countries). However, within the advanced group, the U.S. is growing faster than the rest and Europe is performing especially badly. The data in Table 2 also show two other features. First, the global economy has not recovered its pre-crisis growth rate. Second, growth fell back everywhere after the initial burst of recovery in 2010.

Table 1: Unemployment rates for selected advanced countries and regions in 2007 and 2013

	U.S.	Euro-zone	Japan	OECD
2013 unemployment rate (%)	7.5	12	4	8
2007 unemployment rate (%)	4.6	7.5	3.8	5.7
<i>Change in unemployment rate</i>	<i>2.9</i>	<i>4.5</i>	<i>0.2</i>	<i>2.3</i>

Source: *OECD Economic Outlook*, Annex Table 13, March 2014

Table 2: Real GDP growth rates (%) for selected countries and regions in 2007 and 2013.

	2007	2008	2009	2010	2011	2012	2013*
OECD	2.7	0.2	-3.5	3	1.9	1.6	1.2
U.S.	1.8	-0.3	-2.8	2.5	1.8	2.8	1.7
Eurozone	3	0.2	-4.4	1.9	1.6	-0.6	-0.4
Japan	2.2	-1	-5.5	4.7	-0.6	1.9	1.8
Emerging market & developing economies ⁺	8.8	6.1	2.7	7.6	6.4	5.1	5.3

Source: *OECD Economic Outlook*, Annex Table 1, March 2014.

+ *IMF World Economic Outlook*, Table A1, April 2013. * projected.

The underlying problem is shortage of demand, as can be seen in Table 3, which shows output gaps for selected countries and regions in 2007 and 2013. Output gaps have risen significantly in the U.S., the Eurozone and Japan. For the entire OECD region, the output gap has jumped by 5.8 percentage points. The important feature is not the absolute measure of the gap (which is somewhat open to debate because of issues regarding the definition of full employment), but the large magnitude of the swing which is not contested and equal to 5.8 percent of potential output.

Table 3: Output gaps for selected countries and regions in 2007 and 2013

	U.S.	Euro-zone	Japan	OECD
2013 Output gap (%)	-3	-3.8	0.1	-2.6
2007 Output gap (%)	2.8	3.5	3	3.2
<i>Change in Output gap (%)</i>	<i>-5.8</i>	<i>-7.3</i>	<i>-2.9</i>	<i>-5.8</i>

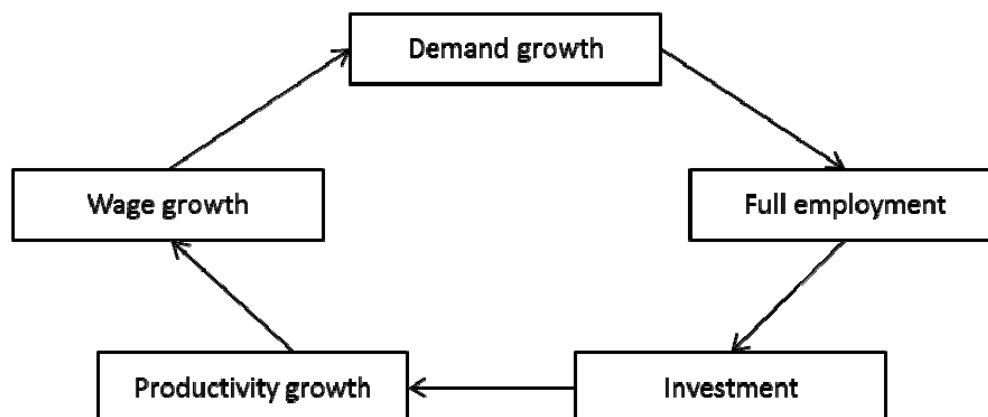
Source: *OECD Economic Outlook*, Annex Table 10, March 2014.

3 Explaining the global demand shortage

The identification of demand shortage as the underlying problem in turn calls for an explanation. This section argues that the underlying cause of demand shortage is wage stagnation among low and middle income workers, allied to the growing income inequality of the past thirty years. This explanation links the current stagnation to a longer narrative about the financial crisis and the economic history of the past 30 years (Palley, 2012). The basic story is that the global economy has seen a gradual emergence of demand shortage for the past thirty years. However, this shortage was masked by a thirty-year credit bubble accompanied by serial asset price bubbles. The financial crisis of 2008 put an end to the credit bubble, thereby exposing the structural demand shortage.

The roots of this structural demand shortage can be traced back to a flawed neoliberal macroeconomic paradigm that was implemented globally after 1980. This paradigm imposed a new growth model that relied on debt and asset price inflation to drive demand in place of wage growth. From 1945 to 1980, the dominant global economic model was a “virtuous circle” Keynesian growth model predicated on full employment and wage growth tied to productivity growth. This model is illustrated in Figure 1. Its logic was simple and coherent. Productivity growth drove wage growth, which fuelled demand growth and created full employment. That in turn provided an incentive for investment, which further drove productivity growth.

Figure 1: The 1945 – 80 virtuous circle Keynesian growth model



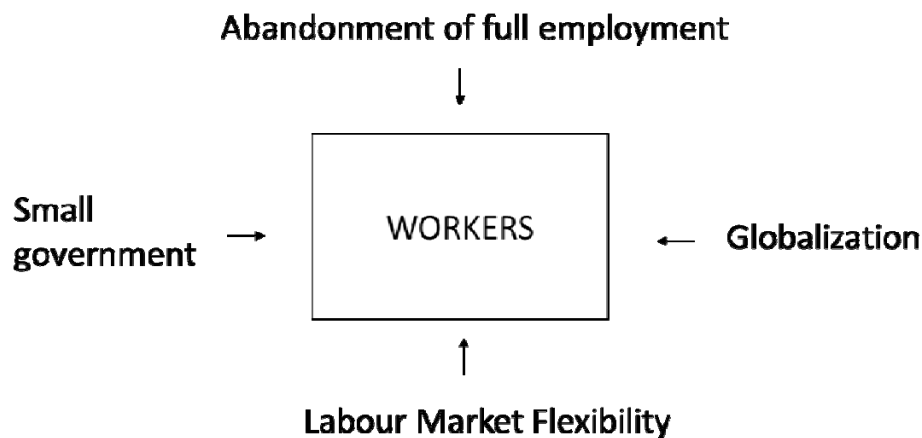
Source: Palley, 2012.

The virtuous circle Keynesian growth model could be seen in one form or another everywhere: not only in the U.S., Europe, Canada, Australia, and Japan, but also in Mexico, Brazil, Argentina and much of Latin America, with modifications in the latter case to facilitate industrial development based on import substitution.

After 1980 the virtuous circle Keynesian growth model was replaced by a neoliberal growth model. The key features of the new model were: 1) abandonment of the commitment to full employment, and 2) severing of the link between wages and productivity growth. These developments promoted wage stagnation and rising income inequality, the macroeconomic effects of which were papered over by the financial markets. Whereas before 1980 wages were the engine of demand growth, after 1980 financial markets made debt and asset price inflation the engines of demand growth.

The new neoliberal paradigm can be described as a “neoliberal policy box” that fences workers in and pressures them from all sides. The model is illustrated in Figure 2. Globalization pressures workers by exposing them to international competition via a new model of global sourcing and production. The small government agenda attacks the legitimacy of government and pushes for market deregulation and privatization of public services. The labour market flexibility agenda attacks unions, labour market supports like the minimum wage, unemployment benefits, employment protection, and workers’ rights. Lastly, stable low inflation becomes the goal of monetary policy in place of full employment, and the latter becomes an accidental and occasional by-product of boom times. This abandonment of full employment exposes workers to pressures of unemployment and job scarcity that reduce their bargaining power.

Figure 2: The neoliberal policy box



Source: Palley, 2012.

Just like the virtuous circle Keynesian model, so too the neoliberal model also became a global model. The neoliberal policy box was implemented on a global scale, in both the North and the South, and can be seen in one form or another in the U.S., Canada, Europe, Australasia, and Latin America. In the global South, the model was enforced by the IMF and World Bank which made financial assistance conditional on “Washington Consensus” structural adjustment policies. That is the historical significance of the “Washington Consensus”, which embodied the neoliberal box and constituted the policy framework of the IMF and World Bank in the 1980s and 1990s.

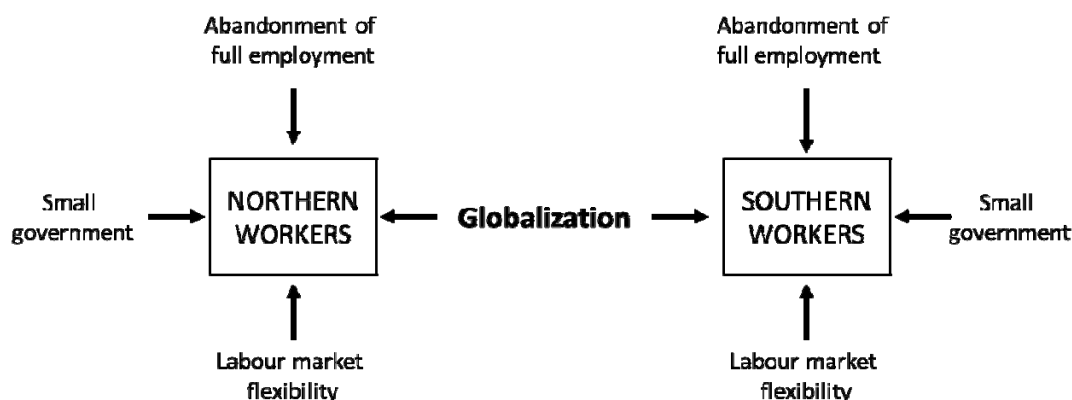
4 The special role of globalization

Globalization is especially important in the neoliberal model and plays a special role within the new paradigm. Unfortunately, globalization is often misunderstood as “free trade”. Free trade is about the international unification of markets for goods so that one country’s firms can sell their products in another’s markets. Globalization is about the creation of flexible global production networks based on the principle of global cost arbitrage. Production moves to wherever the cost is lowest, thereby setting up a competitive dynamic that exerts persistent downward pressure on all costs, especially wages.

The special role of globalization is illustrated in Figure 3. The neoliberal policy box was implemented throughout the global economy, and globalization provides the interface between North and South. For Northern economies, it created a triple economic leakage. Demand leaked out via spending on imports; investment spending was diverted to build factories and facilities offshore; and jobs were lost as manufacturing plants closed and relocated (Bronfenbrenner, 2000; Bronfenbrenner and Luce, 2004).

For Southern economies the effects of globalization were significantly different, and here it is important to distinguish time horizons. Globalization provided immediate up-front benefits via foreign direct investment (FDI) and export-led growth, but the longer-term costs are now starting to show. The combination of export market saturation and global stagnation limits the possibilities of further export-led growth (Blecker, 2000; Palley, 2003a), leaving emerging market economies trapped in “race to the bottom” global competition with few options. These economies now in competition with each other on the wage and regulatory front, as well as facing competition from Northern economies which are trying to recover jobs and investment via wage suppression and deregulation.

Figure 3: The global neoliberal policy box



Source: Palley, 2013

5 Public policy implications of the box analysis

Several critical public policy implications follow from the above analysis. First, a proper diagnosis is essential to the design of a successful policy response. Second, the diagnosis suggests that the global economy faces far more than just cyclical problems. There is also a deep underlying structural problem.

Structural Keynesian analysis takes account of both the cyclical and structural dimensions of stagnation, whereas conventional Keynesian analysis only takes account of the cyclical dimension. That flaw in conventional Keynesian thinking highlights the profound nature of the political challenge. Not only is there a need to block neoliberal policymakers from “doubling down” on the policies of the box, but conventional Keynesians have to be persuaded to support structural change.

Third, the policy box metaphor highlights the multi-dimensional aspect of policies on shared prosperity. Conventional economic analysis tends to frame wage and employment issues exclusively in terms of labour market policy. The box shows that good wage and employment outcomes depend on a matrix of policies. Labour market policy is a vital part of the solution, but the solution also depends on macroeconomic policy, international economic policy, regulatory policy, and government provision of public goods and infrastructure. Policymakers need to implement a consistent set of policies that encapsulate the entirety of the economy because the economy is a system. Piecemeal policy making will be far less effective.

Fourth, in the absence of a comprehensive analytical narrative, the required policy matrix will tend to look like a laundry list that is neither persuasive nor coherent. An analytical framework is essential for winning the public policy debate, but so far it has been difficult to get a hearing for the structural Keynesian framework because of the opposition of vested political and intellectual interests.

Fifth, the box analysis has implications for the International Labour Organization (ILO). The argument that labour market outcomes depend exclusively on labour market policy has been used to limit the ILO’s remit exclusively to labour policy and labour ministries alone. The box shows why the ILO has a much broader policy interest and cannot succeed in its mission without addressing those interests.

6 Re-packing the box

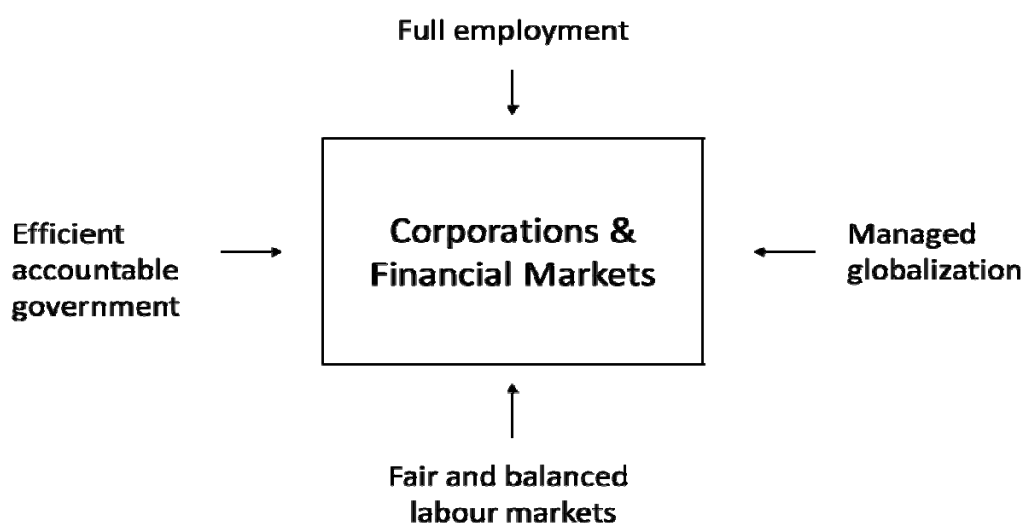
The Keynesian virtuous circle growth model and the neoliberal policy box explain what has gone wrong and indicate what needs to be done to remedy the situation. Policymakers are faced with a dual challenge. The first is a conventional short-run demand management problem, while the second is a longer-run structural rebuilding problem. The short-run task is to revive aggregate demand so as to fill the immediate demand shortfall created by the financial crisis and the Great Recession. This is the role of fiscal and monetary stimulus policy. The long-run task is to rebuild the income and demand generation process so that the economy self-generates a level of aggregate demand sufficient for full-employment on a permanent basis.

The key to rebuilding the income and demand generation process is to restore the wage- productivity growth link and reverse the shift in income share from wages to profits. That task is likely to take many years, which points to the likelihood of prolonged aggregate demand weakness.

The current policy challenge is fundamentally different from past recessions in which policymakers merely had to jump-start the economy. Now, success requires that policymakers simultaneously apply stimulus to jump-start the economy and rebuild the system. Moreover, the required stimulus needs to be substantial and prolonged to offset existing structural weakness during the reconstruction period.

The required structural change can also be understood in terms of the policy box metaphor. Neoliberal policy created a box that trapped workers. It is now time for policy to repack the box, take workers out and put corporations and financial markets in. This structural Keynesian policy box is illustrated in Figure 4. It restores the policy commitment to full employment; replaces the neoliberal labour market flexibility agenda with a fair and balanced labour market; replaces the neoliberal anti-government agenda with efficient and accountable government; and replaces corporate globalization with managed globalization.

Figure 4: The structural Keynesian policy box



Source: Palley, 2012.

7 The link with wage-led growth

The structural Keynesian box links with the theory of wage-led growth that fundamentally challenges mainstream economic theory (see Stockhammer and Lavoie, 2012). Mainstream economics sees wages as exclusively a cost to the economic system, which explains why mainstream policy continually looks to reduce wages as a way to expand employment and grow the economy. Such thinking is reflected in the neoliberal policy box.

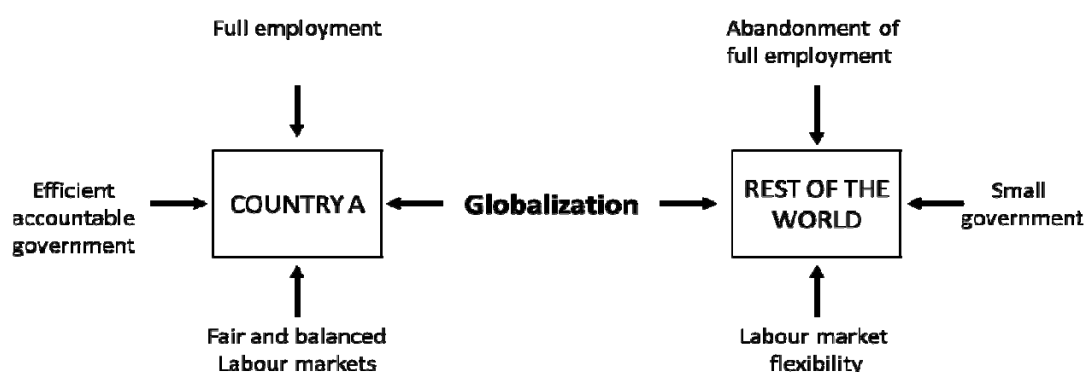
Structural Keynesian analysis sees wages as both a cost and a benefit to the system. On the cost side, higher wages raise the price of labour and can deter employment and investment. On the benefit side, however, wages constitute the income of most households so that higher wages increase consumption spending, which increases aggregate demand, employment, and investment. Structural Keynesianism therefore reveals a fundamental tension in capitalist economies. The profit share can be too low or too high. The policy challenge is to find a socially optimal balance. Stockhammer (2011) provides a survey of the econometric literature examining whether OECD economies are wage or profit-led and concludes that most seem to be wage-led. That suggests there is a role for higher wages and an increased wage share in promoting faster growth.

8 The special challenge of globalization

Neoliberal globalization poses special difficulties when it comes to replacing the neoliberal policy box with the structural Keynesian policy box. That is because it has created new international economic realities that make it more difficult for countries to pursue their own national economic projects.

The problem is illustrated in Figure 5. Suppose country A adopts a “go it alone” strategy and implements the structural Keynesian policy mix. In that case, it will be vulnerable to the effects of neoliberal globalization as long as globalization remains unreformed.

Figure 5: The special challenge of globalization



Source: Palley, 2013.

Globalization raises three difficulties. First, it has increased the external leakages of national economies: goods market leakages, financial market leakages and labour market leakages. Second, it has created a “race to the bottom” competitive dynamic whereby countries have an incentive to pursue “low-road” rather than “high-road” policies in order to gain international competitive advantage. Third, it is difficult to reform and reverse globalization because globalization is embedded in international agreements that require coordinated multilateral change.

Together, these three difficulties discourage the adoption of structural Keynesian policies. Consequently, neoliberal globalization de facto locks in the neoliberal model and blocks change even though the model has failed disastrously.

9 A detailed policy agenda

The Keynesian virtuous circle model and policy box analysis provide a general explanation of what has gone wrong and what needs to be done. The next step is to provide a detailed policy agenda based on this general analysis.

9.1 Fiscal policy: substantial, smart, sustained fiscal stimulus

What business needs first and foremost is continued fiscal stimulus that should be “substantial, smart, and sustained”. It must be substantial because of the large private sector demand shortfall indicated by output gaps. It must be smart to maintain political support and to get the maximum benefit from such spending. And it must be sustained because the demand gap is structural and will not go away with cyclical recovery.

In conditions of secular stagnation when the policy interest rate is at zero, fiscal policy is the essential tool. That is a fundamental insight provided by early Keynesian IS–LM analysis. If stimulus is withdrawn, as has happened in Europe and, to a lesser degree, in the U.S., the economy will slow down due to the structural flaws in the income and demand generation process.

Infrastructure and public capital investment are smart ways to implement fiscal stimulus as they contribute to increased demand and raise future private sector productivity thereby meeting future needs (Aschauer, 1989). That delivers a “two-fer” by delivering both immediate demand-side stimulus and future supply-side gains. Green investment (such as retrofitting buildings to reduce energy consumption) is also smart, as it addresses the problems of both demand shortage and climate change, and it can also be labour intensive (Pollin et al., 2008).

Now, is a particularly good time to undertake such investments because long-term interest rates are low. Deficit finance also creates financial wealth that increases private sector wealth, thereby stimulating consumption spending. There may also be a place for a balanced budget multiplier policy.

The answer to those concerned about the stability of public finances is that restoring full employment and growth is the best approach. That is the lesson of the post-World War II era, and it is also the lesson of current events. Austerity in Europe has worsened the public finance situation, whereas the situation has begun to improve in the U.S. and might have been even better had stimulus been more sustained.

9.2 Monetary policy: prioritizing full employment

Monetary policy also has an important role to play with regard to both the cyclical and structural demand challenges. Easy monetary policy that keeps interest rates low is needed to stimulate private sector demand and help finance budget deficits and the public debt.

Monetary policy also has an important role in restoring the wage-productivity growth link. Policy needs to recommit to full employment as the prerequisite of workers’ wage bargaining power (Schmitt, 2013). That means upgrading the policy significance of employment and downgrading the significance of inflation. As part of that realignment, policymakers should abandon the theory of the natural rate of unemployment (Friedman, 1968) that asserts monetary policy has no impact on employment outcomes. That theory has had a disastrous impact on policy thinking.

9.3 Labour market policy: rebuilding the wage-productivity growth link

Rebuilding the wage-productivity growth link is the central structural policy objective. Having monetary policy commit to full employment is one critical component for this. A second component is labour market policy that rebuilds worker bargaining power vis-à-vis corporations.

This requires increasing union density and union wage bargaining coverage, as well as implementing a robust minimum wage. Unions raise wages and reduce income inequality. The minimum wage is also important. The evidence shows that it is employment neutral and may even have a positive impact on employment (Card and Krueger, 1995). It also has a positive ripple effect on wages at the bottom of the wage distribution that may reach as high as the third decile of the wage distribution (Palley, 1998; Wicks-Lim, 2006).

9.4 Tax policy: restoring tax progressivity

Tax policy, particularly in the U.S., can also make an important contribution to remedying both the cyclical problem of demand shortage and the structural challenge of income inequality. Increasing worker bargaining power addresses these problems at the level of pre-tax incomes. Tax policy addresses these problems by reducing after-tax income inequality. For this purpose, it is critical to restore tax progressivity both in rates and by elimination of regressive tax expenditures.

Another acute problem in the U.S. system is the prevalence of “job taxes” that raise the employment costs and discourage job creation. That suggests financing the social insurance system with less job taxes and more general tax revenues. In the U.S. there is also a need to eliminate deferral of taxes on foreign profits which encourages corporations to move jobs and investment spending off-shore.

9.5 Financial market regulation: making finance serve the real economy

Financial market reform is also a necessary part of the solution. Since the financial crisis there has been much discussion of rebuilding financial regulation to restore financial stability. However, financial stability is too narrow a policy focus. The goal should be to make finance serve the needs of the real economy.

Financial transaction taxes should be used both as a means of limiting destabilizing speculation and of raising revenue (Baker et al., 2009). Financial institutions should also be subject to balance sheet requirements that can be adjusted at the discretion of policymakers. Such requirements include liquidity requirements, capital requirements, and leverage restrictions.

In particular, monetary authorities should adopt a system of asset based reserve requirements that can significantly improve monetary policy and also guard against financial instability (Palley, 2003b). The last decade has shown that trying to manage the economy using just an interest rate target leaves the economy exposed to financial excesses. Interest rate targeting should be supplemented by quantitative balance sheet controls implemented through asset based reserve requirements.

Asset based reserve requirements (ABRR) extend margin requirements to a wide array of assets held by financial institutions. Financial firms have to hold reserves against different classes of assets, and the regulatory authority sets adjustable reserve requirements on the basis of its concerns with each asset class. They offer a new set of policy instruments that can target excesses in specific financial market sectors, leaving interest rate policy free to manage the overall macroeconomic situation. For instance, they can help prevent asset

bubbles by targeting over-heated asset categories. Thus, if the housing sector is over-heated, house prices and sales can be targeted by imposing reserve requirements on new mortgages, thereby making mortgages more expensive. In this fashion, the housing sector is restrained without increasing the general interest rate, thus avoiding collateral damage to the overall economy.

Lastly, asset based reserve requirements can also be used to encourage investment in areas deemed strategically or socially important by imposing low (or even negative) reserve requirements on lending to targeted activities (Thurow, 1972; Pollin, 1993). Negative reserve requirements would be a form of subsidy, giving financial institutions an incentive to engage in lending to activities subject to a negative reserve requirement.

10 Reshaping globalization

As noted earlier, globalization poses special difficulties in replacing the neoliberal box with a structural Keynesian policy box. However, it must be tackled because it has created fundamental structural problems that contribute to stagnation and inhibit shared prosperity.

One problem is the intensification of wage competition. Initially, this was perceived as a North-South issue, but there is now growing recognition that it is equally a South-South concern as emerging market economies compete with each other for export share and foreign direct investment. Another is that globalization has undermined the effectiveness of national policies aimed at domestic demand-led growth, which discourages such policies. A third problem is that it has aggravated adverse policy competition between countries as they strive to gain international competitive advantage.

10.1 Reforming the global financial architecture: exchange rates

The starting point for reform is the global financial architecture which is a central mechanism in generating the adverse outcomes associated with neoliberal globalization. A first reform concerns exchange rates.

The current system of unmanaged exchange rates has several undesirable properties including exacerbating “race to the bottom” competition, generating massive trade imbalances between countries, producing resource misallocation due to large swings in exchange rates, and promoting economic policy conflict between countries. These outcomes are the result of the current system which draws countries into competitive devaluation aimed at enhancing their international competitiveness. That, in turn, pressures other countries to squeeze wages and other costs to stay competitive with rivals.

The solution is to adopt a system of globally managed exchange rates aimed at achieving an approximate current account balance, what Williamson (1985) calls fundamental equilibrium exchange rates (FEER). Enforcing such a system requires rules of intervention. Historically, the onus of defending the exchange rate has fallen on the country whose exchange rate is weakening. That does not work because such countries do not have enough reserves to deter financial market speculators. Consequently, the onus of exchange rate intervention needs to be reversed so that the country with the strong currency is responsible for preventing appreciation. Since its central bank has unlimited amounts of its own currency for sale, it can never be beaten by market speculators (Palley, 2003c).

10.2 Reforming the global financial architecture: capital controls

A second reform concerns capital flows and capital controls. Over the past thirty years, removal of capital controls has created three major problems (Palley, 2009). First, it has promoted financial instability by amplifying boom-bust cycles through pro-cyclical inflows and outflows of financial capital. Second, it has created a system whereby markets can in practice discipline governments and thereby force adoption of neoliberal policies. This is done by implicitly threatening to punish governments that go against the market’s policy desires by destabilizing capital outflows. Third, it has pushed emerging market economies to rely ever more heavily on export-led growth as a way of accumulating international reserves to counter the boom-bust cycle. That has accelerated and deepened the adoption of the export-led growth paradigm which now exerts a deflationary influence on the global economy.

These problems highlight the need to restore capital controls as an important and legitimate policy tool, which also means keeping prohibitions on capital controls out of all

trade agreements. So-called “Chilean-style” capital controls that use adjustable unremunerated reserve requirements to manage the volume of inflows should become a standard tool of counter-cyclical policy management (Palley, 2005). Lastly, the imposition of Tobin taxes on foreign exchange dealings can discourage exchange rate speculation as well as raise significant revenues for financing public investment (Palley, 2001).

Over the last five years there has been some progress on the issue of capital controls. For instance, in December 2012, the IMF’s Executive Board officially endorsed capital flow management measures to contain adverse impacts of flows on financial markets. However, as recommended above, the list of accepted measures needs to be strengthened. The use of capital controls should also be viewed as part of everyday policy rather than as a crisis measure as is the current position. The importance of this issue has resurfaced owing to the financial turmoil in emerging market economies caused by the Federal Reserve’s decision to taper its quantitative easing monetary policy.

10.3 Reforming trade agreements: Enforceable labour standards

Trade agreements are another critical institutional building block of neoliberal globalization because goods still need to move across borders. That makes the rules governing trade critical, as those rules determine what goods are allowed to move and on what terms. They can thereby exert significant influence on the character of production and competition. Enforceable labour standards are a critical requirement for addressing worker exploitation and wage stagnation, and for providing a roadblock against “race to the bottom” competition (Palley, 2004).

10.4 Reforming trade agreements: Enforceable environmental standards

For similar reasons, enforceable environmental standards are needed to prevent an environmental race to the bottom. Such standards will yield a climate change benefit. They can also provide an incentive for green investment spending as companies upgrade equipment to meet standards.

10.5 Reforming trade agreements: Increasing national policy space

A third important reform of trade agreements concerns their impact on space for national policy. Here, the problem is one of trade agreements gradually stripping away policy space by imposing limits on national policy sovereignty. Moreover, moves are afoot to increase those types of limits. In effect, not only have trade agreements facilitated the global production network model, they have also been used to compel countries to adopt and enforce neoliberal box policies by making them surrender national policy space as the price of being allowed to sell in global markets.

Two particular problems are intellectual property rights and the right of international investors to sue governments in international arbitration panels. With regard to intellectual property rights, trade agreements have been used to extend these rights, creating economic rents for owners in developed economies at the expense of developing economies and developing country consumers (Bhagwati, 2002). With regard to the right to sue, this has put corporations on the same legal plane as governments and has undermined the power of sovereign democracies to govern themselves according to national democratic preferences.

10.6 Implementing a global minimum wage system

A final reform is to implement a global minimum wage system (Palley, 2011) that can provide a floor to global wages and provide another source of support for linking wages and productivity growth. Such a system does not mean imposing U.S. or European minimum wages in developing countries. It does mean establishing a global set of rules for setting country minimum wages.

A global minimum wage system would require countries to set a minimum wage that is a fixed percentage (to be negotiated) of their median wage (the wage at which half of workers are paid more and half are paid less). This approach has several advantages. First, the minimum wage will automatically rise with the median wage, creating a true floor that moves with the economy. If the median wage rises with productivity growth, the minimum wage will also rise with productivity growth.

Second, since the minimum wage is set by reference to the local median wage, it is set by reference to local economic conditions and reflects what a country can bear. Third, since all countries are bound by the same rule, all are treated equally so that none are competitively disadvantaged.

Finally, if they wish, countries may choose to set a minimum wage above that required by the global minimum wage system. That would give them freedom to address concerns about ensuring a living wage. Of course, the need for this will depend on both country specific details regarding wage levels and the rule for setting the minimum wage (i.e. as a percentage of the median wage).

11 Conclusion

The global economy is currently suffering from both cyclical and structural shortage of demand. The structural shortage of demand is the result of the neoliberal policy model that has been implemented on a global basis over the past thirty years. Escaping the stagnation caused by demand shortage requires replacing the neoliberal policy model with a structural Keynesian policy model that restores full employment and rebuilds the wage-productivity growth link. Failing that, the outlook is almost certainly one of continued stagnation.

Unfortunately, the prognosis for change is poor. There has been little in the way of political or intellectual advances, and economic discourse remains framed in terms of neoliberal economics. The challenge of our time is to change the parameters of the economic policy debate, thereby enabling a new economic model that can deliver job-rich growth and shared prosperity. The ILO has a crucial role to play in making this happen.

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