



**Statement by Mr. Juan Somavia,  
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**International Monetary and Finance Committee  
and Development Committee**

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**Threats to Stability and Progress**

Stability and progress in the world of work is threatened by instability and setbacks in the world of finance. Uncertainty about the cost of access to credit is spreading from the epicentre of the initial turmoil in the housing finance sector of the USA to other parts of the economy and other countries. Forecasts of the scale, depth and international reach of the slowdown are increasingly gloomy with the IMF World Economic Outlook projecting global growth for 2008 and 2009 at 3.7% and an increasing risk that the outturn could drop below 3%, equivalent to a global recession.<sup>1</sup> The impact on labour markets is apparent in the USA and seems likely to hit other countries during 2008. A global survey of businesses' hiring activity indicates that many are considering holding back on hiring.<sup>2</sup>

The scale of the financial restructuring now underway and the severity of the credit squeeze make the current financial crisis perhaps the most severe since 1945 and may result in markedly slower growth in the USA and other industrialized countries for as much as two to three years.<sup>3</sup> I hope that measures taken by the Federal Reserve and the Administration and Congress will avert a deep and prolonged slowdown and that action by other industrialized countries most directly affected will prevent its spread.

Although important economies in the developing world may have some resilience to the effects of the credit squeeze and slower growth in industrialized economies, the IMF World Economic Outlook points out that "the overall balance of risks to the short term global growth outlook remains tilted to the downside". It warns that "the greatest risk comes from the still unfolding events in financial markets, and particularly the concern that the deep losses on structured credits related to U.S. sub-prime mortgage and other sectors could lead to a mutation of a credit squeeze into a full blown credit crunch with a severe impact on economic activity".

The ILO has followed with great interest the policy debates and actions of central banks and finance ministries over recent months in view of the importance of monetary and fiscal policies to creating a conducive environment for the international community's objectives of full and productive employment and Decent Work for All.

*Imbalances in financial markets are related to wider disequilibria in society and in the process of globalization.* Averting the risk of a major global slowdown and ensuring recovery to a

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<sup>1</sup> IMF: *World Economic Outlook*, April 2008.

<sup>2</sup> Manpower Employment Outlook Global Survey, Quarter 2, 2008.

<sup>3</sup> Is the 2007 U.S. Sub-Prime Financial Crisis So Different? An International Historical Comparison Carmen M. Reinhart, University of Maryland and the NBER, and Kenneth S. Rogoff, Harvard University and the NBER, (February 5 2008 version).

sustainable global development path thus requires coherent policy action within and between countries across several policy fields, including finance and investment, trade, employment and social affairs and environment.

Responding to the current financial turmoil is also an opportunity to develop a new agenda for sustainable development fit for the era of globalization. *We need to find a better balance between the democratic voice of society, the productive dynamic of the market and the regulatory function of the state.*

Fiscal and monetary counter-cyclical measures will need to both reflect the specific situation of individual countries and also the potential for increasing the impact of policy initiatives through coordination. In principle, joint action should be a more efficient way of counteracting the deflationary effects of the credit squeeze than isolated national reactions. It is however vital that underlying challenges of a longer term character are also addressed through an enhanced effort of multilateral cooperation.

I see four priorities for international discussions at the Spring 2008 Meetings of the IMF and World Bank and more widely within the multilateral system:

- Fiscal Policies for Social and Economic Stability
- International Regulation of Financial Markets
- Sustainable Enterprise Development
- The Employment Dimension of Policies to Address Climate Change

### ***Fiscal Policies for Social and Economic Stability***

In considering fiscal policy options, I believe governments will wish to take into account the growing evidence of a widening of income gaps over the last two decades. These social imbalances, as well as creating tension and division, have contributed to financial and economic imbalances. The other side of the sub-prime mortgage crisis is a long period of stagnation in the real wages of middle class America and the consequent increase in borrowing to pay for housing.

Governments can shape the distribution of disposable incomes through the tax and transfer systems.<sup>4</sup> In tandem, progressive taxation and social security systems can reduce the inequality of disposable incomes to a level that is often much lower than that of market incomes.<sup>5</sup> Possible trade-offs between equity and efficiency furthermore need not be steep. Indeed equity and efficiency can often go hand in hand; over the past two decades countries with low inequality – such as the Netherlands – did equally well in terms of growth as those with limited redistribution and higher inequality.<sup>6</sup>

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<sup>4</sup> In Finland, the Gini coefficient for market incomes rose from 0.393 in 1987 to 0.438 in 1995, an extraordinary large increase of 0.046. Over the same period, the Gini coefficient for disposable incomes rose by only 0.017 from 0.209 to 0.210. In the United Kingdom, the Gini coefficient for market incomes rose from 0.476 in 1986 to 0.503 in 1995, an increase of 0.027. Over the same period, the Gini coefficient for disposable incomes grew by 0.041 (from 0.303 to 0.344).

<sup>5</sup> Belgium, Sweden, Finland, Denmark, the Netherlands, Germany and Norway all reached post-tax/post-transfer Gini coefficients that averaged around 0.25 over the past two decades. Yet, the underlying market distribution ranges from high inequality in Belgium to a relatively even distribution in Norway. Conversely, Sweden and the United States have a similar distribution of market incomes among developed countries around Gini 0.45, while the distribution of disposable incomes is noticeably different with Sweden at Gini 0.223 and the United States at Gini 0.345. Both countries are in the top 5 of the World Economic Forum's Global Competitiveness Report 2007

<sup>6</sup> Luebker (2004). 'Globalization and Perceptions of Social Inequality', *International Labour Review*, Vol. 143, No. 1-2, 2004, pp. 91-128, and Luebker (2007). 'Inequality and the Demand for Redistribution: Are the Assumptions of the New Growth Theory Valid?', *Socio-Economic Review*, Vol. 5, No. 1, 2007, pp. 117-148.

This evidence is particularly important in the current economic conjuncture as countries consider the fiscal policy options recommended by Managing Director Strauss-Kahn.<sup>7</sup> In *industrialized countries*, as the World Economic Outlook argues, so-called “automatic stabilizers” consisting in a large measure of progressively financed social security systems are more fully developed in European countries than in the USA and reduce the risk of economic deceleration as well as inequality. *Fiscal responses to slowdown should therefore seek to strengthen the redistributive quality of tax and benefits systems both to ensure the maximum impact on consumption and also to counteract the trend towards increased inequality of market incomes.*

Some *developing countries* have started to build automatic social and economic stabilizers. However such systems often reach only a small layer of society leaving most workers and their families, mainly in the informal economy, vulnerable to risks such as ill-health, injury or job-loss and the country as a whole vulnerable to external and domestic crises. The lessons for developing countries of previous financial crises are that informal employment tends to rise more than outright unemployment driving up the incidence of poverty and that recovery is long and slow for the most vulnerable workers.<sup>8</sup>

*Many developing countries need to address widening economic and social gaps that hinder a balanced expansion of consumption, savings and productivity growth. This is given added urgency by the likelihood that exports to industrial countries may not be sufficient to drive growth and development over the next two to three years. As the World Economic Outlook argues, accelerating public investment plans and advancing the pace of reforms to strengthen social safety nets, healthcare and education is an appropriate response to a more negative external environment for developing countries with the policy room. And as President Zoellick stressed in a recent speech the poorest are hit hardest by rocketing food prices and need cash or food assistance to supplement their incomes.*<sup>9</sup>

*A basic social security floor, adapted to meet specific countries needs and possibilities, is a feasible goal within a reasonable time frame for most developing countries. Such a social security floor could consist of:*

- Access to basic health benefits;
- Income security for all children through family/child benefits aimed to facilitate access to basic social services: education, health, housing;
- Access for the poor and unemployed in active age groups to basic self targeting social assistance, for example through employment guarantee schemes;
- Income security for people in old age, invalidity and survivors through basic pensions.

Brazil, Chile, Mexico, India, Namibia and South Africa are successfully implementing elements of a basic social floor. ILO research shows that the combination of a modest cash benefit for children and a modest pension, which could be an entry level benefit package for the least developed countries, could reduce the poverty head count by about 40 per cent costing about 4 per cent of their GDP.<sup>10</sup>

*The distributional impact as well the size of fiscal policy injections influence the effectiveness of policy packages. The composition of such policy packages should therefore figure in international*

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<sup>7</sup> *The case for a targeted fiscal boost: A commentary*, by Dominique Strauss-Kahn, Managing Director of the International Monetary Fund, in *Financial Times*, 30 Jan. 2008.

<sup>8</sup> R. van der Hoeven and M. Lübker, 2006: “Financial openness and employment: The need for coherent international and national policies”, Working Paper No. 75, Policy Integration Department, ILO, Geneva, May 2006.

<sup>9</sup> “A Challenge to Statecraft”, Robert B Zoellick, Centre for Global Development, Washington, 2 April 2008.

<sup>10</sup> Gassmann and Behrendt (2006), International Labour Office Discussion Paper No. 15. *Cash Benefits in Low-Income Countries: Simulating the Effects on Poverty Reduction for Senegal and Tanzania*.

*discussions on joint efforts to meet the global challenges of underlying social and economic imbalances.*

### ***International Regulation of Financial Markets***

Housing finance has become an international market. Easy lending pushing up property prices which are then used as collateral for further lending is a practice which should be controlled in view of the serious and widespread damage caused by the eventual inevitable bursting of the asset price bubble and collapse of credit pyramids. Experience suggests that a strong direct or regulatory public presence in housing finance markets is needed to dampen volatility and the consequent negative effects on macroeconomic stability. *Ensuring that working families are able to afford decent housing should be the guiding principle in the design of systems of housing finance.*

Over the past years of financial market boom, many viable companies have been bought out using highly leveraged borrowing that will saddle productive businesses and their employees with onerous repayments for years to come. It seems likely that many will not survive. As Bob Lutz Vice Chairman of General Motors said recently, “Real economic growth is created by value-added production. You cannot create real economic growth by trading pieces of paper. We have to relearn that lesson over and over again.”<sup>11</sup> Alongside action to stave off systemic risks to the international financial system governments need to put in place new rules to prevent the imprudent behaviour that fuelled the current turmoil in housing markets and damaged the foundations of the productive economy.

*I look forward to the results of the international discussions now underway on reforms to financial regulations and urge that consideration be given to building in incentives for investment in productive and sustainable enterprises and disincentives for the financing of high risk borrowing against inadequate collateral.*

### ***Sustainable Enterprise Development***

The three pillars of sustainable development – environmental, economic and social – provide a conducive policy framework for enterprise development and an alternative to a narrow short term share holder value framework for business.

At its June 2007 Conference the ILO’s tripartite constituency of employers’ and workers’ organizations and governments agreed on a comprehensive set of conclusions on the promotion of sustainable enterprises which provide a sound platform for coherent policies within the multilateral system.<sup>12</sup> Promoting sustainable enterprises is about strengthening the rule of law, the institutions and governance systems which nurture enterprises, and encouraging them to operate in a sustainable manner. Central to this is an enabling environment which encourages investment, entrepreneurship, workers’ rights and the creation, growth and maintenance of sustainable enterprises. Policy frameworks must balance the interests and need to turn a profit of enterprises with the aspiration of society for a path of development that respects the values and principles of decent work, human dignity and environmental sustainability.

A narrow perspective which fails to take into account the benefits as well as the costs of regulations concerning business is unlikely to be sustainable. Respect for human rights and international labour standards, especially freedom of association and collective bargaining, the

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<sup>11</sup> Newsweek, 22 March 2008.

<sup>12</sup> ILO: *The promotion of sustainable enterprises*, Report of the Committee on Sustainable Enterprises, International Labour Conference, 96th Session, Geneva, 2007.  
<http://www.ilo.org/dyn/empent/docs/F836599903/ILC96-VI-2007-06-0147-2-En.pdf>

abolition of child labour, forced labour and all forms of discrimination, is a distinctive feature of societies that have successfully integrated sustainability and decent work. Poorly designed regulations and unnecessary bureaucratic burdens on businesses limit enterprise start-ups and the ongoing operations of existing companies, and lead to informality, corruption and efficiency costs.

Well-designed transparent, accountable and well-communicated rules, including those that uphold labour and environmental standards, are good for markets and society. They facilitate formalization and boost systemic competitiveness. Reform of laws and the removal of business constraints should not undermine such standards. *International support to private sector development, including rules for finance markets, should build on the comprehensive sustainable enterprise approach.*

### ***The Employment Dimension of Policies to Address Climate Change***

Measures to slow and contain climate change as well as adapt to its now unavoidable consequences require investment in a new reduced carbon emissions economic infrastructure. This will alter the structure of employment, creating new jobs, making some jobs redundant and changing the content of virtually all forms of work. This entails a long term transition in how enterprises organize work and what they make. Social dialogue between management and union representatives is an essential mechanism for developing strategies for such transitions that are both efficient and equitable. The sooner major efforts are started to conserve energy use, shift to renewable sources and adapt production, consumption and employment patterns the better both from the perspective of ecological damage control and also the need to manage significant structural change.

There are likely to be significant opportunities to create green jobs that contribute to sustainable development and redress shortfalls in decent work as a result of economic slowdown. Major examples that are relatively labour-intensive include building insulation, which can yield significant reductions in energy consumption, coast and river flood protection barriers, and the upgrading of public transportation systems. The ILO is working with UNEP, the international trade union movement and others on a Green Jobs Initiative to promote dialogue and action on the employment adjustment challenges posed by adaptation to and mitigation of climate change.

*Investing in the adjustment of our production and employment structures for sustainable development should form part of recovery programmes.*

### **Conclusions**

The ILO Governing Body was pleased to welcome President Zoellick to its March 2008 meeting and much appreciated the wide-ranging discussions his presentation stimulated. They look forward to deepening collaboration on a range of issues between the Bank and the ILO particularly at national and regional level. They also look forward to welcoming Managing Director Strauss-Kahn in the near future. The ILO's tried and tested mechanisms of social dialogue and tripartite discussions are particularly vital in building consensus around policies to avert a steep slowdown and move out of recession. I believe they are an undervalued asset upon which the multilateral system should draw in shaping policies for a sustainable recovery.

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