Ensuring Decent Work for All:
When Micro and Meso Solutions are not Enough

Jo Marie Griesgraber, Executive Director, New Rules for Global Finance Coalition
jgriesgraber@new-rules.org

Presented at the Informal Preparatory Meeting on the Theme of the 2006 High-Level Segment of ECOSOC: "Creating an environment at the national and international levels conducive to generating full and productive employoment and decent work for all, and its impact on sustainable development" United Nations Headquarters, New York, April 4, 2006.

This is a draft. Comments are welcome.

The Economic and Social Commission, under the leadership of President Ali Hachani, is to be congratulated for confronting the challenging yet essential theme: "Creating an environment at the national and international levels conducive to generating full and productive employment and decent work for all, and its impact on sustainable development." This is yet another demonstration of the essential role the United Nation provides in bringing all parties to the table to confront an issue central to the well-being of humankind and of the planet.

I will focus on the institutional and policy aspects of international finance as they relate to the goal of "decent work for all." I will begin with articulating a few "stylized facts" as my analytic foundation. From there I will proceed to make a series of recommendations for the Systemic or global level, at the national or meso level, and close with some brief observations about the firm or microlevel.

Stylized Fact #1: The explosion in global financial liberalization has been associated with frequent and severe bouts of volatility. Because of more mature financial institutions and greater access to capital, industrialized countries have been less affected by such volatility than emerging market, middle income and low income countries. The poorest countries, especially those dependent on one to three basic commodities, not only are badly buffeted, they also do not recover from financial crises.[1] A 1% decline in GDP translates into a 2% increase in abject poverty. When developing and emerging market countries do grow and engage in international trade, the benefits have been found to be much smaller than once projected and skilled workers tend to benefit more than unskilled workers, whether urban or rural, increasing rates of inequality.[2] Indeed in five country case studies sponsored by New Rules, whenever growth did occur, in every case it was accompanied by increased inequality.[3]

Vander Hoeven and Lubker maintain that "volatility in international financial markets is currently perhaps one of the most harmful factors for enterprises and labour in developing countries."[4] Polaski demonstrates that the labor insecurity and increasing income inequality is near universal, including the industrialized world as well.[5] Polaski's observation is the labor over-supply is global, and standard approaches to job creation will not solve this reality.

"Stylized Fact #2" The current financial system is designed to give preference to protecting and expanding the value of capital, resulting in a corresponding de facto devaluing of labor and "land" (natural resource inputs). Capital account liberalization is consistently promoted as the goal for all countries whereas but labor mobility often treated as illegal behavior. (Photo Washington Post, April 1, 2006: fishing boat from Mauritania to the Canary Islands, the Arizona-Mexico Border where white vigilantes—themselves the children of immigrant, hunt down new immigrants.) This may fact may be attributable either to market forces, placing higher value on scarce resources, or to a confluence of dynamics—political, social, and economic—reinforcing the status quo allocation of power.

"Styled Fact #3" Raymond Baker, a business man with 35 years experience in the developing world, and a fellow at the Brookings Institution, recently concluded a masterful book: Capitalism's Achilles Heel.[6] In this book he traces the dirty money that leaves developing countries through corruption, crime and commercial behavior that was either illegally generated, transferred, or spent. Fundamental to his expose, is his description of the systems set up on the 1960s by the wealthy countries of the West to facilitate the withdrawal of wealth from former colonial areas to the West. These systems have been perfected with the advance of computers and telecommunications. Baker is concerned about the survival of capitalism; a major focus is tax havens used to avoid paying taxes by wealthy people from all parts of the globe. The system he describes is the same system that the IMF actively supports as the ideal for all countries: the free, unfettered flow of capitalism. The IMF accepted—seemingly uncritically—the rationale that a fully liberalized financial market would allocate funds in the most efficient manner, bringing about the best results for all, though without looking closely at the immediate or medium term impact on workers. Van der Hoeven and Lubker document how the Fund's positive aspirations have not been the result in reality. Baker summarizes the problem is a system whereby unfettered capital seeks the maximum profit in the shortest possible amount of time. Profits are maximized hourly or overnight—a timeframe too short to build factories, plant crops, train workers, educate children. And Baker worries that the quest for profit maximization will provoke the collapse of capitalism.

This condensed analysis of reality constitutes the background for a series of recommendations that are pragmatic and feasible. Many of these recommendations were derived from the 5 multi-stakeholder consultations the New Rules for Global Finance Coalition conducted in collaboration with the UN Financing for Development Office in the lead up to the 2005 biennial high-level dialogue on the follow-up to the Monterrey Consensus Document.[7] New Rules, a coalition of NGOs and Academics, focused on Section F of the Consensus Document, namely Systemic Issues, involving the governance of international financial rule making bodies and global financial crises—their prevention and resolution.

To achieve the goal of "decent work for all," then changes are required on every level: at the global or systemic level, at the national level and at the level of the firm.

<u>On the global level</u>, the goal must be to reduce volatility while retaining sufficient liquidity for growth.

1. This goal requires institutions that incorporate interests beyond those of capital-rich stakeholders. Currently the key international financial rule-making bodies are the IMF, the Bank for International Settlements, Financial Stability Forum, and the Basel Committees. The governance structure of all of these institutions share common characteristics: a penchant for secrecy and from exclusive to over-representation of countries western capital-rich countries. The Financial Stability Forum is an anamolous institution, where private associations act on par with national governments, and poor countries are "represented" by the World Bank and IMF, themselves run by the economic powers of 1944.

The first steps toward correcting this governance problem are quite simple—even if politically challenging. The IMF must ensure that its Board meetings are open, and reallocate representation on its board to represent current market sizes: Europe and Saudi Arabia are over represented; middle income countries such as Mexico, Brazil, and South Korea are under represented; the African country representatives are over-worked. The BIS and Basle Committees must commence at least rotating representation of developing countries.

Unless their governance changes, one cannot expect different outcomes from these institutions. A global financial system requires global financial institutions that enjoy legitimacy through equitable representation of all peoples.

2. A second pillar of systemic change is to create missing pieces of the financial architecture, most notably a mechanism for dealing with the de facto bankruptcy of sovereign debtors. Bankruptcy courts have long been a core institution of any well functioning market. Governments often borrow and are charged interest like other borrowers. Creditors charge interest for two purposes: first, to cover their opportunity costs since their capital is not invested in some other profit making venture, and second, interest payments serve as an insurance against non-repayment of loans.

The current arrangement of dealing with indebted countries is a labyrinthine maze, with no exit for the debtors, no comprehensive conclusion to their indebtedness. Any analysis of poverty in low income and in many middle income countries invariably refers to the severe costs to the government and to the poor.

It is long overdue that the global community establish a comprehensive debt workout mechanism that embodies the hallmarks of good practice that characterize national bankruptcy courts. These characteristics include:

- Comprehensive treatment of all debt

- Protection of the life and livelihood of debtor (In the case of sovereign debtors, this encompasses the well-being of citizens, including the most vulnerable)
- Neutral judge or balanced panel of arbitrators
- Authority to enforce judgments.

Any reasonable person would recognize that neither the HIPC nor the more recent pledges that originated at the 2005 G-8 Summit approximate this fair and rational approach to sovereign debt workouts. Most reasonable people would also agree that the international political climate is scarcely conducive to supporting any new international debt facility. Therefore, the New Rules Coalition has proposed a gradual approach we call the International Debt Framework.[8] Neither the wholly voluntary approach favored by the private sector, nor the "black letter law" or international treaty approach favored by some non-governmental organization, the International Debt Framework propose using the Anglo-Saxon or Common Law model: go gradually, build trust through information exchange, and develop precedents for comprehensive and pragmatic debt workouts on a case by case basis.

3. A third pillar of reform on the global or systemic level addresses the need for transparency and inclusivity with regard to taxes. Governments cannot acquire the resources to execute their responsibilities without taxes that are characterized by: 1) progressivity, i.e., those who are able to pay more do so; 2) effective collection; and 3) scrupulous integrity on the part of public employees—both elected officials and civil servants, who in turn are paid decent wages so that bribed are not a requirement for survival.

For progress on the tax front on the national scale, international cooperation is a prerequisite. Baker, referred to above, described the activities and consequences when some 70 countries serve as tax havens—locations where one can safely hide one's wealth from any tax collector. While small island states are among the more "notorious" tax havens, the largest tax havens are actually in New York, London, Lichtenstein, and Geneva. The United States is not a model to be emulated in this regard: the IRS cannot share tax information with the Securities and Exchanges Commission. Mark W. Everson, the current IRS Commissioner, recently testified before Congress that many firms report losses to the IRS and gains to the SEC for the same year. The amount of income that developing countries forego under current arrangements—conservative estimates put the amount dirty money fleeing developing countries each year at roughly $500 billion—dwarfs the funds currently available through official development assistance, which is about 1/10 of that, or a mere $50 billion.

The UN is beginning to collaborate with the OECD to establish principles for effective information sharing between banks and other financial agencies in information "transmitting" countries and tax agencies in information "receiving" countries. Noted tax attorney David Spencer with the Tax Justice Network testified before the UN Committee of Experts on International Cooperation in Tax Matters last fall and detailed amendments to basic tax treaties so that "effective" information would be exchanged.

The tax conundrum may be the most central problem to overcome en route to providing decent work for all. Without an adequate tax base, countries turn to loans and then become ensnared in the debt trap. Developing countries lack the resources to invest in their own citizens' health and education as well as national infrastructure. Private capital seeks to maximize profits rather than seek a "fair" return through productive capacities in the real economy.

If governments are going to meet the Millennium Development Goals, or to provide the social and physical infrastructure needed for growth and decent work for all citizens, they cannot do so relying on foreign aid or even foreign direct investment. These external sources of financing will be essential for some of the poorest countries; they may even be helpful in some cases. But governments must be able to have reliable and sufficient sources of revenue from taxes—which are not debts that must be repaid, and are not aid that is accompanied by someone else's agenda, ex pat consultants, and strings stipulating what must be bought from whom at what price. Taxes also entitle citizens to hold their governments accountable. Many developing countries collect taxes that amount to less than 5% of GDP; the minimum goal should be 15% of GDP. If developed countries cooperate by discouraging dirty money from entering their own economies, developing countries have a better chance of capturing some of those funds in taxes. This can only happen with greater international cooperation.

<u>A bridge issue</u> between the Systemic or Macro level Recommendations and the National or "Meso" level is the need for better research. Especially important is the ability to better project the likely impact of policies on the lives of the poor and of the marginally employed. The dirth of such research is painfully evident. For example, in its recent report on the performance of the World Bank's role in trade policy in developing country, the World Bank's Internal Evaluation Group found that the Bank had failed to assess the results on povery of trade liberalization policies. Van der Hoeven's seminal piece on the linkages between financial liberalization and the labor impact thereof proposes a new line of research, for little exists currently. Matthew Martin and Hannah Bargawi, writing for the Commission on Africa on the impact of exogenous shocks on African states, report that a core need is for better research. Martin's recommendation is echoed by the African heads of state.

Currently bilateral donors, especially Germany, the United Kingdom and Canada, are actively supporting Poverty and Social Impact Assessment. PSIA, as it is referred to within the World Bank and IMF, is designed to be a comprehensive analysis of the impact of policies on various segments of the population. It employs social analysis as well as econometric modeling. To date its weaknesses are that it is employed to design approaches to ameliorate policies already in place, instead of being employed before hand to anticipate varying impacts of a range of policies. Further, PSIA has been used on a country-by-country basis primarily to assess sectoral or structural polices, rather than the impact of the package of macro-economic policies prescribed by an IMF arrangements. Still less has PSIA been employed for sub-regional or regional studies of the medium- to long-term effects of exogenous shocks.

The global community has the intellectual capacity to tackle these issues. It is no longer sufficient to require or even to recommend that countries apply policies based on "established economic theory" rather than solid empirical evidence and tools of project. As both Polaski and the World Bank are finding, trade liberalization is not the guaranteed panacea for growth and poverty reduction as was once advertised.

On the national level, policy changes related to the financial sector that would enhance the likelihood of decent work for all include:

1. Capital account regulations. On the national level, governments need to have and to exercise the right to regulate capital flows, with Chile and Malaysia offering successful models for policies that can be replicated. It is recognized that capital regulations will need to be refined and changed over time, since capital will find ways around virtually any regulation.
2. Prudential regulations, including the monitoring of hedge funds and derivatives, beginning in the financial centers.[9]
3. Greater flexibility in macro-economic policies, for example by avoiding "the corner solutions" in the claic policy trilemma regarding open capital account, stable exchange rates, and independent monetary policy. Growth requires stability over the medium to long term, with flexibility in the short term—whether the country involved is in Europe or Africa.[10]
4. Regulation of the financial sector, especially banking.
    a. Retail financial institutions are needed to provide credit at reasonable rates and for extended periods
        i. This can involve national development banks, targeted to small and medium enterprises, structure to avoid the corruption endemic to NDBs of yore (work by DESA)
        ii. National mechanisms for long term mortgages, e.g., US Freddie Mac and Fannie Mae
        iii. Retail institutions will provide funds at rates below "micro-finance" for longer periods of time, offering more services
        iv. Retail banks can assist in low cost transfers of remittances from overseas, and facilitate channeling such funds into longer term investments, and not just immediate consumption needs.

Access to credit is sometimes described as a right. It is certainly essential if unskilled workers struggling to survive in the informal—whether urban or rural—even hope to improve their situation. Credit can come from retail banks, micro-credit, remittances, or government programs, but come it must.

    b. Regulation of operations of foreign banks in the same manner as national banks:
        i. Cannot extract resources from the country side to invest in the cities, nor exact from a developing country to invest in developed countries
        ii. Principle of "Community Reinvestment Act"

I will not focus on the firm level, but suffice it to say three things:

1. Corporations are chartered by governments. The charter is a social contract between the firm and the government, hence the firm has certain obligations, including rights.
2. Corporations benefit from the courts, the physical infrastructure, and public investment in education and health of workers—all provided by governments. They have an obligation to pay for those services through just taxes and decent wages.
3. Shareholders are entitled to fair profit—not to profit maximization in the shortest possible time at the cost of everything else. (Cf. Baker)

In sum, workers as human beings and as citizens are entitled to decent wages. Workers' efforts are located in the real economy where profits are earned over time, unlike the profits from capital which earn profits over nanoseconds. Workers are citizens, and human beings with intrinsic value, essentially different from capital. Firms and governments and global institutions must protect the rights and well being of human beings. This is more likely to happen when governing bodies are characterized by representation that adheres to principles that the polity regards as "fair" and their decisions are made openly and with integrity.

With these changes, financial volatility can be diminished, the real economy can grow, children can be educated, workers and corporations can flourish, and inequality can be reduced.

---

[1] Shocks also tend to have major long-term and cumulative effects on the economy. Commodity price shocks tend to be especially "persistent" – they reach their maximum negative effect after 4 years and low-income economies take 5 years to overcome around 50% of their effects (see World Bank 2004). Shocks also have almost irreversible effects such as falls in human capital (deaths), large capital outflows, credit crunches and permanent unemployment. The most important impact of shocks is on poverty. All of the shocks described above will reduce scope for poverty reduction - for example, by decreasing smallholder export earnings, by reducing imports of goods or aid flows destined for poverty reduction, and by reducing budget expenditure on poverty reduction. A large amount of recent analysis has demonstrated that many different types of shocks – including financial crises - have a dramatic impact on increasing poverty, reversing trends towards the MDGs.16 The precise impact depends on the degree of prior poverty and on the effectiveness of the national and international counter-measures, but in low-income countries high poverty and lack of adequate safety nets, external reserves cushions or internal stabilisation mechanisms exacerbate the impact. The poor tend to suffer much more during crises, because: they lack assets or credit to protect themselves from income falls and unemployment; they are less mobile than the wealthy due to lack of education, skills and health; and they lose sources of income such as transfers from wealthier relatives or communities, or from government, in part because their "voice" is weak. As a result, every 1 per cent decline in growth can increase the proportion of the population in absolute poverty by as much as 2%. In addition, Agenor and Lustig have also argued convincingly that the poor also tend to benefit much less from post-shock recoveries, because they cause irreversible damage to their investment in human (education, health, nutrition) and physical capital. The poor are also constrained in their efforts to get out of poverty by their extreme worry about the risks of future shocks. This makes "economic insecurity" rank very high in their own participatory assessments of factors causing poverty, and leads the poor to invest less for the long-term. As a result, shocks can have a permanent effect of increasing poverty. Due to the absence of reliable costings for MDG expenditures or country-by-country analysis of the impact of shocks on poverty, it is not possible to quantify the potential impact of shocks on poverty reduction in Africa for this paper. However, recent analysis (IMF 2004) has indicated that shocks occur at least once every 1.4 years for the average low-income country, and have an average magnitude of 4.25% of GDP.17 Chart 1 shows an indicative impact on African low-income countries' path to the MDGs compared to the 7% GDP

growth rate calculated by the UN as necessary to attain the MDGs (12 African HIPCs have estimated that the growth rate they need is closer to 6.3%), and the 5% average growth rate currently being projected in IMF PRGF programmes in Africa. It indicates that even if governments target 7% growth initially, shocks would halve the progress to the MDGs. However, given current PRGF projections, which themselves fall short of MDG needs by one third, shocks could lead to a 75% shortfall in the growth needed to reach the MDGs. There is also strong evidence that shocks have a more long-term "drag" effect on economic growth (eg Chauvet and Guillaumont 2001; Collier and Dehn 2001; Guillaumont and Combes 2002), and the frequency and severity of shocks for low-income countries has been growing. These factors mean that the above reduction of growth due to shocks is a considerable underestimate.
"PROTECTING AFRICA AGAINST 'SHOCKS,' " AFRICA COMMISSION BACKGROUND PAPER, Matthew Martin and Hannah Bargawi, Development Finance International, 16 September 2004, p. 9.

[2] Sandra Polaski, Winners and Losers: Impact of the Doha Round on Developing Countries. Carnegie Endowment for International Peace, Washington, DC, 2006

[3] Drafts of the five case studies on experiences with ex ante assessment of macro-economic policies in Bangladesh, Cameroon, Ghana, Nepal, and the Philippines can be found at the website of New Rules for Global Finance Coalition www.new-rules.org

[4] "External Openness and Employment: The Need for Coherent International and National Policies," Rolph van der Hoeven* and Malte Lübker, *Policy Integration Department, International Labour Office (Geneva)* Paper presented at the XXII G24 Technical Group Meeting, March 16-17, 2006 (Palais des Nations, Geneva).

[5] "Job Anxiety is Real, and it's Global," Policy Brief No. 30, April, 2004, Carnegie Endowment for International Peace, Washington, DC.

[6] Raymond W. Baker, Capitalism's Achilles Heel: Dirty Money and How to Renew the Free Market System John Wiley & Sons, 2005.

[7] Final Report and Recommendations Derived from Multi-Stakeholder Consultations Organized by New Rules for Global Finance Coalition November 2004 through September 2005 On "Addressing Systemic Issues", Section F, Monterrey Consensus Document International Conference on Financing for Development Monterrey, Mexico, March 2002. Prepared for UN 2005 World Summit, Segment on Financing for Development, September 14-16, 2005. www.new-rules.org

[8] Kathrin Berensmann and Frank Schroeder, "A proposal for a new International Debt Framework (IDF) for the prevention and resolution of debt crisis in middle income countries," Paper for the Multistakeholder Consultation on Systemic Issues, in Lima, Peru; February 17-18, 2005. Draft. www.new-rules.org

[9] **A. PRUDENTIAL REGULATION OF FINANCIAL MARKETS**
Prudential regulations can improve the resiliency and viability of financial institutions, as well as enhance the efficiency, dependability and stability of financial markets and the overall economy. This latter point is sometimes overlooked. The Standards and Codes project of the International Monetary Fund (IMF), World Bank,2 Bank for International Settlements (BIS) and Financial Stability Forum (FSF), amongst others, focuses their efforts primarily on accounting, governance and capital adequacy of financial institutions in developing and emerging market countries. It does not adequately address issues such as how they act as dealers in over-the-counter (OTC) markets for foreign currency, securities, derivatives and repurchase agreements. Prosperous financial firms might well withdraw from market making activities in these markets, and leave them illiquid at critical moments. The results can be economically catastrophic. Similarly, derivatives are treated primarily as a matter of credit risk to individual financial institutions, and not also as a matter of market risk and overall liquidity risk. Transparency is praised, but it is but not enforced with regard to reporting requirements for market prices, trading volume, open interest in the

market and large trader position. Proper market surveillance by regulatory authorities is not possible without such information. And without such transparency and surveillance to detect and deter fraud and manipulation, investors cannot be assured that prices are fair and honest. Liquidity too is praised, yet regulators do not require that dealers in OTC markets maintain binding quotes throughout the trading day. A notable exception is for primary dealers in US Treasury securities markets where such market-making activities are required as a condition for being registered as a primary dealer. The result is to assure that U.S. government securities markets are liquid throughout the trading day. The point is not to be 'antiderivatives', a concern raised by the Consultation in Washington, D.C., but rather to promote their use for risk management while discouraging the build-up of large, speculative positions, such as occurred prior to the Mexican and East Asian crises and their misuse in Enron-type activities. In addition to the need to apply prudential regulations to markets and financial transactions and not just financial institutions, the application of prudential regulatory measures to developing country financial markets should also take into consideration their particular national circumstances and the intense impact of macro-economic risks on domestic financial institutions and markets.

New Rules recommendation:

1. **Design and implement prudential regulations for financial markets and financial institutions in order to enhance transparency, govern risk taking and foster orderly marketplaces. This should reduce the build up of exposures to risks in such areas as foreign exchange, maturity mismatch, liquidity, and concentrated credit exposures. Especially important is the application of prudential regulation to derivatives markets, which are growing rapidly in the developing world.**

Final Report, Multi-Stakeholder Consultations, New Rules for Global Finance Coalition, p. 5. This portion of the report relies heavily on the work of New Rules member, Randall Dodd, Executive Director of Financial Policy Forum. www.financialpolicy.org

[10] Colin I Bradford, Jr., "Prioritizing Economic Growth: enhancing Macroeconomic Policy choice," Paper presented at the XIX G24 Technical Group Meeting, September 27-28, 2004, Washington, DC. Cited in van der Hoeven and Lubker, p. 23.