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# GLOBALIZATION, FINANCIAL CRISIS, AND LABOR: WHAT CAN WE LEARN FROM THE PREVIOUS CRISES ABOUT THE EFFECTS OF THE FINANCIAL CRISIS ON EMPLOYMENT AND WAGES?

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The aim of this paper is to analyze the channels through which the financial crisis is affecting the real economy, and in particular employment and wages. As public policy in the advanced capitalist countries concentrates on arresting the credit crash, the effects of the crisis on the real sector is just starting to attract the attention of policy makers. Although there is some concern about the possible employment effects, distributional consequences, and the effects of the rescue packages on governments' future social expenditures are not much on the agenda.

Since 1980s, the world economy is being guided by neoliberal economic policies such as openness to trade, foreign direct investment and financial capital flows, and the dismantling of government regulations in financial markets, goods and labor markets. These policies reduce the role for macroeconomic policy interventions with the claim that free market capitalism would increase efficiency, growth and provide a fair distribution. However, after two decades of domination of neoliberal policies, growth on average is lower, the unemployment problem has been persisting, and the distribution of income is changing at the expense of labor in both the North and the South. The increase in the mobility of capital and the stagnation in aggregate demand have been the central powers behind this synchronized development. The stagnation in demand led to higher unemployment and eroded the bargaining power of labor vis a vi capital. In the mean time, the increase in the mobility of capital has not only contributed to this erosion in the bargaining power of labor, but also increased the fragility built in the capitalist system via increased financialization and speculation. This, coupled with the tight fiscal and monetary policies, and a decrease in the labor share in income, set the conditions for the vicious cycle of deficient aggregate demand, low growth, low employment, and a crisis prone global economy. Financial fragility in a deregulated global economy and this vicious cycle have been the structural causes of the current global financial crisis.

This paper analyses the effects of financial crises on the distribution of income and balance of power relations. Past crisis experiences show that the episodes of crisis intensify the distributional struggle, and the question on who will carry the burden of adjustment becomes part of the struggle. The first part of the paper will build on the experiences about the labor market affects of the former financial crises. In that respect we will focus on the experiences of developing countries –East Asia, Turkey, and Latin America. As a developed country case the Japanese recession of the 1990s will also be discussed.

We will analyze the effects of the shocks generated by crises on growth, unemployment, employment, wages, and labor's share in income. Despite former policy differences many developing countries have experienced in the past similar outcomes as a consequence of financial crises that followed the liberalization of capital flows. The effects of the crises in the

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developing countries worked through three channels: 1. the decline in growth and thereby labor demand, 2. the increase in unemployment, and thereby the decline in the bargaining power of workers, 3. inflationary shocks during currency crises. Due to the import dependency of these countries, currency crises, i.e. depreciation has a pass-through effect on prices, generating dramatic increases in inflation. These shocks are not only unexpected but also hard for the workers to reflect to their wages due to the magnitude of the shock.

The outcome in the developing countries has been a radical deterioration in the real wage, and consequently wage share, which has been persisting years after the crisis. Similarly unemployment rates, which hike during the crises, have not been back to pre-crisis levels years after the crises. The paper will decompose the sources of the decline in the wage share to its sources: i.e. changes in real wages and labor productivity, the latter also decomposed as changes in value added and employment. Next the paper will present econometrical estimations on the effects of financial crises on labor's share in ten major developing countries. The paper will also discuss the institutional mechanisms of the wage bargaining process. During a crisis, employers push labor unions to accept dramatic wage cuts or compulsory unpaid leaves to avoid job losses. The crisis also creates a hysteresis effect that destroys the bargaining power of labor for a long period afterwards. Diwan (2001) defines crises as episodes of distributional fights, which leave "distributional scars". The crisis episodes have also been extremely important in facilitating a radical restructuring in some of these economies (e.g. South Korea, Turkey), which could not be achieved via a democratic process under normal economic circumstances.

What will be the effects of the current global crisis on different countries? We need to distinguish four different groups of countries.

1. During this global crisis, many developing countries with a former crisis history are once again experiencing a crisis led by speculative capital outflows, despite significant differences in the fragility of their economies. Speculators seem to fail to distinguish between countries like South Korea and Argentina, which do not have significant current account deficits or even have current account surpluses, vs. countries like Turkey with a high current account deficit, and dependency on capital flows. While the former developing country group is suffering from a crisis, which they have not created, the countries with current account deficits (e.g. Turkey, South Africa) might suffer through a deeper bust, due to the accumulated fragilities during the speculation-led boom cycle.

2. The emerging markets of Eastern Europe are also being threatened by credit crash and capital outflows, and possible currency crisis accompanying the banking crisis. After a decade of restructuring and high growth after the initial transition shock, these countries will once again face the costs of integration to unregulated global markets. For these countries learning from the experience and the policy mistakes of the former crises is extremely important. It is also important to learn from the crisis management techniques of Malaysia through capital controls. The degree of imbalances accumulated regarding current account deficits, exchange rate appreciation, and private indebtedness in particular in foreign currency will determine the differences in the depth of the effects among these countries. Hungary, Bulgaria, Romania, Serbia, Croatia, Baltic Countries, Ukraine, and Russia are more exposed than Poland, Czech Republic, Slovenia, and Slovakia. But even the latter group might suffer from the contagion effects, the slow down in global demand, the decline in FDI inflows, and the contraction in remittances.

3. For other developing countries like China, India, and Brazil, although the contagion effects and the slow-down in global demand will be an important problem, these countries could manage the crisis based on their large domestic markets, if they could make a policy shift away from pure dependence on export orientation based on low labor costs.

4. The developed countries seem to be experiencing the crisis different from the former cases of crises in the developing countries, thanks to their fiscal capacity to weather the shock. The immediate decline in interest rates, and credit lines to domestic banks were measures that were formerly denied to the developing countries by the IMF. Moreover in the developing countries the conditionality credits of the IMF had made use of the crisis to impose further measures of liberalization. It is interesting to observe that now developed countries are even starting to consider counter-cyclical fiscal policy as a reaction to the crisis in their own countries. However despite this crisis management, the effects of the credit crash, particularly in countries with high household debt (e.g. US and UK), will be significant. The multiplier effects of the credit crash as well as the decline in consumption have already started to affect investments. The pessimistic expectations will amplify the decline of both consumption and investments. In this setting, the negative effects of the crisis on labor will work through demand and bargaining power channels. Other additional channels of negative effects will be through the housing debt, which will have strong distributional consequences for the indebted households. Two differences to the former crisis in the developing countries can be expected: a) the dimension of the initial recession might be more moderate, but given that we are facing a global recession, the recovery in economic activity can last much longer, bringing in worries about an "L" type of recession, but much stronger than the Japanese experience of the 1990s. Thus the negative labor market effects could be less severe at the beginning, but might persist and increase at an increasing rate. b) A very high inflationary shock will not accompany the credit crisis in the developed countries, which will moderate the negative effects on real wages. Dramatic increases in inflation in the case of the developing countries have been due to the collapse of currencies. c) Nevertheless, in case the recession persists longer, the likely scenario of deflation can bring other major risks to these economies and labor.

Finally the paper will derive the policy implications. In that sense one dimension of policy alternatives concerns the domestic policies regarding a) the distribution of the costs of the crisis, b) fiscal policy, employment programs, and distributional policy to reverse the negative demand effects of the crisis, c) organizing against the danger of extended effects of the crisis and the bailout packages on distribution through its future effects on social expenditures, d) the redesign of the financial sector, given the massive costs of irresponsible financial sector decisions. The second policy implication concerns the global dimension. Negative effects of globalization are not an unavoidable destiny, rather an outcome of the current neoliberal policies. Labor in the North and the South (or the East and the West) have more common ground than they currently exploit. There is scope for international cooperation, in case the coordination failure can be overcome. Thus redefining the rules of the game, coordinating the institutional setting of the global economy is the only alternative to readjust the playground back to conditions that are fairer to labor. Nevertheless creating a consensus around these targets in the North as well as the South also requires a systematic global policy on international redistribution and development. How or whether the North supports the South in weathering the current global crisis will also be important in creating positive signals for global cooperation. This defines new roles and tasks for the trade unions in each country, since they are the political agents who have interest and the potential to push for such a shift in policy at the global level.