SHIFTING RESPONSIBILITY: HOW THE BURDEN OF THE EUROPEAN FINANCIAL CRISIS SHIFTED AWAY FROM THE FINANCIAL SECTOR AND ONTO LABOR

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I. INTRODUCTION

On August 5 2011, the European Central Bank sent a firmly worded letter dictating an economic policy agenda to Italy's wavering Prime Minister Silvio Berlusconi. Close to half the reforms directly concerned labor and the rest would strongly impact employment. The labor law reforms prescribed included transformation of the collective wage bargaining system allowing for firm-level agreements, changes in the rules regulating hiring and dismissal of employees, more stringent eligibility criteria for seniority pensions (increasing the age of retirement for women in the private sector), and reducing the cost of public employees by changing rules and reducing wages. The letter set a deadline of September 30, 2011 for what would amount to a massive overhaul of Italian labor law, liberalization of public services, the centralization of public administration, making public consultation impossible. As Biasi documents in his contribution to this special edition, the letter triggered the early resignation of Berlusconi and his government, and the subsequent appointment of a "technical government" led by Prime Minister Mario Monti. In June 2012, the Monti government passed Act n. 92/2012, which achieved many (but not all) of the European Central Bank's demands and marked a significant change in Italy's industrial relations style. Prime Minister Letta, who took office in April 2013, continued the path toward flexibility and the "labor law of crisis" in the summer of 2013.

Similar deregulatory labor law reforms were demanded of other E.U. Member States receiving financial support from the "Troika" of the European Commission, European Central Bank, and International Monetary Fund (IMF). Contributors to this number document the way that in Greece,

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Portugal, and Spain reforms were "agreed upon" between the Troika and the respective governments in Memorandums of Understanding. This greatly diminished opportunities for democratic consultation with those who would be affected by the changes. In countries such as Hungary, Estonia, and Slovakia, a change of government (shifting to the right) led to the acceleration of changes to labor law, resulting, also, in the bypassing of participatory consultations with social partners.[1] Indeed, the circumnavigation of democratic processes has been an alarming feature of the labor law reform processes across Europe. In a number of countries, there was recourse to "emergency procedures" by national legislators to sidestep agreements on "anticrisis" measures agreed by the social partners and/or prepared by national governments in consultation with the social partners (Estonia, Hungary, and Slovakia). As the articles in this number show, some European countries have implemented only piecemeal (though still significant) deregulatory measures, while others have undertaken far-reaching overhauls of the whole labor code. Such policies are seen as a means to achieve internal devaluation, with the aim of boosting external competitiveness by curtailing labor costs.[2]

The International Labor Office (ILO) estimates that after three years of continuous crisis conditions in global labor markets there were an added twenty-seven million unemployed people in the global economy.[3] Although economic growth has improved, the outlook for global job creation has been worsening. The ILO's baseline projection shows no change in the global unemployment rate between now and 2016.

In light of these employment conditions, it would seem logical that measures be undertaken at national and international levels to ease the consequences of the crisis for workers. Governments have responded to such conditions the past by creating major social pacts with labor to bolster consumption and faith in the economic system. The U.S. New Deal came out of such a crisis. The system of wrongful dismissals in Germany was adopted to ease the effects of economic hardship on labor.[4] Yet, as all the contributions to this special edition document, instead of softening the burden of the crisis for labor, it has been amplified by the reform processes.

1. Stefan Clauwaert & Isabelle Schömann, *The Crisis and National Labour Reforms: A Mapping Exercise* (Eur. Trade Union Inst., Working Paper, 2012).

2. *See* Etienne Wasmer, *An Introduction to the Special Feature Section: Price, Wage and Employment Adjustments in 2007–2008 and Some Inference for the Current European Crisis*, 19 LAB. ECON. 769 (2012); Aristomene Varo & Jose Luis Diaz Sanchez, *Tracking the Causes of Eurozone External Imbalances: New Evidence*, THE WORLD BANK BLOG (May 1, 2014), http://blogs.world bank.org/developmenttalk/tracking-causes-eurozone-external-imbalances-new-evidence.

3. ILO, GLOBAL EMPLOYMENT TRENDS 2012: PREVENTING A DEEPER JOBS CRISIS 9 (2012) [hereinafter GLOBAL EMPLOYMENT TRENDS 2012].

4. *See* Marco Biasi, *The Effect of the Global Crisis on the Labor Market: Report on Italy*, 35 COMP. LAB. L. & POL'Y J. 371, 378 & n.30 (2014).

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The current global financial crisis can be thought of as a three-stage crisis. The *first stage* was the initial shock, beginning in the United States and spreading quickly thanks to the interconnectedness of financial markets. This was met by coordinated fiscal and monetary stimulus in many countries around the world. In some cases up to 90% of additional public spending went into bailing out banks.[5] In the *second stage*, higher public deficits and sovereign debt problems—seen especially in Europe—led to increased austerity measures in an effort to buoy to capital markets. Fiscal stimuli began to diminish, and advanced economies concentrated on quantitative easing monetary policies. The combined impact appears to have been a weakening of both GDP growth and employment. The *third stage* might be thought of a labor market crisis. Although growth has occurred in many countries, unemployment persists. Labor market imbalances are becoming more structural, and therefore more difficult to eradicate. This is associated with an increased risk of a second dip in growth, intensifying the labor market distress that has deepened since the onset of the crisis. In this third stage of the crisis, policy space has been significantly restricted, making it difficult to halt, or even retard, the further weakening of economic conditions. Weak economic conditions in Europe and the United States are putting pressure on economies worldwide, and threatening the gains made in developing countries in recent decades in the reduction of poverty.

This Article makes three arguments. The first is that labor is incorrectly carrying responsibility for the debt crisis. There are numerous explanations for the U.S. led financial crisis of 2007 and the sovereign debt crisis of 2009/10 in Europe. No legitimate explanations focus on labor as the cause. Yet labor has been targeted in austerity measures that aim to rebalance national budgets and reduce indebtedness. The second argument is that given that inequality is seen by some to be a cause of the crisis, and increased inequality has certainly been an outcome of the crisis, measures should be put in place to increase equality. Labor law is an important tool for reducing inequality, and if designed appropriately, this can occur in a reflexive and responsive manner. Instead of using labor law to this end, conditionalities currently associated with E.U. bailouts are demanding greater labor market flexibilities using blunt tools, together with harsh austerity measures, which are likely to intensify long-term unemployment and inequality rather than reducing them.

The third argument is that the reason why austerity is being chosen over other policy options is because of the dominance of financial markets, combined with restrictions that the E.U. economic and monetary union

5. GLOBAL EMPLOYMENT TRENDS 2012, *supra* note 3, at 12.

places on countries to adjust to economic shock. Because the union has removed the tool of adjusting exchange rates, which is the normal way to effect "external devaluation," "internal devaluation" at the member state level is the only means available to restore public finances and lower nominal wage costs.

This is giving rise to a crisis of a different type. So much economic policy is currently focused on "restoring confidence in the markets," yet, as Wolfgang Streeck has recently commented, it is now impossible to restore the confidence of the financial markets *and* the majority of citizens at the same time.[6] Until financial interests less dominate nations, it seems likely that labor will continue to carry the burden of a crisis for which it was not responsible. If commentators that argue that inequality is one of the causes of the crisis were right, then current trends would indicate that continued instability in the future is likely.

The argument is made in a number of stages. Part II examines contrasting views about the causes of the 2007 U.S. financial crisis, and the 2009/10 European sovereign debt crisis. Part III presents data on the effects of the crisis on labor. It shows that inequality has increased, although the wealth of the top quintile was reduced by financial market losses. Unemployment and informal work have also increased dramatically. Part IV briefly assesses alternatives to the labor law changes documented in this special number. Part V concludes by examining why these tools are not being employed by nation-states following the crisis, and why other measures have been preferred.

II. CAUSES OF THE 2007 AND 2009/10 FINANCIAL CRISES

The reglobalization of capital markets since the 1970s has been painful, pockmarked by periodic crises spanning at times a multitude of countries. These include the inflation crisis of the 1970s, the public debt crises of the 1980s, the private debt crises of the 1990s and early 2000s, finally detonating into the U.S. private debt crisis of 2008, rolling into the European sovereign debt crisis of 2010.[7] Explanations for crises vary, and different understandings of the causes of crises lead to different policy prescriptions regarding how to lift a national economy out of the crisis. This Part examines various explanations for the current financial crisis.

Certain new dimensions played important roles in the severity and global scale of the ongoing crisis, compared with previous crises, particularly, with respect to its transmission and amplification. Although

6. Wolfgang Streeck, *Markets and Peoples: Democratic Capitalism and European Integration*, 73 NEW LEFT REV. 63 (2012).

7. *Id.* at 64.

the crisis is not unusual for having been preceded by financial liberalization, the extent of financial liberalization and the failure of financial regulation are particularly stark. The primary trend that preceded the crisis was the expansion of the financial sector, along with widespread use of complex and opaque financial instruments.[8] This factor could be responsible not only for the bust, but also for the extraordinary character of the current recession in both the United States and Europe. Over time, financial markets grew ever larger relative to the nonfinancial economy. Important financial products became more complex, opaque, and illiquid, and system-wide leverage exploded.[9] In mid-2008, the Basel-based Bank of International Settlements estimated that the global outstanding derivatives reached $1.14 quadrillion: $548 trillion in listed credit derivatives plus $596 trillion in notional/OTC derivatives.[10] By comparison, the gross domestic product of all the countries in the world was only $60 trillion.[11] Derivative financial instruments designed to hedge risk, became themselves the source of volatility.

The interconnectedness of financial markets, nationally and internationally, with the United States at the core, had increased in a short period before the crisis.[12] Capital account openness and financial market reforms led to massive increases in cross-border gross positions, especially among OECD countries. The household sector also played a central role. Most previous episodes of financial distress stemmed at least partially from problems with state borrowing (e.g., Latin America's debt crisis of the 1980s) or the corporate sector (e.g., the Asian crisis). The 2007 U.S. crisis, however, largely originates from overextended households, in particular with respect to subprime mortgage loans that were funded by private lenders who sat outside banking regulation (such as the Community Reinvestment Act) associated with securitized debt.[13] The house price boom was partly fuelled by low (short and long-term) interest rates resulting from abundant global liquidity and large demand for safe assets. The pricing of derivative instruments was often based on a continuation of

8. Barry Eichengreen et al., *How the Subprime Crisis Went Global: Evidence from Bank Credit Default Swap Spreads*, 31 J. INT'L MONEY & FIN. 1299 (2012).

9. James Crotty, *Structural Causes of the Global Financial Crisis: A Critical Assessment of the "New Financial Architecture*,*"* 33 CAMB. J. ECON. 563 (2009); Teakdong Kim et al., *Role of Financial Regulation and Innovation in the Financial Crisis*, 9 J. FIN. STABILITY 662 (2013).

10. Derivatives are financial products with value that stems from an underlying asset or set of assets; what some call "bets on bets."

11. Vladimir Popov, *Why Transition Economies Did Worse than Others in 2008-09 Recession?* (Mar. 1, 2011), *available at* http://ssrn.com/abstract=1893789.

12. Stijn Claessens, M. Ayhan & Marco E. Terrones, *The Global Financial Crisis: How Similar? How Different? How Costly?*, 21 J. ASIAN ECON. 247 (2010).

13. *See* Chris Good, *Friday Interview: Barney Frank on Congress, the Crash, Why Huntsman Is Like Dorothy in Oz*, THE ATLANTIC, Dec 9 2011, http://www.theatlantic.com/politics/archive/2011/12/friday-interview-barney-frank-on-congress-the-crash-why-huntsman-is-like-dorothy-in-oz/249750/.

increasing house prices that facilitated the refinancing of underlying mortgages. These new elements combined to create unprecedented sell-offs in the fall of 2008 and resulted in the global financial crisis.

Evidence shows that past crises often followed credit expansions triggered by financial liberalization that lacked necessary regulatory and prudential reforms to control the liberalization. The poor sequencing of regulatory reforms has also been blamed for past crises.[14] What is unusual about the current crisis is the breakdown in the effectiveness of financial regulators because of unhealthy turf competition between various supervisory agencies in some countries. Conflicts of interest by rating agencies, who were relied on by state agencies and private investors, also exacerbated problems.[15]

In other respects, the crisis was like the others. Relative wages in the financial sector (after controlling for education, experience, and other usual determinants) in recent years were equally unusually high—as high as they were only in the 1930s.[16] The exuberant pattern of asset prices in the United States and other advanced countries prior to the current crisis is reminiscent of those observed in earlier major financial crises episodes in the post-war period. The housing price boom in the United States ahead of the current crisis was, however, unusual both in its strength and duration.[17]

Governments around the world responded to the financial crisis with stimulus packages and massive bailouts of banks, costing great amounts of taxpayer funds. The total amount of stimulus in the G-20 was estimated to cost around $692 billion for 2009, which was about 1.4% of their combined GDP and a little over 1.1% of global GDP.[18] These bailouts and stimulus packages put many countries into great debt. This debt was often funded through the purchase of bonds. Between 2009 and 2010, international bond markets began to price in the growing risks associated with the debt of Greece, Ireland, Italy, Portugal, and Spain (the GIIPS). Bond markets required increasingly higher interest rates to buy debt. Eventually, these interest rates reached such high levels that they became unsustainable. The governments in question were forced to ask for support from the European Union and the IMF. These organizations obliged but made their support conditional on tough austerity programs that would enable these countries to rebalance their budgets, as well as the labor law reforms examined in this

14. Claessens, Ayhan & Terrones, *supra* note 12.

15. *Id.*; see Crotty, *supra* note 9 for a detailed description of key structural flaws in the financial institutions and practices of the neoliberal era that helped generate the current crisis.

16. Popov, *supra* note 11, at 6.

17. Claessens, Ayhan & Terrones, *supra* note 12.

18. Eswar Prasad & Isaac Sorkin, *Assessing the G-20 Economic Stimulus Plans: A Deeper Look* (Mar. 2009), http://www.brookings.edu/~/media/Research/Files/Articles/2009/3/g20%20stimulus%20prasad/03_g20_stimulus_prasad_table.PDF (for a comparative table of 2009 spending).

special number. International financial markets are unwilling to lend to them, except at very high interest rates, because they doubt their ability to produce the economic growth necessary to repay the loans. Instead, the GIIPS are left with "internal devaluation" strategies aimed at reducing prices relative to other countries, in order to make the countries more competitive and boost growth.

Except in the case of Greece, fiscal deficits are not seen to be the consequence of excessive welfare state spending or of overregulation of the labor market within countries most affected by the crisis. This begs the question, then, why the favored way out of it is the retrenchment of the welfare state and removal of the floor of social rights.[19] It cannot be justified based on factors that are understood to have caused the crisis. The answer would appear to lie in political economy dynamics rather than sound policy analysis based on explanations for the crisis and subsequent recession.[20]

A number of commentators blame rising inequality and the decline of labor's share of GDP for various policy decisions that fuelled the crisis. In his 2010 book, *Fault Lines*, Raghuram Rajan—former chief economist at the IMF—argued that rising inequality in the past three decades led to political pressure for redistribution.[21] For reasons of political expedience, this was delivered in the form of subsidized housing finance rather than through increases in real wages or other transfers. Low-income households, who otherwise would not have qualified, received improved access to mortgage finance. The resulting lending boom created a massive run-up in housing prices and enabled consumption to stay above stagnating incomes. The boom reversed in 2007, leading to the banking crisis of 2008. Other commentators have come out in support of this thesis. Nobel laureate Joseph Stiglitz argues that inequality has led to a concentration of power in the hands of the few.[22] This powerful minority use their leverage to make gains at the expense of the majority through "rent seeking." Concentration of power in private hands can be just as damaging to the functioning of markets as excessive regulation and political control. It was this concentration of power that resulted in financial regulations being reformed in such a way that allowed imprudent investment and the creation of asset bubbles.

19. Simon Deakin, *The Sovereign Debt Crisis and European Labour Law*, 41 INDUS. L.J. 251 (2012).

20. Klaus Armingeon & Lucio Baccaro, *Political Economy of the Sovereign Debt Crisis: The Limits of Internal Devaluation*, 41 IND. L.J. 254 (2012).

21. RAGHURAM G. RAJAN, FAULT LINES: HOW HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY (2011).

22. JOSEPH STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE (2012).

Another thesis is that rising inequality contributed to the crisis because it led to unsustainable consumption and debt in households whose disposable income was dropping or growing slowly. The Organization for Economic Cooperation and Development observes that growing inequality was a common trend across the advanced economies between the mid-1980s and late 2000s.[23] Labor's share of national income has fallen across most major advanced economies in the last twenty or so years.[24] Although in some countries, for example, China, India, and Brazil, consumption increased thanks to the sustained growth in household income and savings, in the United States and elsewhere, it increased thanks to the growth in household debt.[25]

This increased inequality was accompanied by a decoupling of profits and investments, as shares of GDP. In the United States since the 1980s, for example, nonresidential private investment has been decreasing while profits have been increasing (with an opposite trend in 2003). Business has not been reinvesting profit at the same rate as occurred in the post-war period. In 2006, the year before the crash, the share of recorded profits as percentage of GDP was more than four times nonresidential investment.[26] Instead of being invested, it is speculated that the profits were paid to top income earners in the form of capital income such as shares. This contributed to inequality, with top quintile wealth increasing at a far higher rate than other quintiles.

Against this thesis, some argue that the rise in inequality and pro-business policies that resulted in the deregulation of the financial industry may have been a reaction to the slowdown of economic activity, rather than its cause.[27] Empirical studies also throw doubt on the theses that inequality caused the crisis. Michael Bordo and Christopher Meissner used data from fourteen advanced countries between 1920 and 2000 to test the hypothesis that inequality causes crises.[28] They find very little evidence linking credit booms and financial crises to rising inequality. Bordo and Meissner conclude that while inequality often ticks upwards in the expansionary phase of the business cycle, this factor does not appear to be a significant determinant of credit growth once they condition on other macroeconomic aggregates.

23. OECD, GROWING INCOME INEQUALITY IN OECD COUNTRIES: WHAT DRIVES AND HOW CAN POLICY TACKLE IT? (May 2, 2011).

24. Massimo Florio, *The Real Roots of the Great Recession*, 40 INT'L J. POL. ECON. 3 (2011).

25. *See id.*

26. *See id.*

27. Daniel Ben-Ami, *Inequality a Symptom Not a Cause*, FUNDWEB (May 12, 2012), www.fundweb.co.uk/fund-strategy/issues/28th-may-2012/inequality-a-symptom-not-a-cause/105192 2.article.

28. Michael Bordo & Christopher Meissner, *Does Inequality Lead to a Financial Crisis?*, 31 J. INT'L MONEY & FIN. 2147 (2012).

This part of the Article has found that there is broad consensus that the crisis was in large part caused by financial liberalization, the spread of financial markets into previously unmarketised areas, the use of increasingly complex and risky instruments, and a failure of financial regulation. The evidence on whether inequality is a cause of the crisis is mixed. Regardless of the causes of the crisis, it is clear that the crisis and the subsequent recession have had dire consequences for labor. The evidence concerning the effect of the crisis and the recession on labor is presented in the next Part, focusing on Europe.

III. THE EFFECT OF THE CRISIS ON LABOR

Recessions leave scars on the labor market. The evidence available so far from the European crisis suggests that unemployment has grown dramatically, particularly amongst younger people and low-skilled workers. Precarious work has increased, leaving workers more vulnerable to economic shocks. The crisis has exacerbated inequality because of the variegated impact of employment adjustments imposed on the workforce.

A. Unemployment Increases and Labor Force Participation Decreases

The ILO has voiced alarm over the extent of unemployment following three years of crisis conditions. One reason the global unemployment rate continues to increase is because unemployment is a "lagging indicator." When there is an economic downturn, it usually takes several months before the unemployment rate begins to rise. Once the economy starts to pick up again, employers usually remain cautious about hiring new staff, and it may take several months before unemployment rates start to fall.

The unemployment rate in the European Union and the euro area continued to climb until early 2013, reaching values above 11% and 12%, respectively. 2013 unemployment rates are unprecedented for both the euro area and the European Union in recent history, being well above the previous peak registered after the 1993 recession.[29] The unemployment rate differs considerably from country to country and between regions. In the current European debt crisis, the countries that have preserved employment include Austria, Germany, and the Netherlands.[30] In contrast, Estonia, Ireland, Latvia, and Spain have experienced extreme employment loss. The

29. EUR. COMM'N, LABOUR MARKET DEVELOPMENTS IN EUROPE 2013 (2013).

30. In March 2012, Eurostats showed the lowest unemployment rates were recorded in Austria (4.0%), the Netherlands (5.0%), Luxembourg (5.2%), and Germany (5.6%).

Spanish market has been one of the hardest hit in the European crisis: in December 2009, unemployment rose to almost 20%.[31]

For some countries, this reduction in labor force participation was particularly devastating because it reversed growth that had been hard won after major social upheaval. For example, the crisis undid a great deal of the gains made in the Baltic States since their independence. Due to strong economic growth and migration, unemployment decreased considerably in all three Baltic States in the mid-2000s and until the beginning of the recession, unemployment rates were below the EU-27 average. While in most new Member States unemployment rates have not reached the levels of the early 2000s, the Baltic States have regressed to post-independence rates. The unemployment rate rose particularly rapidly in Latvia (to almost 20% at the end of 2009), and also in Estonia and Lithuania (about 15.5% by the end of 2009), perhaps due to labor market flexibility.[32] This labor market flexibility has not, however, resulted in fast reemployment. The share of long-term unemployed also increased.[33]

By 2012, some 35% of all jobseekers in the Developed Economies and E.U. region had been unemployed for twelve months or longer.[34] The longer people are unemployed, the more their job chances are eroded. Qualifications and skills erode over time, making it harder for firms to find the right people. This presents considerable policy challenges for reducing unemployment. Reactivating long-term unemployed and inactive workers entails considerable fiscal costs and is hard to achieve. When people have been unemployed for a long time, they often stop seeking work and stop participating in the workforce, creating a gap between unemployment figures and workforce participation figures.

B. Age Dimensions of Unemployment

Unemployment is not experienced equally across populations. In general, during crises, unemployment affects youth and low-skilled workers to the greatest extent. This may, in part, reflect the principle of last in, first out—the "seniority principle"—that has been generally applied by employers in their efforts to shed part of their labor force during recessions. In some countries, such as Sweden, it is even stipulated in the Labor Code. It also reflects the propensity of youth to be employed on temporary contracts, and the fact that employers have found it easier not to renew such contracts or to shed temporary workers.

31. WORK INEQUALITIES IN THE CRISIS: EVIDENCE FROM EUROPE 5 (Daniel Vaughan-Whitehead ed., 2011) [hereinafter WORK INEQUALITIES IN THE CRISIS].
32. *Id.* at 41.
33. *Id.*
34. GLOBAL EMPLOYMENT TRENDS 2012, *supra* note 3, at 47.

Increasing youth unemployment has been particularly marked in the three Baltic States, Ireland, and Spain, with an increase in the unemployment rate for workers below 25 years of age of 10–15 percentage points above the increase in the rate of unemployment among those above 25 years of age.[35] The labor force participation rate for ages 15-24 in the European Union was 43.71 in 2011. By way of comparison, its highest value over the past 21 years was 54.09 in 1990, while its lowest value was 43.40 in 2010.[36] Yannakourou and Tsimpoukis in this volume record that in 2010, when labor reform measures were first adopted in Greece, unemployment among fifteen to twenty-four year olds was 31.9%. By 2013 unemployment among this group was 64.9%.

Interestingly, while older workers—between 50 and 60 years of age—are traditionally a vulnerable group in the labor market, they have been less affected by employment adjustments in a number of countries. This may reflect the lower reliance on early retirement schemes, due to changes in legal retirement ages in a number of countries.

C. Gendered Dimensions of Unemployment

Women are normally worst hit by unemployment during financial crises, but the figures are mixed for the current crisis in Europe. The annual average unemployment rates for 2009 and 2010 were slightly higher for men (9.1% and 9.7% respectively) than for women (9.0% and 9.6%); in 2011, however, unemployment for males slightly declined in the EU-27, while that of women continued to increase such that the rate for males was again lower at 9.6% than that for females (9.8%).[37]

An explanation for these mixed results is that the initial impact of the crisis was felt on male dominated sectors such as construction and manufacturing. On the other hand, women employed in male-dominated sectors have often been the first to be dismissed. The reduction in employment for women later in the crisis can be explained by the fact that the second wave of job losses has been in female-dominated sectors such as the public sector.

D. Temporary and Precarious Work Increases

The crisis has led to an increase in the number of workers in precarious work. Temporary workers functioned as a sort of employment buffer in the

35. WORK INEQUALITIES IN THE CRISIS, *supra* note 31, at 7.

36. INDEXMUNDI, *European Union: Labor Participation Rate*, www.indexmundi.com/facts/european-union/labor-participation-rate (last visited Apr. 21, 2014).

37. EUROSTAT, *Unemployment Statistics*, http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics (last visited Apr. 21, 2014).

crisis. The crisis in Europe has further polarized the workforce. Workers at the periphery of the workforce have been the first to be affected by employment cuts, with the core labor force remaining protected, at least in the short term. For instance, nearly 50% of employment losses in France concerned temporary workers, and about 90% of them in Spain.[38] At the same time, part-time contracts have increased for both men and women, as a number of countries and enterprises have encouraged reductions in working hours, leading to a shift of workers from full-time to part-time work to adjust to the economic slowdown.[39]

According to the IMF, policy choices that make labor markets more flexible may have aggravated the increase in precarious work:

> [O]ne labor market policy that appears to have aggravated the pain during the recession is the dual labor market system, which was introduced to make labor markets more flexible . . . . These disparities between the permanent and temporary workforce risk becoming entrenched as the temporary workforce has less access to on-the-job training and thus acquire less human capital than their permanent peers, which in turn worsens their prospective employment opportunities.[40]

E. Reduced Wages

A decline in real wage progression has been observed around Europe, with some countries experiencing not only real wage cuts but also nominal wage cuts, as in Estonia, Latvia, Lithuania, and other new E.U. Member States. Wage declines have often been the result of cuts in working hours applied as an alternative to layoffs. Wage cuts, at least in a first phase, seem to have been more substantial in the public sector. However, budgetary cuts in public administration in most countries—as already observed in Bulgaria, Greece, Hungary, and Ireland—should lead to further wage cuts in the public sector, together with employment reductions, thereby making public employees the category that is most at risk. According to Eurofound research, in 2007, 38% of residents of the EU-28 reported that their household had between "some difficulties" and "great difficulties" in making ends meet. In 2011–2012, this proportion had increased by seven percentage points to 45%. The increase can be observed in all E.U. Member States, except Austria and Bulgaria, where the proportion of people reporting difficulties in making ends meet decreased

38. WORK INEQUALITIES IN THE CRISIS, *supra* note 31, at 5.
39. *Id.*
40. MAI DAO & PRAKASH LOUGANI, THE HUMAN COST OF RECESSIONS: ASSESSING IT, REDUCING IT 5 (Nov. 11, 2010), https://www.imf.org/external/pubs/ft/spn/2010/spn1017.pdf.

by four and six percentage points respectively. Increases were most dramatic in Slovakia, Ireland, Greece, Estonia, and the United Kingdom.[41]

F. Inequality and Poverty

Evidence collected on European countries shows that the crisis has deepened inequalities, and that certain categories of workers have been hit more than others. Currently, in advanced economies, the average income of the richest 10% of the population is about nine times that of the poorest 10%.[42] There were wide inequalities in the distribution of income in 2011. Measured as a population-weighted average of EU-28 Member States' national figures, the top 20% (highest equalized disposable income) of a Member State's population received 5.1 times as much income as the bottom 20% (lowest equalized disposable income) of the Member State's population.[43] This ratio varied considerably across the EU-28 Member States, from 3.5 in Slovenia and the Czech Republic, to at least 6.0 in Greece, Romania, Bulgaria, and Latvia, peaking at 6.8 in Spain.

Although the largest part of global increases in inequality was due to top earners "flying away" from the majority, another part was due to the so-called "collapsing bottom," where the distance between median workers and low-paid workers has increased.[44] Various studies have found that financial crises are followed by rising inequality, compared with crises related to collapse in consumption or GDP.[45] Reliable data to show the effect of the current crisis on inequality in Europe is not yet available. One reason for this is that different stages of the crisis have had different effects. Initial financial shocks resulted in losses for the top quintile, promoting equality. The effects on inequality will certainly become more critical and more visible in the long term. Initial data suggests that employment losses and wage losses in the later stage of the crisis and recession have once again resulted in increases in inequality, with considerable differences between countries. Portugal, Greece, and Italy, for example, saw increases in their net income inequality of almost one percentage point during 2010–2011.[46]

41. EUROFUND, FEELING THE SQUEEZE? PAY, WAGES AND INCOME UNDER PRESSURE (Nov. 2013), http://www.eurofound.europa.eu/publications/htmlfiles/ef1382.htm.

42. OECD, DIVIDED WE STAND: WHY INEQUALITY KEEPS RISING (2011), www.oecd.org/els/soc/49170768.pdf.

43. EUROSTAT, *Income Distribution Statistics* (Feb. 23, 2014), http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Income_distribution_statistics.

44. GLOBAL EMPLOYMENT TRENDS 2012, *supra* note 3.

45. A. B. Atkinson & Salvatore Morelli, *Economic Crises and Inequality* (UNDP Hum. Dev. Report Office Occasional Paper Series, No. 2011/6, 2011), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2351471##.

46. See EUROSTAT, *Distribution of Income by Quantiles*, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_di01&lang=en (last modified on Apr. 30, 2014), which shows inequality for each year from 2004 to 2013.

In the years since the financial crisis, the countries most affected by austerity measures—Greece, Italy, Spain, Portugal, and the United Kingdom—have seen one of two impacts: either the richest tenth of the population has seen their share of total income increase, or the poorest tenth has seen their share decrease.[47] In some cases both impacts occurred. Data also suggests alarming increases in people at risk of poverty or social exclusion.[48]

G. Long-Term Impact

Although the economic outlook for many European countries has improved, the impact of the European financial crisis is only just becoming evident for labor. Evidence from past recessions show that even after economic growth recovers, considerable pain is still to come for workers. The human and social costs of unemployment are more far-reaching than the immediate temporary loss of income. They include loss of lifetime earnings, loss of human capital, worker discouragement, adverse health outcomes, and loss of social cohesion. Moreover, parents' unemployment can even affect the health and education outcomes of their children. The IMF has warned:

> If past is prologue, the cost to those who get unemployed could be a loss in earnings not just today but persisting 15–20 years into the future; reduced life expectancy of 1 to 1.5 years; and lower academic achievement and earnings for their children. And unemployment is likely to reduce social cohesion, a cost that all will bear.[49]

These broader costs of unemployment and inequality suggest an urgent incentive to enact policy measures to ease the immediate effects of financial crisis and recession on the labor force and reduce these long-term negative impacts.

IV. POLICY MEASURES TO ADDRESS THESE PROBLEMS

The articles in this special number of the *Comparative Labor Law and Policy Journal* suggest that the emphasis has not been on easing the impact of the crisis on labor, at least in the area of labor law.

Many Member States have attempted to render their labor market more flexible by changing the rules governing atypical contracts. One popular means of doing so has been to further flexibilize the rules on fixed-term contracts by extending their maximum length. The European Trade Union

47. *Id.*

48. EUROSTAT, *People at Risk of Poverty or Social Exclusion*, http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=t2020_50&plugin=1 (last modified Oct. 17, 2013).

49. DAO & LOUGANI, *supra* note 40, at 3.

Institute has recorded changes in Greece (also from two to three years), Portugal (maximum length three years, previously six months), Spain (up to three years, from none previously, and the possibility of an additional year by collective agreement), the Czech Republic (extension from two to three years, with two renewals, yielding a total of nine years during which one can be employed on a fixed-term contract by the same employer), Romania (maximum length increased from 24 to 36 months, with three successive fixed-term contracts: the first for a maximum of 36 months and the other two for 12 months each; previously three successive contracts were allowed but with a total period of 24 months).[50] Such changes are in likely breach of the European Directive whose main objective is to prevent the abuse of successive fixed-term contracts.[51]

Another trend evidenced in the articles in this number is the decentralization of collective bargaining, giving a more prominent role to enterprise bargaining compared to national and sectoral bargaining. Examples can be found in Italy, Greece, Portugal, and Spain. In Romania, Social Dialogue Law No. 62/2011 and amendments to the Romanian Labor Code as provided by Law No. 40/2011 resulted in annual national collective agreements being abolished in favor of sectoral collective agreements.[52] Following major protests and ILO intervention, an agreement was subsequently reached to re-amend these agreements to bring them in line with ILO standards.[53] In Ireland, national-level collective bargaining and social dialogue collapsed in 2010, after the government decided on a straightforward unilateral wage cut for over 250,000 public servants.[54] Other countries have adopted more creative approaches. In Spain, Law No. 3/2012 of July 6, 2012 allows opting out from collective bargaining if the enterprise records a drop in its revenues or sales during six consecutive months, as José Luis Gil y Gil documents in his article in this number.

A further observable trend is amendments to labor codes and other labor regulations on collective and individual redundancies and dismissals aimed mainly at simplifying hiring and dismissal rules. In Greece, for example, Yannakourou and Tsimpoukis, in this number describe the introduction of Acts 3863/2010 and 3899/2010 that implemented a significant decrease in the notice period. The obligation of notice and severance pay now does not start until after 12 months of service and its

50. Clauwaert & Schömann, *supra* note 1.
51. Council Directive 1999/70/EC, 1999 O.J. (L 175) 43–48 (EC).
52. Clauwaert & Schömann, *supra* note 1.
53. Press Release, ILO, New ILO Study Urges Romania to Make Changes to Its Labour and Social Dialogue Legislation (Sept. 20, 2013), http://www.ilo.org/budapest/information-resources/press-releases/WCMS_221849/lang—en/index.htm.
54. EIRONLINE, *Ireland: Industrial Relations Profile* (Apr. 15, 2013), www.eurofound.europa.eu/eiro/country/ireland_2.htm.

duration may never exceed six months, even for employees with a lifetime of service. Portugal has likewise reduced the amount of compensation for (lawful) termination, as Monteiro Fernandes describes in his contribution to this number. Law No. 23/2012, which came into force on August 1, 2012, reduces severance pay to 20 days' pay per year of service, eliminates the three month minimum, and caps it at a maximum of either 12 months' pay or no more than 240 times the minimum wage.[55] The new regulations apply in all cases where employees are entitled to severance pay, whether redundancy is individual or part of collective dismissals. This was combined with a change in the unemployment insurance regime. Law No. 64/2012 reduced the maximum amount of unemployment insurance by a third and the maximum length of time the benefit could be paid was reduced from 900 to 540 days.

Time will tell whether these labor law reforms were the most effective means to address the financial crisis in the long term. Concern has been raised that they have already exacerbated the polarization of the workforce and existing dualism in the labor market. Given that inequality is seen by some to be a cause of the crisis, and increased inequality has certainly been an outcome of the crisis as demonstrated in the Part III of this Article, it would seem logical for measures to be put in place to increase equality and long-term economic stability. Labor law can be an important tool for reducing inequality. The changes to labor law across much of Europe documented in this special number are likely to intensify long-term unemployment and inequality rather than reduce it.

In the short term, also, they have resulted in well widespread protest and social unrest. A recent study conducted by the ILO found that in 57 out of 106 countries, the Social Unrest Index increased in 2011 compared to 2010. Europe, the Middle East, North Africa, and Sub-Saharan Africa show the most heightened risk of social unrest. On average, Latin America—where there has been a degree of employment recovery and, in a few cases, improvements in job quality—has experienced a decline in the risk of social unrest.[56] This index suggests that there are considerable dangers in continuing with austerity measures at the cost of social cohesion and the promotion of equality. As Joseph Stiglitz put it, "I hope the debate will be what are the things we can do to promote growth rather than how do we strangle each other together."[57] What are the alternatives to reforms of the type charted in this special number?

55. Maria da Paz Campos Lima, *Controversial New Labour Code Comes into Force* (Oct. 1, 2012), http://www.eurofound.europa.eu/eiro/2012/05/articles/pt1205019i.htm.

56. ILO, WORLD OF WORK REPORT 2012: BETTER JOBS FOR A BETTER ECONOMY (2012).

57. Cited by Brad Plumer, *Are There Any Alternatives to Austerity? Six Ideas for Fixing Europe*, WASH. POST, July 5, 2012, http://www.washingtonpost.com/blogs/wonkblog/post/does-europe-have-any-alternatives-to-austerity-here-are-six/2012/05/07/gIQA140g8T_blog.html.

A. Alternative Labor Market Regulation and Policy Responses

A number of organizations have proposed labor market policy tools that could be harnessed to produce job growth, to ease the effects of job shedding on the new and long-term unemployed, assist with job seeking, and distribute risk. The ILO has produced numerous papers on the topic since the European crisis began,[58] and the European Trade Union Institute has recently published its report from the proceedings of a conference titled *Getting Europe Back to Work: Alternatives to Austerity*.[59]

The ILO has proposed the following measures[60]:

Measures for Employment and Social Protection

Stimulate employment generation by:

(1) Investing public resources for infrastructure of all types;
(2) Providing additional support through credit facilities, tax reductions, and technical guidance to small enterprises in particular;
(3) Granting subsidies and reductions in social security contributions to enterprises to lower the cost of retaining workers in jobs and facilitating new hires;
(4) Retaining workers in jobs through working time reductions, partial unemployment benefits, labor cost reductions and training schemes.

Provide income support to workers and families through:

(1) Extension of unemployment benefits;
(2) Extension of and adjustments in health benefits and old-age retirement benefits;
(3) Expansion of cash transfer programs and social assistance programs.

Support unemployed and jobseekers through:

(1) Strengthening of public employment services;
(2) Expansion of training programs and facilities.

Stimulate social dialogue and consultations with business and labor on measures to counter the crisis through:

(1) National and sectoral consultations between business and labor and with governments;
(2) National and sectoral agreements between business, labor and with governments;
(3) Enterprise consultations and agreements.

It is clear that labor market institutions can play important roles in income redistribution to produce greater social cohesion. This was certainly the aim of past responses to financial crisis such as Roosevelt's New Deal, which entailed a huge suite of reforms, including new labor market institutions. In in this Article, I do not, however, wish to

58. *See, e.g.*, ILO, PROTECTING PEOPLE, PROMOTING JOBS (Sept. 2009).
59. ETUI, GETTING EUROPE BACK TO WORK: ALTERNATIVES TO AUSTERITY (Nov. 6, 2013).
60. PROTECTING PEOPLE, PROMOTING JOBS, *supra* note 58.

concentrate on possible labor market policies and regulation. I wish to point to an alternative focus for reform.

B. Financial Regulation Reform

The first part of this Article explored the causes for the United States and European financial crises. There are numerous explanations for the U.S.-led financial crisis of 2007 and the sovereign debt crisis of 2009/10 in Europe, and they rarely focus on labor regulation as the cause. This suggests that labor law reform will not address the underlying causes of the crisis. Austerity packages might help to balance accounts, which can give governments greater economic freedom to address economic shocks in the future. Labor law reform may also go some way to effecting "internal devaluation" but it will not address the longer term causes of economic instability. Thanks to early stimulus packages and sovereign debt crises, the policy space available for responding to the third stage of the crisis is currently limited. Deficit-financed public spending and monetary easing simultaneously implemented by many economies at the beginning of the crisis is no longer a feasible option.[61]

Given the broad consensus that the crisis was caused by financial markets in various respects the most important measure that could be undertaken would entail addressing gaps in financial regulation. The recent financial crisis has demonstrated the underlying infrastructural role of finance. All other sectors of advanced economies, and increasingly also emerging economies, depend on the financial system. As we have seen over the last six or so years, the successes and failures of the financial system impact entire economies.

In keeping with Polanyi's famous double movement,[62] bank and financial system crises throughout the long history of capitalism have triggered reregulation of financial markets.[63] After the Great Depression, all the advanced capitalist economies introduced restrictive financial regulatory regimes designed to minimize systemic risk from bank failures. Such regimes often included regulations that intentionally fragmented markets geographically or by financial product, and limited any individual financial institution to operating within one or a few market segments. In the post-war period, restrictive domestic financial regulatory regimes were combined with capital controls that limited international movements of

61. GLOBAL EMPLOYMENT TRENDS 2012, *supra* note 3, at 13.

62. KARL POLANYI, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME (1944).

63. ALLEN BERGER ET AL., THE OXFORD HANDBOOK OF BANKING (2009).

capital.[64] The post-war Bretton Woods international monetary regime aimed to stabilize fixed exchange rates through such controls and, when necessary, lending by the IMF) to countries that could not pay for their external debts. Following the collapse of the Bretton Woods regime in the early 1970s, and especially since the 1980s, all the advanced capitalist economies started liberalizing financial market regulation and removing capital controls.[65] This movement was a response to the widespread economic problems of the 1970s and, broadly speaking, part of a policy shift in the advanced economies toward a neoliberal economic philosophy. As we saw in the first part of this Article, these deregulatory measures brought about a dramatic transformation of domestic financial systems and the reemergence of a dynamic and rapidly growing international financial market. Layered onto this broad trend toward liberalizing markets, in the European Union, a distinct driver of financial reform in the two decades preceding the crisis was the effort to create a single market for financial services, particularly after the introduction of the euro in 1999.[66]

There was a clear turning point in 2008 with a revival of the idea that financial systems, including banking systems, could not be left to their own devices. The large economic cost of financial crises, compounded by the public expenditure that is generally a key component of their resolution, brought attention to the need for reregulation. It was clear that what was needed was the quick implementation of financial sector reforms and the setting up of an operational framework that encompasses both domestic and international financial market reforms to substantially reduce financial market volatility.[67] This would require far greater coordination between countries in the regulation of finance.

The subsequent Sections of this Article examine some aspects of the reregulation of financial markets that has occurred since 2008. There have been countless books produced since the crisis suggesting new reforms and analyzing the reforms that have occurred,[68] and far more regulatory reforms that are accounted for here. This Article only briefly outlines some of the main regulatory initiatives and comments on the reach of their ambition.

64. Richard Deeg & Mary A. O'Sullivan, *The Political Economy of Global Finance Capital*, 61 WORLD POL. 731 (2009).

65. Eric Helleiner & Stefano Pagliari, *The End of an Era in International Financial Regulation? A Postcrisis Research Agenda*, 65 INT'L ORG. 169 (2011)..

66. Nicolas Véron, *Financial Reform after the Crisis: An Early Assessment* (Bruegel Working Paper, 2012).

67. GLOBAL EMPLOYMENT TRENDS 2012, *supra* note 3, at 28–29.

68. ALAN S. BLINDER, AFTER THE MUSIC STOPPED: THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD (2013); FINANCIAL CRISIS INQUIRY COMMISSION, FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (Feb. 5, 2011); EMMANUEL FARHI ET AL., REFORMING INTERNATIONAL MONETARY SYSTEM (CEPR 2011), http://www10.iadb.org/intal/intalcdi/PE/2011/09330.pdf; Barry Eichengreen, *Implications of the Euro's Crisis for International Monetary Reform*, 34 J. POL'Y MODELING 541 (2012).

C. International Financial Regulation Coordination

One of the earliest actions taken after the crisis began was the creation of the G-20. On the face of it, the creation of the G-20 was, at least initially, a significant shift toward global decision making in the financial regulatory area. Many political leaders, particularly those from large Western European countries, heralded the need to define "global solutions" to a crisis that was described as a "global problem" as European Central Bank President Jean-Claude Trichet said at the Davos meeting in 2010.[69] Indeed, the G-20 agreements to adopt the Basel III accord or to move the clearing of over-the-counter derivatives to central counterparties were landmark instances of international joint regulatory action with few precedents in the preceding two decades. However, there have also been crisis-related setbacks in terms of the regulatory underpinnings of global financial integration. This particularly applies to the European Commission, which was a determined champion of global regulatory harmonization throughout the 1990s and 2000s but shifted markedly from 2008 toward a more unilateralist stance in many areas.[70]

G-20 leaders endorsed Basel III at the Seoul Summit in November 2010 and committed to implement it in their respective jurisdictions. The Basel Accords are a set of agreements set by the Basel Committee on Bank Supervision, which provides international recommendations on banking regulations in regards to capital risk, market risk and operational risk.[71] The Basel Accords are the primary means of international cooperation in bank regulation and their purpose is to ensure that financial institutions have enough capital on account to meet obligations and absorb unexpected losses. Despite the improvements in terms of asset categorization in comparison to Basel I, Basel II was discredited during the financial crisis for looking too closely at individual bank risk, and failing to look at systemic risks imposed on the financial sector as a whole. Basel III attempts to improve these problems by (1) requiring stricter definitions of the capital that banks are required to hold, (2) requiring banks to hold greater amounts of capital, and (3) creating not only asset, but also liquidity ratios (measuring the assets a bank can expect to sell at any time). Thus, under the third of the Basel Accords banks must triple the size of the capital reserves that they hold against losses. Yet as Martin Wolf says, "This

69. *"Global" Solution Urged at Davos*, REUTERS, Jan. 30, 2010, http://www.recorder.ca/2010/01/30/global-solution-urged-at-davos-10; see Gordon Brown's later recognition of the need for global coordination. Gordon Brown, *Let's Stick Together*, N.Y. TIMES, Nov. 30, 2012, www.nytimes.com/2012/11/30/opinion/global/gordon-brown-global-economic-problems-need-glo bal-solutions.html.

70. Véron, *supra* note 66.

71. *See* BANK FOR INT'L SETTLEMENTS, *Basel II: Revised International Capital Framework*, www.bis.org/publ/bcbsca.htm (last visited Apr. 28, 2014) for a neat timeline of the development of the Basel Accords.

sounds tough, but only if one fails to realize that tripling almost nothing does not give one very much."[72] Others have criticized requirements for bank equity holdings not only for being low but also for being imprecise, creating the risk of avoidance.[73]

At the November 4, 2011 Cannes Summit, the G-20 endorsed a comprehensive framework to reduce the risks posed by Systemically Important Financial Institutions (SIFIs) (also known as "too big to fail" institutions). This came shortly after the publication of a package of measures approved by the Financial Stability Board (FSB) to address the "too big to fail" (TBTF) problem. Financial firms are said to be TBTF when policymakers judge that their failure would cause unacceptable disruptions to the overall financial system, and they can be TBTF because of their size or interconnectedness.

Following the decisions of the G-20 and other international fora, it then lay with regional bodies such as the European Union and national governments to enact the program set out in these international agreements.

D. E.U. Arrangements

The crisis revealed a major shortcoming of the European monetary union in the absence of bank regulation at the level of the union. Banks are key mechanisms for transmitting shocks across Member States, whether through the interbank market, their holdings of neighboring countries' sovereign debt, or their day-to-day lending activities. Yet supervision and regulation of the banking system in Europe remains a national competence. As Eichengreen observes, this creates a bias toward under-regulation, and under-capitalization in particular, insofar as regulators are sympathetic to the desire of national champions to attract business from abroad.[74]

The European Union has not been a strong implementer of the third iteration of the Basel Accord. The first draft of the E.U. legislation transposing Basel III softened some of the Basel Committee's tightening of the definition of capital, and prohibited the voluntary application of higher capital requirements by individual Member States. The European Council proposed less stringent capital measures at the request of French and German governments, reflecting the on-going uncertainties these

72. Martin Wolf, *Basel III: Too Soft, Not Enough*, BUS. SPECTATOR, Sept. 15, 2010.

73. Anat R. Admati et al., *Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity Is Not Expensive* (Stanford Grad. Sch. Bus. Paper, No. 2065, Working Paper, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669704.

74. Eichengreen, *supra* note 68.

governments face as they attempt to manage the financial sector's deleveraging of sovereign bond markets.[75]

Uldis Cerps, executive director for banking at the Swedish Financial Supervisory Authority and member of the Basel Review Board, stated that the European Union risks violating international bank-capital standards and its implementing law should face a rigorous review by global regulators. He pointed out that the European Union's implementation falls short in multiple areas, from requirements applied to government debt to treatment of loans to small businesses.[76]

E. National-Level Financial Regulation

In the European Union, crisis management and legislative reform have both been continuous processes in Member States since the financial crisis began. Two countries stand out in Europe for their initiative in financial reregulation: the United Kingdom and Switzerland.

The United Kingdom has distinguished itself from other European countries with a more in-depth debate on banking structures than its E.U. peers through the Independent Commission on Banking chaired by John Vickers, which delivered its final report in September 2011.[77] However, subsequent government policy softened the Commission's recommendations. For example, in the government's first detailed response to the proposals made by former Bank of England Chief Economist John Vickers, the Treasury said that banks will only have to hold 3% of capital against total assets in line with Basel III requirements rather than the 4.06% recommended in the Independent Banking Commission report so as to make it less costly for banks.[78]

Switzerland stands out for its decision to raise capital requirements of largest banks to 19%, which goes well beyond the minimum set by Basel III.[79] Due to major risk-management shortcomings at UBS, Swiss authorities were forced to step in and provide financial assistance to the Swiss global financial services giant in the aftermath of the Lehman Brothers collapse in 2008. This event made an enduring impression on

75. Colby Mangels, *International Financial Regulation Since 2008: Why Implementation Delays of Basel III Are Likely to Persist in the U.S. and EU* (Feb. 26, 2013), http://berkeleytravaux.com/international-financial-regulation-since-2008-why-implementation-delays-of-basel-iii-are-likely-to-persist-in-the-u-s-and-eu/.

76. Jim Brunsden & Johan Carlstrom, *EU Risks Violating Bank-Capital Pact, Basel Member Says*, BLOOMBERG NEWS, Nov. 21, 2013, http://www.bloomberg.com/news/2013-11-20/eu-risks-violating-bank-capital-pact-basel-member-says.html.

77. INDEPENDENT COMMISSION ON BANKING (2011).

78. The Government response to the INDEPENDENT COMMISSION ON BANKING (2013).

79. BANK FOR INT'L SETTLEMENTS, *Regulatory Consistency Assessment Programme: Assessment of Basel III Regulations—Switzerland* (2013), www.bis.org/bcbs/implementation/l2_ch.pdf.

Swiss public opinion. In January 2014, Switzerland announced that it would raise the amount of capital banks must set aside against the mortgages they extend further, to attempt to curb the housing price bubble.[80]

In contrast, large continental European countries, such as Germany and France, were reluctant to tighten the definition of capital and impose higher minimum capital requirements in the negotiation of the Basel III Accord and in the subsequent discussion of SIFI (systemically important financial institution) or TBTF institution surcharges. A joint paper in January 2012 by Wolfgang Schäuble, German finance minister, and his French counterpart, François Baroin, called for important elements of the Basel III rules to be watered down to mitigate any "negative effect" on growth.[81]

Though important, the focus on TBTF policies has been criticized for the risk that it may lead regulators to miss the next big financial failure, which could come in the areas of shadow banking and short-term financing.[82] Innovation in financial instruments means that regulation is always playing catch up with the institutions that generate these instruments.

F. Regulating Transnational Financial Transactions

The crisis brought a sense of urgency to the challenge of regulating transnational financial transactions. Transnational financial corporations, for example, can shift risks across borders in ways that escape the oversight of national supervisors, as was illustrated by the concentration of risk in the London-based operations of AIG Financial Products, which precipitated the downfall of the entire AIG Group.[83] Moreover, when such firms collapse, the absence of a centralized resolution process creates the scope for considerable uncertainty and cross-border contagion, a striking example of which was provided by the Lehman Brothers bankruptcy in 2008.[84] Banks also act as a conduit for transmitting disturbances internationally, both

80. Neil Maclucus, *Switzerland Toughens Bank Capital Rules As House Prices Jump*, WALL ST. J., Jan. 23, 2014, http://online.wsj.com/news/articles/SB10001424052702304856504579338111483383286.

81. Alex Barker & Brooke Masters, *Alex Barker in Brussels and Brooke Masters*, FIN. TIMES, Jan. 22, 2012.

82. Elias Bengtsson, *Shadow Banking and Financial Stability: European Money Market Funds in the Global Financial Crisis*, 32 J. INT'L MONEY & FIN. (2013).

83. For a timeline of AIG's collapse see Gregory Gethard, *Falling Giant: A Case Study of AIG*, INVESTOPEDIA (Mar. 25, 2009), http://www.investopedia.com/articles/economics/09/american-investment-group-aig-bailout.asp and Shah Gilani, *The Inside Story of the Collapse of AIG*, MONEY MORNING (Sept. 23, 2008), http://moneymorning.com/2008/09/23/credit-default-swaps-3/.

84. For a timeline of the Lehman Brothers bankruptcy see Josh Fineman & Yalman Onaran, *Lehman Brothers' Corporate History and Chronology: Timeline*, BLOOMBERG, Sept. 15, 2008, www.bloomberg.com/apps/news?pid=newsarchive&sid=a63mWc3ILlTo.

when they borrow on the interbank market and when they invest in private-label securities.[85]

One option would be to move back to more fragmented national financial markets. The United Kingdom's Independent Commission on Banking, chaired by John Vickers, recommended ring-fencing the domestic retail activities of U.K. financial firms in order to more easily separate them from international wholesale activities in the event of a crisis. This raises the possibility of protecting depository operations from the consequences of international financial failures. However, it does not tackle the problem posed by cross-border failures of pure wholesale operations, as was the case with Lehman Brothers.

The Financial Stability Board, an international body that monitors and makes recommendations about the global financial system established after the 2009 G-20 London summit in April 2009, has attempted to foster coordination of contingency planning and resolution efforts for global systemically important financial institutions. It has initiated the development of common processes and tools by national supervisory and resolution authorities. However, the European experience suggests caution over the operational success of such coordination efforts. When the Fortis financial group collapsed in late September and early October 2008, preexisting arrangements among national regulators, enshrined in memorandums of understanding and other nonbinding endeavors to promote constructive cooperation, were largely ignored due to the urgency of the situation.[86] The focus quickly shifted to within-country solutions. Some policymakers, such as China's top banking regulator Liu Mingkang, have suggested the possibility that more binding international approaches to addressing this challenge should be considered, possibly through international law.[87] However, such approaches remain likely to give rise to significant political resistance and are therefore widely considered no more than a remote possibility.

One area of financial regulation that has gained support across much of Europe, even amongst Germany and France, is the financial transaction tax colloquially known as a "Robin Hood" or "Tobin" tax. This is a tax on financial transactions, which aims to dampening financial speculation and reducing the size of the financial sector, while helping to finance important development objectives and/or insuring against future crises. For example, a tax at a rate of 0.1% would be insignificant in relation to the transactions

85. Eichengreen, *supra* note 68.
86. Véron, *supra* note 66.
87. Liu Mingkang, *Financial Regulation: Why Reform Must Go Further*, EMERGING MARKETS (July 10, 2010), http://www.emergingmarkets.org/Article/2683877/FINANCIAL-REGULATION-Why-reform-must-go-further.html.

costs associated with international trade or long-term investments. On the other hand, daily transactions of $3 trillion would yield revenue of $30 billion per day, or nearly $1 trillion per year. The idea is that lead to a drastic reduction in the volume of short-term financial flows. On the other hand, revenue from a Tobin tax, while significant, would not be sufficient to replace the main existing sources of taxation such as income tax or company tax.

For many years, discussions of the Tobin tax were largely the preserve of academics or activist organizations, such as the Paris-based Association for the Taxation of Financial Transactions and for Citizens' Action (ATTAC). Following the crisis, however, French President Nicolas Sarkozy and several other government leaders endorsed the idea. The financial transaction tax (FTT) is likely to be levied at 0.1% on shares and bonds, and at 0.01% on derivatives. France, Germany, and nine other countries are pushing ahead with a European Commission proposal to impose a levy on stock, bond and derivative trades, after discussions broke down in 2012 on a European Union-wide financial-transaction tax. But at their first meeting in almost three months in November 2013, representatives of the 11 states agreed that the tax would not come into force until 2015, at the earliest.[88]

This will provide a useful experiment, but for the tax to operate effectively, it requires the participation of a far larger number of countries. Ideally, it would include all nations in the world, so as to avoid the creation of perverse incentives to set up of Tobin Tax havens. Nevertheless, the tax may provide funding for much needed pro-employment policies. If it is seen to be a success, more countries are likely join the scheme.

What can we conclude from this assessment of financial reregulation since the beginning of the 2008 financial crisis, then? Despite some positive developments, after over six years of rolling global instability, there is nothing on the horizon remotely resembling a global regulator. There is no cross-border resolution regime for failed global banks and, aspirations to the contrary, little progress toward creating one. As Barry Eichengreen warns: "If pan-European banking without a pan-European regulator is problematic, then global banking without a global regulator is more problematic still."[89]

88. Tom Fairless, *EU Financial-Transactions Tax Faces More Delays: Governments Remain Divided on Key Details*, WALL ST. J., Dec. 1, 2013, http://online.wsj.com/news/articles/SB10001424052702304579404579231730343028774.

89. Eichengreen, *supra* note 68.

V. WHY WAS RESPONSIBILITY SHIFTED TO LABOR?

Before boarding a plane on Saturday the 18th of October 2008 to meet President George W. Bush, French President Nicolas Sarkozy proclaimed, "Europe wants it. Europe demands it. Europe will get it." The "it" here is global financial regulation reform, which was seen to be necessary to stave off the spread of the U.S. financial crisis. Almost six years later, we have no new global financial order and the crisis is still thundering in Europe. Although changes to the Basel Accord are important, and initiatives like the Tobin Tax are exciting, both are a long way off a scheme of the scale of the Bretton Woods Agreement. There is no "game changer" on the horizon and no institution exists that can regulate transnational financial transactions.

Why have bolder and more global reform of financial regulation not been forthcoming instead of the dogged pursuit of deregulatory labor law reform? The financial crisis surely created an opening for the restraint of financialization with labor and middle class interest being given greater priority in policy decisions.

One reason European governments have relied on labor law reforms as a means to promote economic recovery is because the European Union restricts the policy tools available to governments in responding to economic shock. Governments that are part of the currency union cannot conduct "external devaluation" that is the standard solution to a competitiveness problem. This is normally carried out through exchange-rate devaluation, which occurs through market mechanisms in a liberalized currency system or is adjusted by central banks where the currency is set. If it were not a member of the Eurozone, Greece's currency would have devalued drastically over the period before and during the financial crisis, making its exports more attractive while making imports more expensive. Exchange-rate devaluation tends to be more effective in reducing real wage wages than nominal wage cuts, as wages tend to be sticky. A further benefit of currency rate devaluation is that it increases domestic inflation and this in turn reduces debt problem.[90]

This option is not available to members of the currency union.[91] Single currencies require all the countries in the monetary union to have the

90. Armingeon & Baccaro, *supra* note 20.

91. The treaty on the Functioning of the European Union (TFEU), in its Articles 121 et seq., provides a complex coordination procedure for the Economic Policies of the Member States. As a result of the current crisis, the European Union has considerably strengthened this procedure and has established monitoring processes for those countries that do not comply with the Union's recommendations. The same applies to the coordination of the budgetary policies of the Member States. Consolidated Version of the Treaty on the Functioning of the European Union art. 126, Sept. 5, 2008, 2008 O.J. (C 115). See the contribution by Achim Seifert to this special number, which expands on this theme. Achim Seifert, *European Economic Governance and the Labor Laws of the E.U. Member States*, 35 COMP. LAB. L. & POL'Y J. 311 (2014).

same monetary policy and the same basic interest rate, with interest rates differing among borrowers only due to perceived differences in credit risk. A single currency also means a fixed exchange rate within the monetary union and the same exchange rate relative to all other currencies, even when individual countries in the monetary union would benefit from changes in relative values.[92] By ruling out exchange-rate devaluation, membership in the Eurozone severely limits the ability of economically nonhomogenous countries to adjust. Instead, countries are left with the option of conducting devaluation through reducing unit labor costs and increasing competitiveness by other means, primarily the labor law reforms charted in this special number. Known as "internal devaluation" such measures are intended to act as a functional substitute to currency devaluation. The goal of such policies is to reduce prices relative to other countries by cutting employment and wages and by introducing structural policies aimed to increase wage and price flexibility. However, as Armingeon and Baccaro observe, "the gains in competitiveness have been marginal, and the measures taken to improve the primary balance have depressed nominal growth, which even rating agencies and market actors perceive at this point as the key indicator of long-term fiscal sustainability."[93] Internal devaluation operates at a high social cost, and it puts additional pressure on public finance by lowering the tax base in countries most affected by the financial crisis.[94]

Compared with labor law, financial regulation has low political salience.[95] Unlike labor law, which everyone seems to have an opinion about, financial regulation was rarely a topic of dinner party conversation before the crisis. Indeed, except in times of crisis, most voters—and therefore politicians—have relatively little interest in the matter. Even during crises, knowledge of the area is low and thus few ideas are circulated in the media or in public discourse. This can be attributed in part to the complex and technical nature of financial markets and regulation. As Nicolas Véron puts it, "Financial regulation is a complex thicket of highly technical policy challenges, often subject to the use of mutually

92. Monetary policy is a factor in the crisis in other respects. The tough anti-inflationary policy of the European Central Bank caused interest rates to fall in countries such as Italy and Spain, where expectations of high inflation had previously kept interest rates high. Households and governments in those countries responded to the low interest rates by increasing their borrowing, with households using the increased debt to finance a surge in home building and housing prices and the governments using it to fund larger social programs. Martin Feldstein, *The Failure of the Euro: The Little Currency That Couldn't*, 91 FOREIGN AFF. (2012).

93. Armingeon & Baccaro, *supra* note 20; see also the study by Varo & Sanchez, *supra* note 2, whose empirical work corroborates this view.

94. Wasmer, *supra* note 2.

95. PEPPER D. CULPEPPER, QUIET POLITICS AND BUSINESS POWER: CORPORATE CONTROL IN EUROPE AND JAPAN (2011).

incomprehensible jargons even as they are mutually interrelated. The devil is generally in the details, and elegant quantitative models of policy trade-offs are rarely available."[96] Low political salience facilitates a regulatory process that is very heavily shaped by regulators (technocrats). It also amplifies the influence of the industry they regulate.[97] Elected political leaders are ill placed to provide direction and other interest groups are not capable of intervening in debates in the same way as occurs in other policy areas.

At play, also, is the fact that it is intrinsically more difficult to achieve international regulatory convergence in an era of financial reregulation than in an era of liberalization. Reregulation is simply hard to do. It is easier to remove restrictions than to work out where to place restrictions in a highly technical area on which the rest of the economy is highly dependent. Reregulation is a high risk strategy. If policymakers get it wrong, the results for economic growth could be very damaging. And reregulation is made even more difficult when it requires coordination between multiple governments, many of whom are weathering the worst crisis of the last 80 years.

Perhaps the most significant reason that financial market reform of the type needed to stem the boom and bust cycle has not occurred is simply because of the power of banks and financial institutions. Jacoby calls this "deregulatory capture."[98] This power is direct, in the form of lobbying and through representation where it matters.[99] It is also indirect, associated with the capacity to influence norms and is related to fear. At a national level, the power of financial institutions has been well documented. In 2009 and early 2010, for instance, financial firms in the United States spent $1.3 billion to lobby Congress during the passage of the Dodd-Frank Act.[100] This lobbying is seen to be responsible for the weakening of legislation in the areas of derivatives trading and shareholder rights and its slow progress through parliament, and why—more than three years after Dodd-Frank was enacted—only 40% of the rules required under Dodd-Frank had been finalized.[101]

96. Véron, *supra* note 66.

97. Helleiner & Pagliari, *supra* note 65.

98. See Sanford M. Jacoby, *Finance and Labor: Perspectives on Risk, Inequality, and Democracy*, 30 COMP. LAB. L. & POL'Y J. 17 (2008) that shows that upswings in financial development are related to political pressure exerted by elite beneficiaries of financial development.

99. CHARLES R. GEISST, UNDUE INFLUENCE: HOW THE WALL STREET ELITE PUT THE FINANCIAL SYSTEM AT RISK (2005); Robin Blackburn, *The Subprime Crisis*, 50 NEW LEFT REV. 63 (2008); Thomas H Hammond & Jack H Knott, *The Deregulatory Snowball: Explaining Deregulation in the Financial Industry*, 50 J. POL. 13 (1988).

100. Deniz Igan & Prachi Mishra, *Making Friends*, 48 FIN. & DEV. 27 (2011).

101. This figure comes from Davis Polk & Wardwell, a law firm that is tracking the Dodd-Frank rulemaking progress. John W. Schoen, *Why Washington Is Failing at "Too Big to Fail" Regulations*,

It is more difficult to trace the lobbying activities of banks and financial institutions at an international level, where there is no transparency required on expenditures of this type. However, we can assume that vast sums have been spent. Equally important is the fact that labor and other interests have not had a seat at the forums that have made decisions about international regulation.

Financiers are lobbyists, and they are also norm entrepreneurs. Financial interests fund committees and think tanks to promote the idea of financial expansion and deregulation. They have encouraged a change in cultural expectations around regulation. Yet the fear of further instability may be more significant than the influence gained through lobbying activities and the promotion of deregulatory norms. Europeans are concerned about imposing heavy burdens on financial institutions when they are in the middle of a process of intense deleveraging following recent volatilities on the European sovereign bond markets. Although recently markets have calmed, European regulators remain sensitive to intensive assessments of bank balance sheets that might reveal under capitalization. Pressured with handling this delicate balance, European regulators want to give banks more time.[102] Governments are fearful of regulating finance or "punishing" the banks in case it jeopardizes fragile economic growth. As one former U.S. Fannie Mae official was quoted as saying in *The New York Times*, "I am afraid that we risk pushing these guys off a cliff and we're going to have to bail out the banks again."[103] Ironically, then, it is the perception of instability that gives financial markets negotiating leverage, when the aim ought to be to reduce instability and its harmful effects.

Wolfgang Streeck has argued that today "democratic capitalism" involves a fundamental contradiction between the interests of capital markets and those of voters or citizens. In the past, this tension has been put to one side by borrowing from the future, either in the form of public debt or private debt. The problem, according to Streeck, is that states have two sovereigns; their people *and* global markets. Politicians are increasingly being selected for their capacity to appease financial markets, rather than for their democratic credentials. According to Streeck:

> People whisperers' are succeeded by "capital whisperers" who, it is hoped, know the secret tricks needed to ensure that investors receive their money back with compound interest. Since investor confidence is more important now than voter confidence, the ongoing takeover of

NBC NEWS, (Oct. 31, 2013), http://www.nbcnews.com/business/economy/why-wash ington-failing-too-big-fail-regulations-f8C11497734.

102. Mangels, *supra* note 75.

103. Nelson Schwartz, *U.S. Is Set to Sue a Dozen Big Banks Over Mortgages*, N.Y. TIMES, Sept. 1, 2011, at A1.

> power by the confidents of capital is seen by centre left and right alike as not a problem, but as the solution.[104]

This view may sound radical, but financial analysts share it. The highly influential Cheuvreux Credit Agricole Group's political analysis section dismissed as unlikely Hollande's claim that he would stand up to "faceless" financial markets and would put in place pro-growth policies instead of austerity measures[105]:

> While shrewd from an electoral point of view, Hollande's strategy is sure to backfire once elected[,] . . . François Hollande will have to displease either financial markets or voters right after the end of the 2012 electoral cycle, as he is sure to be unable to reconcile both.[106]

The picture is not entirely bleak. The opening of multiple regulatory fronts by the European Commission successively on hedge funds and private equity, credit rating agencies, remuneration policies, short selling, regulation of audit firms, and the introduction of a Financial Transaction Tax, responds in part to a politically motivated urge to act. But rather than putting individual governments at risk of being demoted in Standard and Poor ratings, capital flight and sustained litigation, it would be simpler to put in place international and global policies and institutions that promote global economic stability. Otherwise, we risk further financial shocks and a deepening of the labor market crisis that Europe and other parts of the world are currently experiencing.

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104. Streeck, *supra* note 6, at 64–65.

105. François Hollande, President of France, Hollande Campaign Speech (Le Bourget, Jan. 22, 2012).

106. POLITOSCOPE No. 3. (Mar. 8, 2012), http://www.reporterre.net/IMG/pdf/Chevreux-Hollande.pdf (Fr.).