TUAC trade union advisory committee to the
OECD organisation for economic cooperation and development
■ CSC commission syndicale consultative auprès de
OCDE l'organisation de coopération et de développement économiques

TUAC STATEMENT ON THE ECONOMIC SITUATION
November 2007

Overview

Two central economic policy concerns that TUAC raised in consultations with the OECD Ministerial Council in May 2007 were the need to reverse the declining wage share and increase in earnings inequality throughout the OECD area and to rebalance growth among OECD regions at high levels of employment and reduce risks of a disorderly correction of trade imbalances. These remain central concerns. The declining wage share as well as rising earnings inequality has been confirmed in the OECD Employment Outlook and in the IMF's World Economic Outlook. The unsustainable imbalances in global trade, in consumption and in savings constitute a threat to economic stability. However the TUAC statement in May was made against then relatively benign overall growth prospects for the world economy.

Those prospects look increasingly uncertain following the financial crisis of the summer that is still unfolding. Through the third quarter of 2007, economic growth has been strong in the U.S. and much improved in Europe and Japan. Demand from China and other emerging markets has powered rapid growth globally. However, the sub-prime crisis in the U.S. has triggered severe tightening of global credit markets and turbulence in global equity markets which are now threatening a serious deceleration of growth in the real economy in the U.S. and beyond. At the same time the rise in energy demand has also led to oil prices approaching 100$ per barrel – a quadrupling of price since 2004. Even if the oil intensity of output has been reduced since the 1980s, this will depress demand while raising headline inflation. Given their current account positions, consumer debt levels and overblown housing markets, the Anglo-Saxon economies and some others appear to be particularly at risk of a recession or even stagflation.

TUAC is therefore particularly concerned at the downside risks to the current outlook and we are calling for a coordinated government policy response. In the near-term, because of the global implications of slowing growth in the U.S., OECD member governments must coordinate monetary and fiscal polices to assure that the, now perhaps unavoidable, re-balancing of exchange rates which up to now has involved almost exclusively the euro-dollar relationship, takes place in the context of robust growth to prevent unnecessary unemployment and continued stagnation of wages.

The United States

The Federal Reserve, along with other central banks, has responded aggressively to tightening credit markets by opening the discount window and lowering short-term interest rates. In doing so, however, the Fed has precipitated a sharp and perhaps uncontrolled decline in the dollar's exchange rate. The Fed now faces a serious dilemma. Sharply falling U.S. housing prices and stagnant wages threaten the debt-financed consumer spending that has powered the current U.S. recovery. And a falling dollar, together with rising energy prices, threatens an acceleration of domestic prices. The Fed may be faced with a painful near-term prospect of stagflation.

How the Fed negotiates this complex situation carries enormous implications for the future of growth in the U.S. but also in Europe, Japan and globally as well. Falling housing prices threaten a much broader decline of consumer spending than the decline of equity prices in 2000, a decline only partially offset by an improvement in the U.S. external account by virtue of a declining dollar. A deceleration of growth in the U.S. will be a drag on global growth as well. A falling dollar will aggravate the problem for Europe, Japan and other countries whose currencies are appreciating. And, if the dollar's decline is uncontrolled and continues to decline rapidly, it threatens to undermine global financial and economic stability.

The Euro-zone

The European Labour Network for Economic Policy (http://www.elnep.org/) which is linked to the ETUI, the Research Institute of the ETUC - issued in October their updated forecast for the Euro zone. The forecast also reflects a rather benign situation with more robust growth in 2007 of 2.5 % than forecast in the spring. Looking forward, however the update notes the less sound forecast for 2008 and the likely impact of the continuing financial turmoil. Even over the past month since the cut-off date for the forecast the assumptions look increasing optimistic with regard to exchange rates and energy prices.

In Europe the financial crisis has changed the terms of the debate on monetary policy. Where as prior to the summer the European Central Bank had been set on increasing interest rates to slow European growth, interest rates are now being kept on hold and the ECB has been injecting massive liquidity into money markets to maintain liquidity. However European trade unions are of the view that this is not enough. Past monetary tightening is already in the system and coupled with the Euro's rise and the financial shock, as well as the decline in purchasing power due to higher energy and food prices presents a picture of greater downside risks than the ECB is estimating. The ETUC has therefore called for immediate cuts in interest rates in the Euro area.

Japan

In Japan, the concerns that TUAC raised in May remain. Although growth over the past two years has recovered from the long-lasting recession, stagnant real wages and declining disposable income due to increases in tax and social security contributions by working households remain serious problems. The challenge is to ensure that growth is more equitably shared and sustainable by encouraging rising wages and incomes and domestic demand. The current nominal wages increases fall short of increases necessary to stimulate stronger household spending and domestic growth. They must be backed up by fiscal policy in support of household consumption. The Bank of Japan should for the time being shy away from further increases in interest rates that could choke off potential recovery.

Regulation of financial markets

OECD governments must also now address the lack of adequate regulation of global capital markets. The phenomenal growth derivative markets has been regarded by the OECD and most financial observers as a positive development in spreading and mitigating risk. The transformation of the US mortgage crisis in February into a global financial turmoil during the summer 2007 has shown the dangers. The growth of derivative products, such as collateralised debt obligations, has resulted in the US residential mortgage debt default being passed on to global credit markets and have served as an accelerant to the crisis. Contagion has been fuelled by the opacity of derivatives' asset price fixing and underlying risks, the highly leveraged investment strategies of hedge funds, the widespread use by banks of off-balance sheet and un-regulated 'special investment vehicles', and the absence of adequate public regulation and supervision. Short term monetary action, necessary as it is, leaves unaddressed the existence of large gaps in the regulatory coverage of global financial markets. The TUAC President wrote to the OECD Secretary General in August pointing out that the OECD was uniquely positioned to help address the many important issues posed by these new financial players and inform the discussions now underway among a number of national governments. At the May Ministerial, the TUAC called for a horizontal consultation addressing these complex and timely issues. Such a consultation, drawing on expertise from throughout the OECD, from the advisory bodies and from outside experts is more necessary than ever.