Building a sustainable economy in the post-crisis era: Why workplace institutions matter

A paper for the Chifley Research Centre

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Executive Summary

- The fact of the global financial crisis in 2007-08 invalidated many of the assumptions accepted by policymakers for the previous thirty years. Yet despite the manifest failure of the model the political terms of trade have changed very little. Parties of the right continue to extol the virtues of low taxes, light touch regulation, a small state and weak trade unions, even though these approaches created the conditions for the crisis.

- It is almost as if the cataclysm never happened. The common sense of the policy elite, certainly on the right, but to a degree on the mainstream left too, accepts that the approach to economic policy accepted before the Thatcher-Reagan revolution has little to offer by way of guidance today. Despite the claims made for the conventional wisdom, however, there is a strong case for saying that the model abandoned in the UK and the USA in the 1980s delivered superior social and economic outcomes to its more market friendly successor.

- Rates of productivity growth were *not* consistently higher in the post reform period. Increases in income inequality generally followed an attack on trade union bargaining power and big tax cuts for the better off. By the early 1990s in the UK wage growth had become disconnected from productivity growth for workers at median earnings and below – a phenomenon that began in the USA in the 1970s.

- Weak wage growth led to an increase in household indebtedness as people sought to maintain their living standards with their relative wages shrinking. A deregulated financial system repacked these debts into increasingly exotic derivative instruments and a small minority of financial services professionals made a great deal of money. The tower of debt collapsed, with devastating consequences for the global economy, when debtors began to default on their repayments. Far from managing these risks more effectively, the deregulated banking system spread the contagion across the world.

- The task for those on the left is to learn from the mistakes of the past and recognise the strengths of the post-war consensus too. The good social outcomes in that period rested on three pillars: the government's commitment to maintain full employment; a redistributive welfare state; and, the presence of strong labour market institutions (notably trade unions), which ensured a reasonably equitable distribution of incomes before the intervention of the tax and benefits system. The American scholar Jacob Hacker has described this third pillar as supporting "predistribution" rather than redistribution – the function of the second pillar. The challenge is to build a similar model of inclusive prosperity in the twenty-first century.

- Australia wisely avoided the worst excesses of the pre-crisis boom. There are still reasons to be worried, however, not least the high level of household indebtedness, rising income inequality and weakening institutions of predistribution – trade union membership and collective bargaining coverage is now comparable to the UK.

Why does inequality matter?

- At the core of the argument in this paper is the belief that rising income inequality is a source of economic instability. That is the clear conclusion of a series of papers produced by the research department of the International Monetary Fund (IMF). Moreover, there is strong evidence to support the argument that redistribution, far from constraining growth as the pre-crisis orthodoxy maintained, can boost growth by maintaining the purchasing power of the least well off, ensuring that there is sufficient aggregate demand in the economy.

- Research by the Organisation for Economic Co-operation and Development (OECD) confirms that lower inequality is good for growth and that trade unions have the effect of reducing wage inequality. In the right circumstances it can be argued with conviction that strong and responsible trade unions are good for growth.

- There are two further reasons of principle why those on the left should care about inequality. First, in unequal societies there is a yawning chasm between the life chances of the rich and those of the poor. In all societies those with higher incomes have better health and longer life expectancy than those with fewer resources, but the gap in health outcomes between rich and poor is significantly wider in more unequal societies. This is inconsistent with any commitment to the notion of social justice. It means that not all human lives are seen as equally valuable and it is difficult for some citizens to acquire the capabilities they need to choose lives that they value.

- Second, in unequal societies the rich are better equipped than the majority of citizens to influence the political process. This influence can be secured either through individual donations to political parties or through the activities of corporate lobbyists who have a vested interest in maintaining the status quo on their clients' behalf.

The weakening of labour market institutions

- It was an article of faith amongst market fundamentalist thinkers that trade unions were damaging to productivity, enterprise and national prosperity. Often these views were inconsistent with the realities, simply because some countries with very high levels of union membership (notably the Nordics) performed just as well as more liberal economies over a prolonged period. A deliberate assault on British unions took place under the Conservative governments of Margaret Thatcher and John Major. John Howard's government in Australia adopted a similar approach.

- Many of the problems in the UK labour market are a result of this institutional revolution. Low pay is widespread (more than one in five workers is low paid), since the early 1990s pay growth has become disconnected from productivity growth, there is a real problem of unfairness in the workplace and many workers are "disengaged". In addition, the UK has a real problem in securing high rates of productivity growth, principally because of management styles and workplace cultures.

- This is not the path to the almost universally shared ambition of a high pay-high productivity economy. Much of the innovation driving productivity growth is incremental, small-scale, but cumulatively very important. It depends on workers demonstrating commitment to their employer's business, but that depends on trust and on workers being treated as people rather than an intractable factor of production. In many countries in the English speaking developed world workers surrender their rights as citizens at the point they cross their employer's threshold.

- The task for the left is to revive the idea of industrial democracy, rooting our arguments for fair treatment in the notion that people are citizens-at-work. The rights that we value in a democracy – to speak freely, to associate with people of like mind, to be confident that decisions affecting our lives have been justified and legitimised - are just as relevant at work.

Rebalancing the power relationship?

- It is impossible to develop this notion of workplace citizenship without ensuring an appropriate balance of power between workers and their employer. That means that some consideration has to be given to rebuilding the predistribution pillar of the post war settlement. Inevitably there will be variations across countries, just as there were in the post-war period – the British taste for free collective bargaining and the Australian enthusiasm for the Award system are at opposite ends of the spectrum. Whatever the specifics, however, there are three principles that must be observed:

    - The balance of power between capital and labour is a legitimate matter for public policy intervention.
    - Achieving an effective level of predistribution is necessary if the redistributive efforts of the state are to be seen by citizens as legitimate and deserving of political support.
    - Giving workers voice and influence in the workplace is essential for reasons of fairness and productivity. A model of the employment relationship based on command and control is unlikely to deliver the sustained innovation that employers say they want.

- For most of the past thirty years an account of this kind was seen either as absurdly radical or as a form of political nostalgia. Recent comments from the IMF and the OECD suggest that the concern about inequality and fairness in distribution is now accepted as legitimate by policy elites. This creates a great opportunity for the left to reunite the politics of production and distribution, forging a new economic model that offers both sustainable growth and inclusive prosperity in the future.

Building a fair and sustainable economy in the post-crisis era: Why workplace institutions matter

Introduction

In his now somewhat notorious evidence to the House of Representatives in 2008, Alan Greenspan, former chair of the US Federal Reserve, recognised that for much of his professional life he had held beliefs that proved to be false:

> *I made a mistake in presuming that the self-interests of organisations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms…This modern risk management paradigm held sway for decades…the whole intellectual edifice collapsed in the summer of last year.*

This could be read as a practical example of the maxim often attributed to John Maynard Keynes: *when the facts change I change my mind. What do you do sir?* But in confessing to an intellectual error Greenspan was also declaring that the worldview of the political right (and much of the centre) had been comprehensively invalidated by the financial crisis.

The British commentator Martin Wolf has gone further in arguing that the crisis represented a catastrophic elite failure (Wolf 2014). Policymakers did not understand that the growing trade in exotic financial derivatives created unquantifiable systemic risks. Bankers were discredited by their behaviour – gambling dangerously with other people's money and reaping unjustified rewards. Intellectuals failed to either foresee the crisis (with some notable exceptions) or agree on what should be done to restore the economy to health. Politicians were blamed for creating the conditions that caused the crisis and for rescuing the banks, however necessary that may have been.

One might have thought that the fact of the crisis would inspire some reconsideration of the dominant policy consensus of the previous thirty years. This consensus went well beyond the role of financial markets and the desirability (or otherwise) of regulation and included a very clear view about the role (and size) of the state, the foundations of productive enterprise and the role of institutions in economic governance. Put rather crudely, the pre-crisis conventional wisdom recommended light touch regulation, low taxes, weak welfare states, flexible labour markets and coercive approaches to the unemployed.

These ideas were initially associated with Margaret Thatcher and Ronald Reagan and were presented as a deliberate alternative to the post-war consensus, which, until the middle 1970s, had proved successful at delivering widely shared, and rising prosperity. The model rested on three pillars: the management of monetary and fiscal policy to achieve and sustain full employment; a redistributive welfare state; and, the presence of labour market institutions that achieved a fairly equitable distribution of incomes before the intervention of the tax and benefit system.

In recent times the American scholar Jacob Hacker has pointed to the importance of what he calls "predistribution" as a necessary condition for both fair societies and legitimate welfare states. If the initial distribution of incomes in the market is fairer then the state has less to do through income transfers to the poor. There is less resistance to taxation simply because taxes are lower. The state has to do less heavy lifting. In other words, predistribution depends on labour market institutions being effective and the pre-crisis paradigm was predicated on a weakening of these institutions.

What is "predistribution?
When we think of government's effects on inequality, we think of redistribution – government taxes and transfers that take from some and give to others. Yet many of the most important changes have been in what might be called pre-distribution – the way in which the market distributes rewards in the first place. Policies governing financial markets, the rights of unions and the pay of top executives have all shifted to favour those at the top…The moral of this story is that progressive reformers need to focus on market reforms that encourage a more equal distribution of economic power and rewards even before the government collects taxes or pays out benefits…The regulation of markets to limit extremes and give the middle class more voice is hardly easy. But it is both more popular and more effective than after-the-fact mopping up. (Hacker 2011)

The purpose of this paper is to explore these arguments in greater detail, referring specifically to the UK and Australia, recognising that the principal strategic objective of progressives and social democrats must be to develop and implement a new model of inclusive prosperity.

The political challenge
All of this is very easy to write, but much harder to achieve in practice. One consequence of the crisis has been a general disenchantment with mainstream political parties and the rise of a disturbing anti-political cynicism. This can be seen in the fracturing of historic loyalties, the rise of right-wing populism and nationalism (the Tea Party in the USA, UKIP and the Scottish National Party in the UK, the National Front in France, the Sweden Democrats) and an emerging populism of the Left (Syriza in Greece, Podemos in Spain).

In Europe social democrats and progressives have struggled to respond effectively to these challenges. In part this is a consequence of the modernisation processes that many parties went through in the 1990s. An accommodation was reached with the market friendly consensus, principally for reasons of electoral expediency. New Labour, for example, was founded on the belief that a party of the centre-left could not win an election in an essentially conservative country like the UK unless it embraced the interests of business and made clear that the central elements of the post-Thatcher settlement would remain intact. Since 2010 this has made it especially difficult for the party either to articulate a critique of the immediate pre-crisis period when Labour was in government, or offer a compelling vision of the country's economic future, despite Ed Miliband's best efforts to do so[1].

Seven years since the collapse of Lehman Brothers, the arguments between conservatives and those on the centre-left seem to have changed very little in either the US or the UK. Yes, there has been some reform of banking regulation and yes the financial sector is subject to much greater scrutiny – witness the recent travails of HSBC in the UK, where the Swiss division of the bank has been accused of promoting aggressive tax avoidance for British citizens. But the fundamental terms of trade between left and right remain the same. For conservatives it is axiomatic that smaller government is better government, that markets, if they require regulation at all demand only a light touch, that weak trade unions and

[1] Ed Miliband was elected leader of the Labour Party in September 2010. He has made a commitment to responsible capitalism the lodestone of his leadership – although the specifics are not always entirely clear.

declining collective bargaining coverage are hallmarks of an efficient economy and that government works best when it gets out of the way of business.

The political challenge for progressives and social democrats can best be summarised in four simple questions: Why is the world the way it is? What's wrong with it? What should we do about it? Why should the voters trust us to get things right in the future?

The crisis: causes and consequences

The origins of the crisis lie in the paradigm shift in public policy that occurred in the 1980s. This was a reaction to the supposed policy failures of the 1970s. For those on the right, demand management policies, far from fine-tuning the economy to deliver full employment, created inflationary expectations that initiated a wage-price spiral. Welfare states required punitive levels of taxation that sapped incentives and weakened enterprise. Trade unions were coercive agents, compelling workers to take action against their own best interests, making it almost impossible to run businesses profitably. This analysis was always partial (emphasising the bad over the good) and essentially ideological. Growth rates after the Thatcher-Reagan revolutions were no better than in the immediate post-war era and social outcomes considerably worse. Supply-side, Voodoo Economics in the USA did nothing more than push up the Federal government's deficit and further enrich the already wealthy at the same time.

The last thirty years in the USA and the UK could be seen as a natural experiment, testing these ideological principles to destruction. Liberalising financial markets in the 1980s and 1990s did lead to a great deal of innovation but it was innovation that proved to be "socially useless", in the words of Adair Turner, former chair of the UK's Financial Services Authority (Turner 2009). Easy credit led to lots of reckless lending to consumers, who were more than happy to borrow because the decline of trade union bargaining power had led to weak wage growth. For many households greater indebtedness was the only way to maintain or improve living standards.

It is here that the tangled roots of the crisis are to be found. A misplaced faith in the wisdom of markets collided with monetary policy mistakes and labour market deregulation to produce a toxic cocktail that almost destroyed the global financial system. Colin Crouch has described the pre-crisis model as a form of privatised Keynesianism, where rising household debt rather than government borrowing compensated for what would otherwise be seen as a deficiency of effective demand (Crouch 2011). Eventually of course the music had to stop. In the UK and the USA falling house prices and rising interest rates were the rock on which the market fundamentalist ship foundered. And as consumers defaulted on mortgage and credit card payments the tower of exotic financial instruments came tumbling down.

Australia wisely managed to avoid most of the worst excesses of the pre-crisis boom. The financial services sector played (and continues to play) a smaller role in the economy, Chinese demand for resources continued after 2008 and a domestic stimulus was administered by the Labor government elected in 2007: the GFC may have been global, but its effects in Australia were muted.

Nonetheless, there are still reasons to believe Australia shares common characteristics with economies more severely affected by the crisis. For example, the level of household indebtedness is very high, running at 166% of GDP in 2013 according to the McKinsey Global

Institute - the comparable figure for the UK was 134%, which is generally regarded as a threat to stable growth (McKinsey Global Institute 2015). Income inequality has also been rising, albeit more slowly than in some other major OECD economies. The balance of power between capital and labour has shifted decisively in capital's favour; trade union membership and collective bargaining coverage have both fallen significantly in the last twenty years. Jacob Hacker's institutions of predistribution have been seriously weakened.

So what are the problems?

1. Growing income inequality

For those on the right, it is a matter of no concern at all that the gap between the rich and the poor has grown. So long as absolute incomes at the bottom are rising there is little to worry about[2]. This is both complacent and ignores some uncomfortable facts. According to an IMF research paper, the years from 1920-29 and 1980-2008 both witnessed a large increase in the income share of the rich and an equally large rise in the indebtedness of those on lower incomes (Kumhof and Ranciere 2010). The end of both periods saw a global financial crisis and throughout both periods there had been a decline in workers' bargaining power. According to the IMF researchers there are two possible strategies to halt and reverse the trend (and therefore prevent further crises): improving the effectiveness of collective bargaining to ensure that workers get their fair share of the fruits of growth; and, redistribution by the state through the tax and benefits system to improve incomes at the bottom.

More recent work by the IMF research department has confirmed that redistribution *can* have a positive effect on growth, contrary to the assumptions of the market fundamentalist model (Ostry, Berg and Tsangarides 2014, Berg and Ostry 2011). Three central conclusions emerge from this work. First, more unequal societies tend to redistribute more, endorsing the argument that predistribution matters and highlighting that even those countries apparently relaxed about inequality take some action to modify market outcomes. Second, lower inequality drives faster growth for a given level of redistribution. Third, redistribution has a benign impact on growth. Only in extreme cases are the effects of redistribution negative for growth.

The OECD has also undertaken a comprehensive analysis of recent inequality trends, recognising that the extent of social distance matters for reasons of economic stability and social cohesion. They have investigated the impact of institutions of predistribution (notably trade unions) and produced the following key findings (OECD 2011):

- Trade unions have the effect of reducing wage inequality and this effect is strongest where union membership and coverage are high and where bargaining is centralised, with national agreements at sectoral level and co-ordinated bargaining across sectors.
- Declining union coverage rates (falling collective bargaining coverage) have the effect of increasing wage inequality

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[2] Some Conservatives would probably argue that they do care about poverty. Who after all could be in favour of destitution? But they are supremely relaxed about inequality. For more extreme conservatives relieving destitution is a task for private and charitable endeavour – efforts that can be blunted by the role of the state. On the other hand, inequality may have reached a level in some countries that it cannot be ignored. David Cameron expressed such sentiments before he became prime minister, although his government has made the situation worse.

- Countries with weaker employment protection legislation generally experience higher levels of wage inequality – this is almost entirely a result of the way in which temporary work is regulated.
- Lower taxes on incomes may increase the dispersion of wages because they attract more low-paid, low skilled workers into the labour market.
- Higher benefits for the unemployed are associated with lower wage inequality. This is because the generosity of benefits affects the reservation wage of those at the bottom of the earnings distribution – they will want to be confident that they are earning more from work than they will receive in benefits.
- Countries with more liberal product markets tend to experience higher levels of wage inequality.
- Higher minimum wages reduce wage inequality.

We should not to get too carried away by these results, not least because they are average effects across the developed world. Moreover, the OECD itself has not abandoned the notion that some of the measures promoting greater wage equality may also have the effect of reducing employment opportunities, especially for the most disadvantaged groups.

The important point here it to recognise the complementarity of policies. For example, the Nordic countries are open economies with strong competition policies and liberal product markets but remain amongst the most egalitarian in the developed world. Denmark has a low level of employment protection legislation, no minimum wage, high union membership and wide collective bargaining coverage.

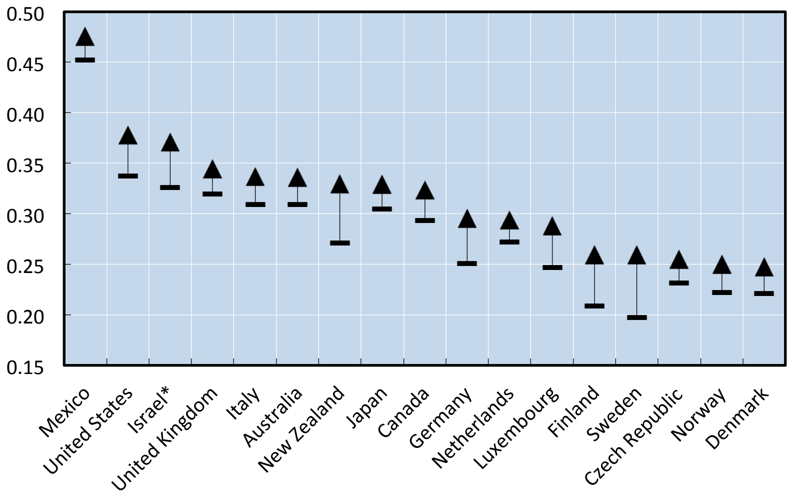
A comparison between these results and the situation in Australia and the UK is also instructive. Both countries witnessed significant increases in income inequality on the Gini coefficient measure in the period 1985-2008 (Figure 1)[3]. While it is true to say that inequality increased in most developed countries (with the exception of France and Belgium), both Australia and the UK started with a higher level of inequality and the most affluent in both countries saw their incomes rise significantly by the end of the period. The social distance between rich and poor was greater in only two other major developed countries – Italy and the United States.

As Thomas Piketty has pointed out in his monumental *Capital in the Twenty-First Century*, these trends are not entirely surprising, since the returns to capital generally exceed the growth rate of the economy – meaning that the rich can race away from the majority of citizens, particularly when growth rates are low (Piketty 2013). Changes to the taxation of top incomes are also relevant here. The pre-crisis conventional wisdom suggested that allowing the rich to enrich themselves further would benefit society as a whole. As Joseph Stiglitz has argued, social norms have also been reshaped over the last thirty years to support the belief that high earners deserve their rewards because of their unique contribution to corporate success (Stiglitz 2012). There is also a strong case for saying, as Piketty argues, that some of the increase in income inequality can be attributed to the growth of a class of super-managers who can determine their own rewards without challenge from shareholders. This is obviously a problem and is especially acute in the USA

[3] The Gini coefficient is the standard measure of income inequality recorded on a scale of zero (everybody has an equal income) to one (one person has all the income and everybody else has nothing).

but the trend is not consistent across all countries. What is euphemistically called executive compensation remains somewhat lower in Europe and significantly lower in Japan.

Figure 1: Inequality rising in most OECD countries 1985-2008 (Gini coefficient)



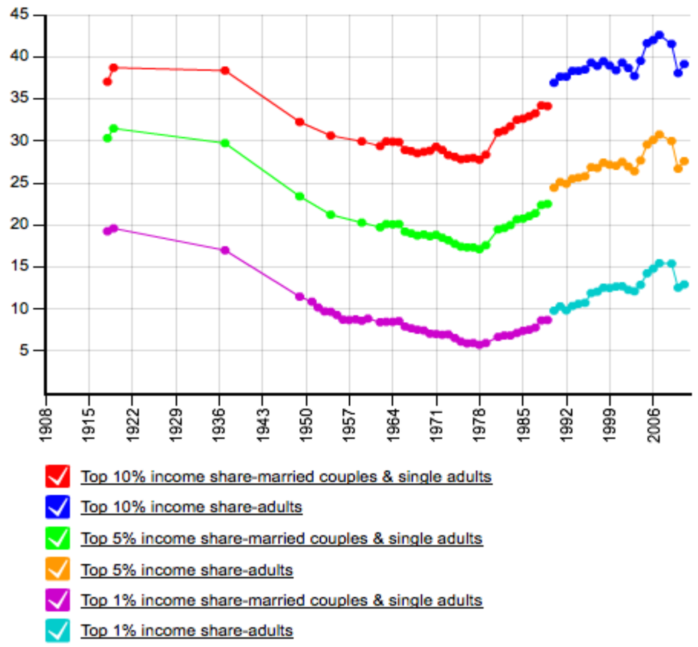
Source: OECD database on household income distribution and poverty

The consequence of these three trends has been a concentration of income at the top of the distribution in the UK, counteracting a movement towards greater equality that could be observed from the early twentieth century through to the late 1970s. A similar and more pronounced pattern can be seen in the USA, where a great compression took place from the Great Depression through to the 1970s. What is most remarkable, perhaps, is that the highest earners (the top 10%) saw their share of total income remain at historically high levels *despite* the crisis. Certainly, there was a small drop in the income share in 2008-09, but given the severity of the downturn that was predictable. Most importantly, perhaps, top income shares have recovered rapidly.

The position in Australia is not quite as bad. The top ten per cent of earners consume just over 30 per cent of total income as compared with close to 40 per cent in the UK. Nevertheless, the trends of compression and divergence are clearly visible even if they are not quite so marked. Australia is a more egalitarian society than either the USA or the UK but appears to be on a similar trajectory.

It is sometimes argued that these trends are an inevitable consequence of globalisation and technological change. Competition from the developing world (notably China) and the increasing returns to higher level skills in developed countries have led to an unavoidable increase in inequality. From the standpoint of a centre-right politician, rising income inequality is the entirely reasonable price to be paid for progress. But if this argument were right then one ought to be able to observe similar levels of inequality across the developed world. Technology is ubiquitous and markets increasingly open and integrated, yet the patterns of inequality are by no means uniform. In Denmark the process of compression has not been reversed at all and, as Piketty has argued, the growth of large incomes at the very top (the top 1% and 0.1%) is a phenomenon restricted to the developed English-speaking world.

Figure 2: Top incomes in the UK 1908-2011 (% total income)



Source: World Top Incomes Database

The only conclusion one can draw is that national policy choices still matter despite the supposed effects of globalisation. Moreover, the OECD's work shows that trade openness has *not* been a significant driver of wage inequality (OECD 2011). On the other hand they do endorse the argument that skill-biased technical change has fuelled the rise in inequality, but this finding is hardly consistent with the differences between countries. For example, the biggest increases in income inequality in the UK took place in the 1980s, long before the advent of the Internet or the widespread use of information and communication technologies. At the same time, the rhetoric about competition from developing countries simply did not feature in the public conversation– and with good reason; China was only just emerging from Maoism, India was still labouring under the constraints of the licence-permit Raj, Brazil was a military dictatorship until 1985 and Russia was still the Soviet Union.

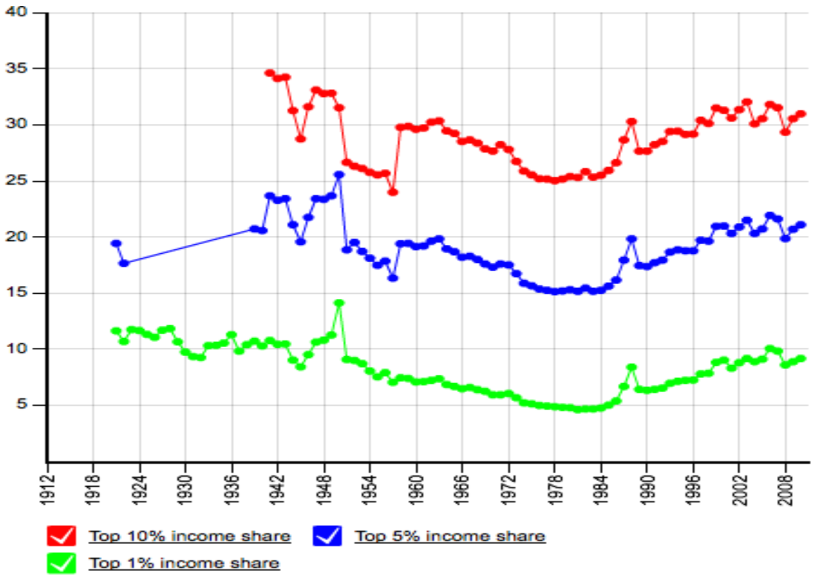
Of course, the big increases in income inequality in the UK in the 1980s (which have not been halted and reversed since) did coincide with the abandonment of full employment as an objective of public policy, a deep recession, a step-by-step programme of labour market reform designed to disempower trade unions, big reductions in taxes for the highest earners and the liberalisation of financial markets. Far from being economically determined, the rise in inequality in the UK was a result of deliberate political choice.

The importance of political choice can be seen too in a comparison of the income shares of the top ten per cent in Sweden and the USA (Piketty 2013). In Sweden the top ten per cent take just over 25% of income, whereas in the USA the top ten per cent share is almost 50% of income[4]. This difference cannot be explained by either technological change or trade openness – not least because Sweden is a more open economy than the USA. The best

[4] See piketty.pse.ens.fr/capital21c

explanation must lie in the differences in institutions and social norms and the way in which institutions both entrench and reshape these norms. In other words, power matters and achieving a better balance of power between labour and capital ought to be a priority for social democrats and progressives.

Figure 3: Top Income Shares in Australia 1912-2010 (%total income)



Source: World Top Incomes Database

So far, the arguments made for the reduction of inequality have been instrumental or consequentialist, focused on economic outcomes and the prospects for stable, sustainable growth. But there are two more profound arguments of principle that demand attention.

First, inequality can corrupt the political process by giving the wealthy undue influence over policymakers. Rich individuals can, putting it crudely, use their money to determine public policy[5]. Corporations can also afford battalions of lobbyists to maintain the status quo and defeat the manifesto commitments of governments. The phenomenon is obviously most developed in the USA, but can also be seen in the UK and in Australia, where the travails of Labor's emissions trading scheme are a case in point.

That the affluent can determine policy is particularly troubling at a time when there is a rampant anti-politics mood in many developed countries. Influence peddling of this kind discredits the political process and is wholly inconsistent with democratic values. Sources of countervailing power (most notably the trade unions) have been diminished over the last thirty years. It is not entirely fanciful to say that the populist tendencies emerging in many developed countries are the unforeseen consequence of market fundamentalism. Nevertheless, the challenge is to all political elites, including those of the centre-left. Recognising the need for need for inclusive prosperity and the wider distribution of power is essential for democratic renewal and electoral success.

Second, there is compelling evidence to show that more unequal societies offer more limited life chances for poorer citizens. Those with lower incomes generally die younger

[5] The British Conservative Party now raises most of its funds from rich donors in the City of London.

than the rich in all societies and enjoy worse health throughout their lives. In more equal societies, however, the gap in health outcomes and life expectancy is much narrower (Marmot 2004, Wilkinson and Pickett 2009).

The impact of inequality on life chances raises some profound questions about the left's political goals. It is simply inconsistent with our values to allow health inequalities to limit the capabilities of citizens to choose lives that they value. Social democracy's purpose is to use the power of collective action, whether through the state or civil society organisations, to liberate individuals and widen the range of choices available to them. Acting to reduce inequality is central to the meaning of social democracy.

No doubt a conservative critic will question the validity of equality as a goal, arguing that as ever the left is in favour of some grey uniformity or equality of outcome. That is certainly not the case made in this paper. Some income inequality is necessary to create incentives and reward effort; trade unions have always maintained, for example, that workers should get the rate for the job and that differentials should be felt to be fair. But neither principle endorses the current level of income inequality in either the UK or Australia. Nor is it the case that more equal societies have worse economic performance. The Nordic countries remain a practical example to the contrary. In other words, it is possible to choose to have less income inequality than is found today in the major English speaking countries of the developed world.

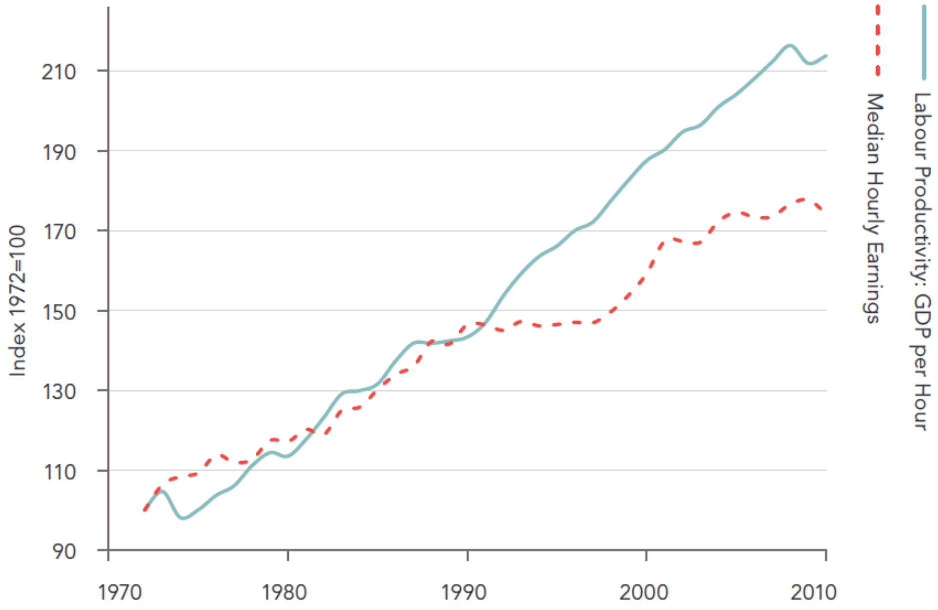
2. *Wage stagnation*

Another important feature of the pre-crisis conventional wisdom was a belief that wealth would trickle down from the rich to those with lower incomes. So far as the UK is concerned this has proved not to be the case. Neo-classical economics tells us that wages ought to grow in line with productivity and the importance of productivity growth as an objective of public policy is shared across the political spectrum. As Paul Krugman noted more than twenty years ago, productivity isn't everything, but it's almost everything. Unless employers are becoming more efficient in their management of people and resources then the economy will not grow and incomes will not rise.

Unfortunately, it cannot be assumed that productivity growth necessarily leads to a fair distribution of rewards. We have already recorded that those at the top have seen their share of national income increase over the last 25 years. The corollary of this phenomenon is that those in the middle of the income distribution and below in the UK has seen their pay consistently lagging behind increases in productivity. The break in the historic trend took place in the early 1990s, at which point the Thatcherite reconstruction of the labour market was complete.

Over the last decade or more wages have stagnated for those on median earnings and below, with many workers experiencing real terms pay cuts. The extent of the pay squeeze is revealed in the uncomfortable fact that real living standards have fallen consistently since the crisis and average earnings are lower in real terms today than they were in 2002-03. One of the reasons why employment remained buoyant through the recession was that wages proved to be not at all sticky downwards. Rather than making people redundant to cut labour costs, employers simply cut real levels of pay. This is hardly an indicator of economic success and also helps to explain (alongside the UK government's over-enthusiastic austerity programme) why domestic demand has remained relatively subdued, supported principally by further increases in household indebtedness. The recent falls in commodity prices may help a little, but the UK economy is hardly a beacon to the world – and it has profound structural problems too, particularly the persistence of low pay and in-work poverty[6].

Figure 4: Median earnings and productivity growth in the UK 1970-2010



Source: Resolution Foundation 2011, Pessoa and van Reenen 2011

The story can be told quite simply. From the early 1990s onwards workers in the middle of the labour market and below lacked the bargaining power to secure their fair share of the fruits of growth. This imbalance of power was exacerbated during the crisis and, while there has been some modest wage growth in recent months, it would be unwise to believe that the pre-crisis trend has been halted and reversed. Unless further action is taken then the likelihood is that income inequality will increase further when the economy does return to a (relatively) stable growth path.

One could read this data as a vindication of the IMF's analysis that bargaining power matters and policymakers ignore that principle at their peril. What is most striking about the UK, perhaps, is that the most revolutionary consequences of Thatcherism are to be found in the labour market. The Conservative governments of 1979-97 were class warriors to the extent that they empowered capital and disempowered labour. How much of this shift was a consequence of government policy and how much a result of structural change in the economy is the question to which we now turn. This is a critical issue for the left, principally because the analysis of these trends will influence the construction of policy in the future. Is it possible for policymakers to devise (or support) new approaches that restore some balance in the world of work? How much responsibility should be borne by governments and how much by independent civil society institutions?

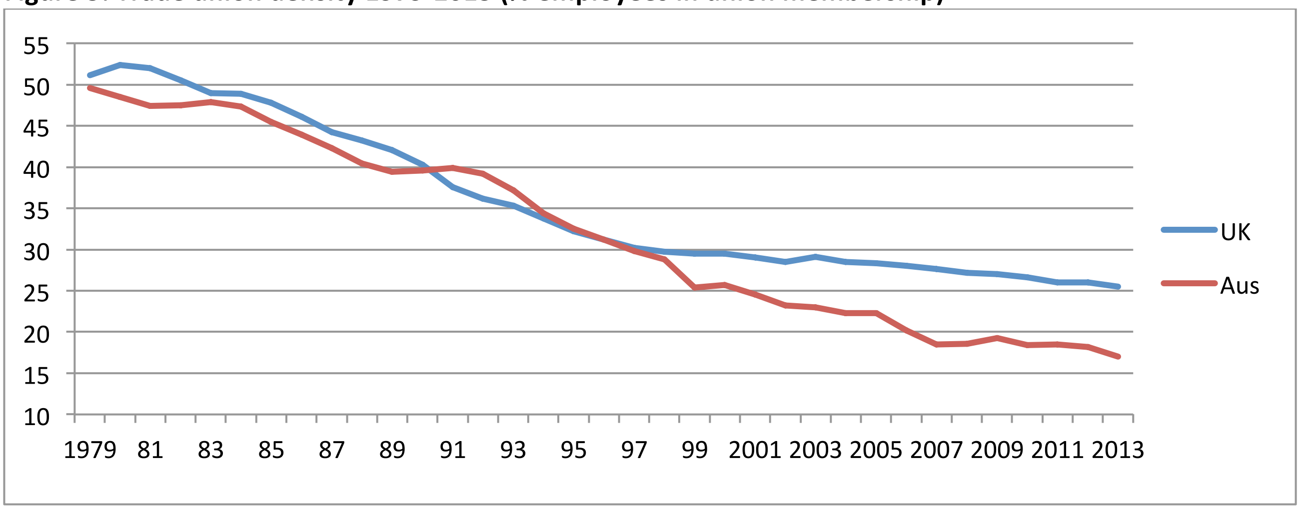
[6] Paul Krugman has likened the UK government's austerity policies to hitting the economy on the head with a baseball bat for three years (cricket bat might be more culturally appropriate) and then stopping. Obviously everybody has less of a headache, but may not be healthy in the future. The Conservative Party's fiscal plans for the next parliament indicate that the rain of blows will begin again very soon and continue until the 2020 election.

3. *The decline of trade unions: the extent of labour market reform*
Both the UK and Australia went through a significant period of labour market reform in the 1980s and 1990s. In Australia the process continued into the 2000s, with the Howard government's *Work Choices* legislation and its replacement by Labor's *Fair Work Act* in 2009. From the early 1980s to the mid-1990s, however, the ideological inspiration for reform and the policy goals sought looked very different. The Hawke and Keating governments still viewed trade unions as indispensable institutions of economic governance. Reforms to the award system and the introduction (or expansion) of enterprise bargaining all took place under the umbrella of the Accords. Certainly, the objective was to move to a more market driven system of wage formation, but circumscribing the legitimate role of unions was not the objective at all. And even under the new enterprise bargaining arrangements the award system continued to fix minimum labour standards.

The Thatcher and Major governments in the UK took a very different view, with the explicit objective of undermining the role of collective bargaining. To begin with, wage floors in the public sector supply chain were removed, through the rescission of the 1946 Fair Wages Resolution and the denouncing of ILO convention number 94 on labour clauses in public contracts[7]. Measures to promote the extension of collective agreements through a system of unilateral arbitration were repealed and a step-by-step programme of labour law reform gradually abolished the closed shop, restricted the freedom of unions to take industrial action and subjected unions' internal democratic processes to statutory control. Trade union defeats in iconic industrial disputes (the miners' strike of 1984-85 and the print workers' strike in 1986) weakened union bargaining power further.

Most interesting for the purposes of this discussion, however, is that the trajectory of trade union membership looks very similar in both countries, despite the very different ideological stances and policy goals. The coverage of collective agreements has also fallen over the same period, with the OECD recording a 40% fall in Australia over the period 1985-2007 (OECD 2011). In the UK barely one in six employees in the private sector is now covered by a collective agreement.

Figure 5: Trade union density 1979-2013 (% employees in union membership)



[7] Australia never ratified the convention, presumably because the award system establishes the wage floor.

Source: OECD Stat

In both countries progressive governments have sought to undo some of the damage – the Employment Relations Act 1999 in the UK, which created a legal framework for the establishment of collective bargaining in the workplace and the Fair Work Act 2009 in Australia. Both countries have made a serious effort to establish a labour market floor, eliminate low pay and establish minimum standards in the workplace: the National Minimum Wage (NMW) in the UK and the modern awards in Australia under the Fair Work Act.

So far as the UK is concerned, a more favourable legislative environment has not led to union membership growth or higher collective bargaining coverage. Indeed, the UK has the lowest level of employee participation in organisational governance of any country in the EU except Lithuania.

The NMW has eliminated extreme low pay, with only 2% of employees now earning less than half median earnings, but has had little or no effect on the wider problem. More than one in five employees in the UK continues to be low paid on the accepted international definition – earnings of less than two-thirds of the median.

It may be premature to judge the impact of the Fair Work Act even though a glance at the data suggests a further decline in union membership. There is some evidence to suggest, on the other hand, that the coverage of collective bargaining increased somewhat, albeit that some employers remain resistant and have called for the repeal or amendment of the legislation (Cooper et al 2012).

What is most striking about both countries is the deep-rooted employer resistance to collectivism in the workplace and the continued commitment of the parties of the right to an anti-union agenda. There is no sympathy here for Hacker's case for predistribution. The old market fundamentalist tunes about labour market flexibility and the awfulness of regulation remain depressingly popular even though the evidence points to a more complex story. For example, the OECD's work makes clear that there is no relationship between the strength of employment protection legislation and employment performance over the course of the economic cycle (OECD 2004). Moreover, the World Bank's 2013 report on jobs has established that countries have considerable room for manoeuvre in deciding how extensively the labour market should be regulated (World Bank 2013). Policymakers are operating on what is described as a "regulatory plateau" and provided they do not get too close to the edges, under-regulating to allow for unacceptable levels of injustice or over-regulating to damage employment growth, then appropriate trade offs can be made between fairness and efficiency, reflecting social and political choices. According to the OECD's employment protection indicators, Australia and the UK are liberal economies. It is absurd to argue that either country's labour market is over regulated or that a dose of deregulation would boost productivity growth.

One might conclude that the efforts of progressive governments in both countries have not yet proved successful in rebuilding the predistribution pillar. It is also possible to say that more ambition may be required if the policy goals identified in this paper are to be achieved. Quite how a new settlement might be crafted is considered in outline at the end of this paper.

4. Insecurity and unfairness

It has already been noted that the British economy has suffered from a low pay problem for a considerable time. These difficulties are compounded by a rising level of concern about the quality of jobs that have been created in the immediate post-crisis period. It has been said, for example, that many part-time workers are making a virtue of necessity and would like to work longer hours should a job opening become available. This is more than just a perception and the official statistics confirm that around a quarter of those with part-time jobs are underemployed. Another cause for concern is the rise of so-called zero hours contracts, which offer no fixed hours of work and enable the employer to call on the worker as and when necessary. The more egregious forms of the zero hours arrangements contain exclusivity clauses, preventing the worker from taking work elsewhere. Action is being taken by the coalition government to outlaw these clauses, although some small legislative changes in these terms are unlikely to deal adequately with the problem. Labour market flexibility has a very dark side.

What is not clear, however, is just how widespread these contracts have become. The official data has been consistently revised upwards and the most recent estimates suggest that around 1.5 million workers have contracts with no fixed hours. But not all these arrangements will be zero hours and not all will be found at the rougher end of the labour market. Agency workers in the National Health Service, for example, may well count as zero hours workers.

There has also been a great deal of journalistic commentary about the rise of unpaid internships for recent graduates. Once again the number of workers affected is unclear, although given the articulate, middle-class composition of this group one can understand why the issue has achieved such prominence.

Both the zero hours and internships issues have become totemic, supposedly indicative of wider problems in the labour market. The difficulty with the public conversation so far, however, is that other, potentially more serious questions, have been neglected. According to the *British Workplace Behaviour Survey*, for example, unfair treatment is deeply rooted in many British workplaces (Fevre et al 2012). Often the perceived unfairness is beyond the limits of employment rights and reflects poor management practice driven by intrusive systems of performance management. Workplace representatives who, in an earlier period, would have been available to nip these problems in the bud are now conspicuous by their absence. Around one in five workers is employed in a "troubled" workplace and the worst affected are often those in middle management roles or with higher-level skills. Trouble at work on these dimensions is not experienced by those at the bottom of the labour market generally thought to be most at risk. More than half the workforce reported some experience of unfair or unreasonable treatment in the year before the study was completed.

Perceived employment insecurity also rose as a consequence of the global crisis. In 2012, around one in four workers expressed a fear of job loss – a larger proportion than in the 1980s when unemployment was higher. More seriously, however, almost half the workforce were concerned about a risk to their *job status* by being deprived of job influence, being moved to a job requiring lower skills, finding that their wages were falling in real terms or being moved to less interesting work. Without wishing to over-interpret these results, it is not too fanciful to say that many workers take the view that events just happen to them. They are victims of circumstance rather than participants in a process of workplace change. This raises some profound questions about whether it makes any sense to talk about workplace citizenship in the UK today. Workers seem to sacrifice their fundamental rights to associate and speak up at the point they cross their employer's threshold. The aspiration for industrial democracy, which was central to much mid-twentieth century social democratic thinking, appears to have been buried under the rubble of Mrs Thatcher's demolition job. Nothing that the Blair and Brown governments did between 1997 and 2010 altered that fact.

These results are more than a little surprising, not least because the human resource profession has devoted so much time and energy to the promotion of "employee engagement". In principle, engagement is the result that follows from the creation of opportunities for employee participation, with workers contributing to the governance of the workplace and the improvement of organisational performance. But this participation takes place on the employer's terms, is oriented to the achievement of business goals and assumes that individual workers can, by advancing logically beautiful arguments, convince their employers to act differently. One might view the whole enterprise as an exercise in self-deception or wishful thinking, not least because the surveys conducted by the Chartered Institute of Personnel and Development reveal that barely a third of British employees are "engaged" – around one in twenty are disengaged, apparently having made industrial sabotage their mission and the remainder are merely cynical or indifferent (CIPD 2014).

There are two other features of Britain's labour market that are worthy of comment. First, temporary work constitutes a fairly small percentage of total employment (just over 5%). This should be contrasted with other European countries with much higher levels of temporary work. Almost a quarter of workers in Spain are employed on temporary contracts and the same is true of Poland. More than one in ten workers in Germany have a temporary contract. There appears to be an inverse relationship between the protection of permanent employment and the extent of temporary work. Employers in the UK do not need to use temporary contracts because workers with permanent contracts are so easy to hire and fire. This is not necessarily a hallmark of labour market efficiency.

Second, the level of self-employment has been generally stable, with some variation over the course of the economic cycle. Historically, self-employment has fallen in booms and rising in recessions. According to the Resolution Foundation, around one in four of the self-employed would prefer a conventional employee job is they could find one (D'Arcy et al 2014). People who are self employed generally earn 40% less than the typical employee and have seen their earnings fall by 20% since 2007. Some commentators have suggested that there is a boom in self-employment in the UK today and it is true that the numbers have risen since the global crisis (Dellot 2014). But it would be unwise to see this as a break in the historic pattern: 12% of the workforce was self-employed in 1986 as compared with just under 15% today. Many self-employed people are making a virtue of necessity (they simply cannot find the job they want) and experience a significant pay penalty as a result. The rise of self-employment since the crisis cannot be read as an either an indication of creeping individualism or as a burgeoning of entrepreneurship.

Productivity, innovation and fair distribution

Central to the case made by the right is that markets, left to themselves, without the encumbrances of regulation and collective bargaining will deliver higher productivity, higher growth and generally higher incomes for all. Experience over the last two decades has shown all of these claims to be mostly false. The price has been paid in rising inequality, social exclusion and the collapse of the global financial system.

This critique is generally accepted on the centre-left. The difficult challenge, returning to our four central political questions, is what should be done about the world as it is? How can we make things better for the majority of working people? Simply demanding fairer shares is a start but no more than that. The left must be making the case that producing wealth in the first place requires greater equality – otherwise the economy will not grow because demand will be deficient and the curse of inequality will precipitate further crises. The politics of production and the politics of distribution should have a symbiotic relationship for all those of us on the left. There is no contradiction between economic dynamism and fairness because sustainable dynamic economies rest on a foundation of social justice.

Once this principle has been accepted, it then becomes much easier to announce with conviction that government has a central role to play in promoting inclusive workplaces with real opportunities for worker participation. To begin with one might make an instrumental argument: a good deal of workplace innovation is incremental, relatively small scale but cumulatively very important. It is the workers themselves who know the most about a particular job and how it can be done better. The management task is to foster a workplace culture where this kind of innovation can flourish. Command and control management styles are unlikely to do the trick and a model of corporate growth based upon deal making or the execution of a merger or acquisition can undermine years of patient work. Moreover, trust is the lubricant that makes workplaces effective and trust demands mutuality and respect. Simply delivering orders from the boardroom and expecting them to be executed is not the best way to create and sustain trust. Real dialogue is required.

It is here that consequential arguments focused on measures to boost productivity growth usefully intersect with more profound arguments of principle relating to industrial citizenship and workplace democracy. Of course, equal civil and political rights are foundational, but modern conservatives as well as classical liberals could accept that principle. What makes social democrats and progressives different is the belief in the importance of agency: that we are, following Amartya Sen's argument, committed to building a just society where people have the capabilities they need to choose lives that they value (Sen 2009). In other words, people should enjoy the same rights at work that they enjoy in society more widely – to speak up and be given a fair hearing by their employers, to associate with colleagues of like mind, put their collective opinions on record and receive a reasoned response. It is assumed by most citizens that in a democracy they will have some voice in the critical decisions affecting their lives.

The principles of justification and legitimation are fundamental. This can be expressed in common sense terms: everybody knows that they have rights to vote in general and municipal elections, opportunities to participate in the governance of their children's schools and an expectation that they will be consulted about local planning or traffic management policies. In most developed English speaking countries, however, this common sense stops at the door of the workplace; a more archaic principle of quasi- autocracy prevails beyond the employer's threshold. A serious attempt to build a sustainable economy in the post-crisis era demands that the left revive the case for industrial democracy for reasons of fairness and economic efficiency. It is difficult to construct an economic model with a fairer distribution of incomes unless an effort is made to rebalance the power relationship between workers and their employer in the workplace and the wider economy.

Towards a new institutional settlement?

So what should governments on the centre-left do? It is simply impossible to legislate for high quality work, high trust in the workplace and an innovation culture based on dialogue and mutuality. Equally, we have seen that efforts by the state to correct excessive inequality through the tax and benefit system can generate political resistance and allow the right to caricature progressives as favouring confiscatory policies or support for the undeserving.

Historically, centre-left governments have generally understood that predistribution matters (even if they would have been unfamiliar with the terminology) and have, to a greater or lesser extent, supported the claims of industrial democracy. Different national situations and cultures led to very different solutions being developed – the Australian award system and the British preference for free collective bargaining are as different as could be – but all had the same ends in view: a recognition that the balance of power mattered, a belief that a fairer distribution would result from negotiation on relatively level terms between employers and unions and a commitment to the idea that giving workers collective voice was necessary for high productivity.

It is important to be clear that this is not an argument in favour of worker voice without qualification. Research from the era of stronger unions showed that workplace collectivism could be good for productivity, bad for productivity or have no effect at all (Freeman and Medoff 1984). What mattered then and matters today is the quality of the relationship that exists between workers, their representatives and the employer. Some of this can be reinforced by legal rights, with guarantees that workers' representatives must be consulted before significant changes are made but much depends on social norms and the general habit that employers treat workers as citizens-at-work rather than just human resources or another, slightly intractable, factor of production.

It ought to be a matter of agreement on the left in both Australia and the UK that the action taken by previous governments has failed to correct the power imbalance that has been created by the labour market reforms of the last thirty years. In the UK there is a serious question whether the unions can revive themselves using conventional means – organising workplaces to secure recognition for collective bargaining – or whether a transitional strategy is needed, using some of the institutional mechanisms commonly found in continental Europe. There is a strong case being made for the development of a works council system in the UK (Coats 2013). Representatives would be elected on a universal franchise and would have statutory rights to be informed and consulted about the following issues (in some cases with a view to reaching an agreement):

- The strategic plans for the business
- The likely trajectory of staffing levels in the medium term, including any threats to employment and remedial action to be taken
- Significant changes to work organisation or contractual relations
- Joint management of health and safety in the workplace
- Consultation on redundancies
- Consultation on business transfers (changes of ownership covered by the EU's Transfers of Undertakings Regulations)
- Consultation on changes to occupational pensions
- The flexible implementation of the UK's Working Time Regulations 2004 – flexibilities around the length of the working week, breaks, rest periods.

This could be viewed as a major departure for policy, but all these rights are already on the UK statute book. It is simply that workers find it hard to make use of the provisions if they know they exist and unions face unreasonably high hurdles before they can vindicate these rights. In principle, however, a strengthening of rights to training and time off for representatives alongside the rationalisation of employers' obligations under the umbrella of a single consultative body in the workplace would be a major step forward.

A critic might argue that none of these rights affect pay levels and none of them are about bargaining. This is a legitimate point, of course, but the counter-argument is that British unions at present lack the legitimacy with either workers or employers to move immediately to a revival of collective methods of pay determination. The challenges in Australia may be similar, not least because many workers are unlikely to encounter a union in their workplace today and employers have lost the habit of observing collective agreements – or are opposed to collectivism of any kind.

There are other measures that the government can take to promote collective bargaining and collective voice – notably through the management of public procurement. It is possible to refuse to do business with suppliers who fail to pay the going rate for the job or who fail to meet some minimum standards of worker participation. In the UK, it would be possible to expand the terms of reference of the Low Pay Commission so that some consideration is given to the medium term trajectory of the NMW and a strategy developed, in co-operation with other government departments, to reduce the UK's reliance on low pay-low productivity business models.

Finally, the government can provide small amounts of money to incentivise innovation in worker participation with a view to boosting productivity. This happened under the 1997-2010 Labour governments in the UK through the Partnership Fund (which supported improvements in employment relations) and the Workers' Safety Adviser Challenge Fund (used to improve health and safety outcomes in small and medium sized enterprises) and the Union Modernisation Fund (designed to build union capacities to respond to a rapidly changing economic environment).

At this point in the conversation the precise policies may be less important than acceptance of the principles that industrial citizenship, worker voice and the balance of power matter – although it is important to have an outline of a programme for government in mind.

Even if we leave the details to one side for the moment, there can be little doubt that a prospectus of the kind described in this paper will be subjected to a ferocious political attack from the right, with a reprise of all the usual campaign tunes: "You have failed to learn the lessons of the past"; "You want to take us back to the era of over-mighty union bosses"; "This is the economics of the madhouse".

What would be most striking to earlier mainstream thinkers on the left, however, is the relative modesty of the measures proposed here. There is no suggestion of irreversible social transformation or that mysterious process "the transition to socialism". The essence of the capitalist system is preserved – and saved from itself. The goal is to ensure that the system works in the interests of all citizens and meets the tests of equity and sustainability.

Straws in the Wind?

It would be wrong to be too pessimistic, however, not least because elements of the global business and policy elite have begun to recognise that the pre-crisis status quo was unsustainable – although some politicians on the right are struggling to catch up. At the 2015 Davos meeting of the World Economic Forum, for example, the continuing growth of income inequality across the developed world was identified as a serious threat to economic stability. Even so, the discussion did not progress much beyond well-intentioned hand wringing, save for a somewhat narrow focus on improving the skills of the least well qualified.

The same might also be said of recent remarks by Christine Lagarde, managing director of the IMF and of the OECD's work on income inequality, where once again an attempt is being made to shift the focus exclusively onto education and training policies. But what all these elite contributions do is open up territory for the left previously marked "here be dragons". It is no longer outlandish or absurdly radical to talk about the importance of income inequality. Nor is it ridiculously leftist to talk about bargaining power or the imperative to achieve a balance between the interests of employers and workers. Social democrats and progressives must take these valuable arguments and use them to reforge the link between the politics of production and the politics of distribution. That was the stroke of genius in Roosevelt's New Deal and it remained at the heart of the economic policy consensus across most of the developed world from 1945 to the middle 1970s. The task for social democrats today is to devise an equally compelling (and durable) settlement in the very different circumstances of the twenty-first century.

In other words, despite the enormous changes of the last forty years the fundamental workplace issues confronting the left remain the same. Otto Kahn-Freund, the eminent Anglo-German labour lawyer put it like this[8]:

> *Any approach to the relations between management and labour is fruitless unless the divergency of their interests is plainly recognised and articulated…There must always be someone who seeks to increase the rate of consumption and some who seek to increase the rate of investment. The distribution of the social product can only be determined by a constant and unending dialogue of powers, no matter whether this takes place at the bargaining table, in Parliament or in the recesses (more or less dark) of government offices* (Kahn-Freund 1972).

The pre-crisis conventional wisdom told us that there was no need for dialogue; employers knew best and governments were well advised to step out of their way. The disappointing results are there for all to see. It is time to get the conversation started again.

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[8] Otto Kahn-Freund is generally seen as the architect of the discipline of labour law in Britain. He had been a judge of the Weimar Republic's labour court and had to leave Germany to escape Nazi persecution.

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