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FINANCIAL INSTITUTIONS & ECONOMIC SECURITY (FIES)

POLICY BRIEF

Employment Security

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This policy brief has been produced for The Open University *Innovation, Knowledge, and Development (IKD)* Centre by Professor William Lazonick and Mr Öner Tulum with assistance from the participants in the IKD Conference on *Financial Institutions and Economic Security (FIES)* held in London, UK on 21-22 May 2009. The FIES conference considered the influence of financial institutions on employment security, retirement security, and housing security, as well as the interrelations among these forms of economic security in North America and Europe. The outputs of the FIES conference around the subject of *Employment Security* are summarised in this brief. For further information on the FIES project, working papers and upcoming events, please email: ikd-enquiries@open.ac.uk

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Financial institutions – such as investment banks, stock markets and hedge funds – have a major impact on employment, housing and retirement security and their policies can either support or undermine a person's ability to earn money, pay a rent or mortgage and meet the costs of retirement.

At the Financial Institutions and Economic Security (FIES) Conference held in London (May 21-22, 2009), researchers from around the globe explored the issues surrounding the 'financialisation' of the major Western economies and the implications for industrial innovation and stable and equitable economic growth.

Before the financial meltdown of 2009 it was popularly believed that what went on in the world of high finance was divorced from 'ordinary' people's lives. The growth in housing prices left many with a sense of financial well-being, while rising stock markets promised a comfortable retirement. Recent events have focused attention on the role of financial institutions in the operation of the 'real' economy. In particular, the public became aware of the extent to which major banks and insurance companies have been engaged in highly speculative financial transactions, using "other people's money".

A powerful driver for speculative trading was the growth in derivative securities backed by "subprime" mortgages as home ownership was extended to many low-income households across America. The crisis also spread to Europe where many banks and investors had become deeply involved in the speculative derivatives markets.

However, the root cause of economic insecurity lies not in the speculative machinations of the financial services sector but in the failure of business corporations in general, including major industrial enterprises, to provide employment security to the national workforce in the 1990s and 2000s on the scale that was the norm from the 1950s into the 1980s. It was the failure of secure employment that triggered the crisis of confidence in derivatives. William Lazonick argues that the role of financial institutions exacerbated economic insecurity that stemmed from the progressive transformation of the dominant business model that prevails in the United States.[1]

Under what can be called the "Old Economy business model", industrial corporations held out the promise to both white-collar and blue-collar workers of employment with one company over the entire course of their careers. Since the 1980s, however, changes in global competition, technology, and corporate financial behaviour have eroded the extent to which major US companies have been able and willing to provide such employment security. The rise of the Asian economies, including Japan, South Korea, Taiwan, China and India, have created intense competition for US business in the very industries that US corporations once dominated, making it more difficult for companies to deliver on the promise of career-long employment. The replacement of proprietary technology standards with industry-wide technology standards, associated with the microelectronics revolution, has made the retention of experienced and expensive career employees less valuable to companies. As these companies have searched for abundant sources of less expensive, but qualified, labour, they have increasingly turned to countries like China and India.

Most importantly, however, under the "New Economy business model", US companies use their profits to buy back their own stock in massive amounts, justifying the practice as a way to "maximize shareholder value". Stock buybacks help to enrich the top executives who make these decisions and who are heavily compensated with stock options. But this financial behaviour is at the expense of creating more and better jobs for members of the US labour force. While the collapse of the derivatives market was the immediate cause of the present crisis, its origins can be traced to the overwhelming influence of the stock market in corporate decision-making.

Andrew Tylecote contends that in recent years the globalisation of finance and trade has had adverse effects on technology development and employment security across all capitalist

[1] William Lazonick, "The New Economy Business Model and the crisis of US capitalism" (a revised version of this paper will appear in *Capitalism and Society*, 3, 1, 2009).

societies.[2] Shareholder capitalism (characterised by outsider control) that prevails in the United States and the United Kingdom, and stakeholder capitalism (characterised by insider control) that exists in the rest of the world are the two major types of financial systems that are supporting national innovation and industrial growth. Unlike stakeholder capitalism, shareholder capitalism separates finance from industry, with the main goal of shareholders being to make money through financial markets rather than to exercise corporate control. This loose relation of shareholders to industry has enabled financiers to allocate resources to a diversity of industries, including a number that are technology-based.

With the globalisation of finance and trade, moreover, "footloose" money has begun to move into different regions of the world, embedding shareholder ideology as it has travelled around the globe. Shareholder ideology combined with intense foreign competition has placed stakeholder capitalism under pressure to take advantage of global labour and low-cost manufacturing hubs by laying off some employees, previously seen as stakeholders.

The increasing global homogeneity of national financial systems has put technology development in danger because different innovation systems and technology regimes require different financial systems. Maintaining the diversity of financial systems to ensure sustainable technology development, diffusion and ultimately employment security will be the challenge for policy makers in the coming years. Yannick Lung and Matthieu Montalban illustrate the shift in corporate ideology from stakeholder to shareholder capitalism in France.[3] During the 1990s, the French economy underwent a radical privatisation and financialisation process that resulted in the disappearance of the cross-shareholding system that protected companies from the demands of external financial interests. With the new model of capitalism, French firms shifted their focus from business growth, including employment, to short term financial gains. Encouraging this change in corporate objectives has been the inflow into France of "footloose" money from the United States and the United Kingdom.

The financialisation of the French economy was accompanied by declines in business-financed investments in technology, R&D intensity, wages, and employment security, especially for younger workers. Before the wave of privatisation and financialisation, large-scale state interventions were common practices to regulate financial and labour markets. The role of the state was basically to modernise the economy by requiring compromises from different economic institutions and actors who had to cooperate in the modernisation process. Nevertheless, although France seems to be adopting the Anglo-Saxon model of capitalism with its flexible labour markets and weak employment security, what remains in place is a more socio-democratic form of that model through the maintenance of a strong welfare system. French social movements have constrained policy attempts to institute significant employment flexibility in France. The OECD Employment Protection Legislation (EPL) index actually indicates an increase in employment security in France for the period of 1990-2003 compared with eight other OECD nations.

Jürgen Kädtler examines how the dual system of collective bargaining in Germany, operating at both local and national levels, can ensure the persistence of stakeholder capitalism in Germany with a high level of employment security.[4] The success of the social partnership between employers and employees in Germany has depended upon a constant flow of information, worker access to top management through representatives, and worker involvement in the corporate decision-making process.

With the globalisation of finance and trade, however, the large German chemical, automobile, and tyre companies that are the engines of the German economy have modified their employee representation systems. Influenced by the globally dominant Anglo-Saxon capitalist model,

[2] Andrew Tylecote, "How the deficiencies of the financial system reduce spending on technological innovation and diffusion", paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.
[3] Yannick Lung and Matthieu Montalban, "Stock market and employment security: the French case", paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.
[4] Jürgen Kädtler, "Risking relegation or staying in the first league?: Industrial relations and enterprise restructuring in Germany under the impact of globalisation and financialisation", paper presented at the conference on Financial Institutions and Economic Security, London, 21-22 May, 2009.

shareholder ideology and financial management have had a strong influence on the business strategies of globalised German companies. On the one hand, national and global financial institutions have urged these German companies to “maximise shareholder value”; on the other, globalisation has weakened worker representation.

Kädtler shows how two chemical giants, Bayer and Hoechst, have used global restructuring strategies to undermine the bargaining power of German workers. The essence of these strategies has been to use global production networks to break the companies into small to mid-sized service providers located around the world. However, another chemical giant, BASF, has taken a different strategic approach by aiming to produce a wide range of high-quality products and achieving higher productivity. This strategy required high levels of worker involvement and motivation, which has served to strengthen the role of the traditional German structure of work councils and labour unions. Similar attempts to build on, rather than tear down, the distinctive German model can be found in the automobile industry. In Germany, there remains a strong institutional foundation for the pursuit of what US labour unions call a “high-road” strategy - one that stresses productivity and product innovation rather than simple cost-cutting.

What all of these perspectives have in common is the argument that financialisation of the corporate economy has undermined economic security. This financialisation is rooted in how and for whom the modern corporation is run. In the United States, and to a lesser extent in the United Kingdom, the ideology prevails that companies should be run for the sole benefit of shareholders resulting in an exclusive focus on the stock market price. At the same time, the deregulation of financial markets has enabled the top executives of major financial and industrial corporations as well as the operators of private hedge funds and private equity firms to extract massive gains for themselves. The result has been an increasingly unstable and unequal economy now highlighted by the recent financial meltdown which has shown the extent to which the financialisation of resource allocation has spiralled out of control.

There has been considerable resistance to this ideology in continental European nations such as France and Germany, where the notion of a “social market” economy still prevails. Government policies that seek to promote stable and equitable economic growth should take control of the allocation of resources out of the hands of those who are currently positioned to extract value from the economic system through speculation and manipulation, and give control instead to economic entities that will invest in generating the goods and services that the population needs at prices that the population can afford.

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