SUSTAINABILITY CHALLENGE # 5:

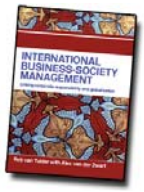
SUSTAINABLE GROWTH

1. Introduction: on core issues and the nature of growth regimes [1]

Growth is the paradigm of economic policy and the performance yardstick of macro-economic orthodoxy. Revenue growth often presents a bigger management imperative than profit maximalisation. Without growth no value-added, progress, wealth or stock market gains. So it seems. Economic growth has not always had these mythical proportions. In the 1970s, the controversial Club of Rome reported on the 'limits to growth' (Meadows et al, 1972) and announced a rapid depletion of non-renewable resources. When OPEC countries raised their strategic leverage to raise oil prices, latent feelings of unrest turned into overt crisis. In response, some governments and firms tried to adopt 'selective growth' strategies. Two 'oil shocks' later, however, crisis sentiments vaporised and selective growth strategies were quickly shelved. NGOs or political parties that since the mid-1980s opted for zero- or selective-growth strategies, faced the worst fate anybody could have in a bargaining society: they became ignored. The 1990s were the era of uncompromising growth. By the end of the 1990s, international development organisations like the World Bank adopted 'pro-poor growth' strategies, although it is not sure that anybody really understands what the concept implies (Lopez, 2004) - other than the idea that growth is always good for the poor (Dollar and Kraay, 2001). In the meantime, a thirty-year update of the 'limits to growth' idea by its original authors (Meadows *et al*, 2004) – re-iterating the dangers of global ecological collapse and the need for a 'sustainability revolution' - went largely unnoticed. By 2005, the OECD countries' prime worry again was an outright 'going for growth' strategy, as the title of a major publication read (OECD, 2005).

The more a topic reaches paradigm status, the more it loses its (controversial) 'issue' character. The principle of economic growth itself might not be fundamentally disputed at the moment, other dimensions remain nevertheless hugely controversial, not in the least because economic growth is very unequally distributed over the world. The access to the *sources* of economic growth has always been heavily contested. The sources of economic growth are not necessarily exactly known – relevant scientific evidence is ambiguous – but it is clear nevertheless that they are unequally distributed over and within societies.

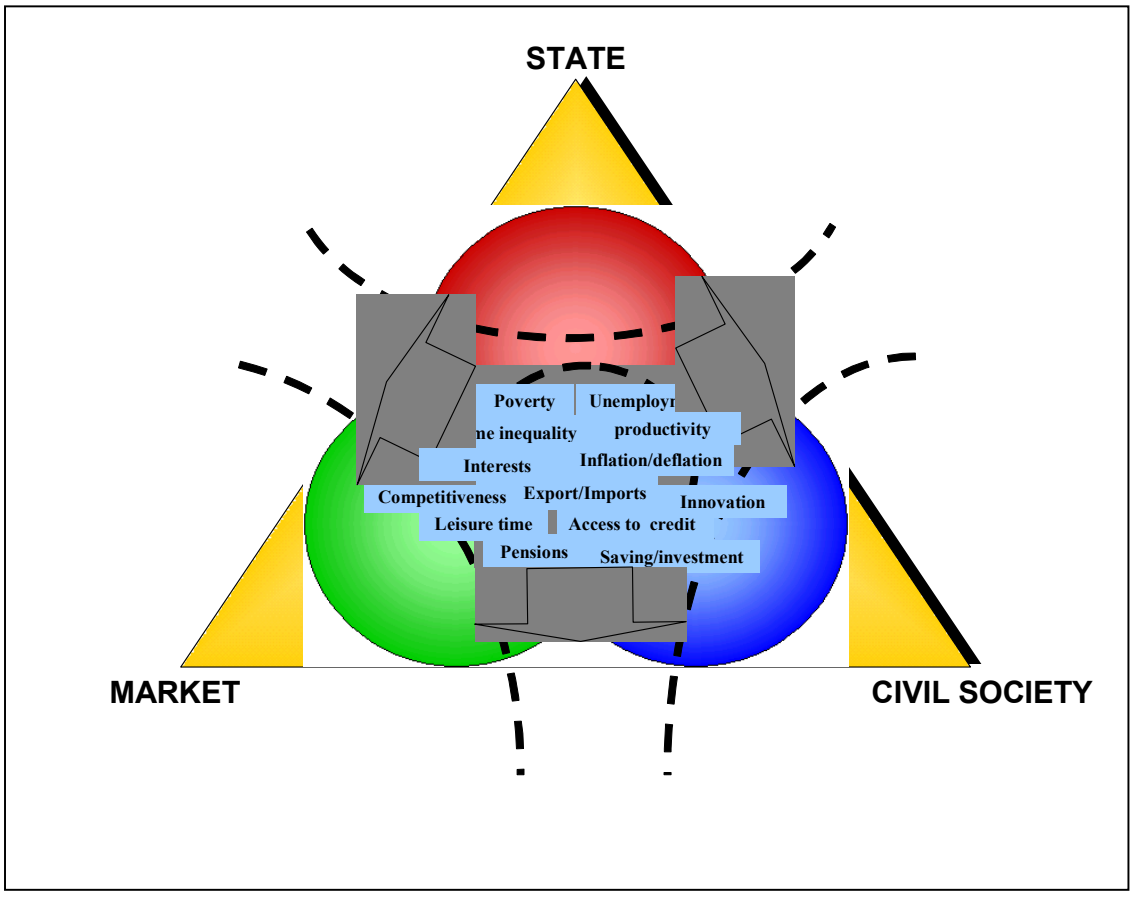
[1] This issue dossier was written by Rob van Tulder. It elaborates a cluster of issues around the core theme of growth regimes. This theme has been shortly addressed in chapter 10 of the book (on 'The Stakes – Firms part of the problem or part of the Solution'). References in the text to Figures, Chapters and Tables, refer to the original book "International Business-Society Management" (Van Tulder with Van der Zwart, 2006). The dossier is intended to illustrate how this particular issue is and can be approached by both scientists and practitioners. Last updated: March 2006.

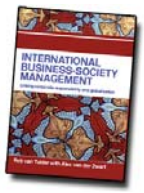


Once growth and wealth are established, the redistribution of it becomes a major area of controversy that in turn has a strong impact on the very sources of economic growth. Furthermore, economic growth has major spill-over effects on the rest of the economy. The magnitude, nature and sometimes even the existence of most other (interface) issues are affected by the pace and nature of economic growth. Growth cycles, finally, can also turn vicious because the growth always involves a number of fundamental trade-offs that contain considerable paradoxes.

All bargaining dilemmas apply *a forteriori* to issues related to the basic economic 'fabric' of societies – its so-called 'growth' or 'accumulation regime'. They represent a number of fundamental trade-offs between Equity and Efficiency in which the position of all three societal spheres is fundamentally affected and with large spill-over effects to all the other issues identified in the previous chapter. Growth issues can be positioned in the core of the societal triangle (Figure 1). Chapter 2 already identified a number of different societal arrangement that represent rival growth regimes. Addressing interface problems under a 'virtuous' growth regime is always easier than in case the economy is shrinking – a 'vicious' growth regime. But economic growth can come with a price: intensive production increases pollution and the depletion of non-renewable resources, cheap production lowers direct incomes and increases the number of 'working poor'. These are some of the basic paradoxes of capitalism – also hailed as the 'dialectics of progress'. Whether economic growth represents a sustainable story for the participants, therefore, depends on the 'vicious' or 'virtuous' shape of the growth regime, which in turn depends on the outcome of three elementary economic trade-offs that will be explored in this chapter.

Figure 1 Growth Regime Issues



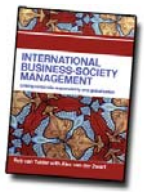


2. Growth theory: economic trade-offs as areas of societal controversy

Classic macro-economic models already contain all the basic components of economic growth thinking: employment, savings, investment, interest, money and labour supply, capital stock, demand, income, exports and imports. Early generations of (endogenous) growth models emphasized externalities (societal spill-overs) in capital accumulation and total factor productivity of an economy as a major source of sustained economic growth. Taxation, savings, education and trade policies, thereby affected growth through their influence on capital accumulation (Aghion, 2001). Modern growth models have added in particular technical advance or innovation as a key driving force behind economic growth. Innovation is strongly influenced by the social institutions that mold technical advance (Nelson, 1996; Aghion, Howitt, 1997) and create a *selection environment* in which some technologies can mature and others are – paraphrasing Schumpeter – 'creatively destructed'.

The actual operation of this selection environment is increasingly dependent upon the efforts of individual companies as well (see chapter 5). Studies with a particular focus on the micro-economic foundations of economic growth combined these two insights and stressed the importance of 'competitive advantage' based on productivity advancements as the most important source of competitiveness in international markets, and consequently of sustained economic growth (Porter, 1991). Development economics models, finally, focused particularly on identifying growth inhibiting factors and the causes of the 'poverty of nations' (Cf. Fortanier, Van Tulder, 2006). Poverty not only is the result of lacking economic growth, but also a factor inhibiting further economic growth. Dependency theorists in development economics stressed external causes such as unequal trade conditions for developing countries and the negative consequences of direct investments by multinational corporations. Scholars looking at the intrinsic factors inhibiting development stressed domestic factors such as income inequality, unemployment, absolute level of poverty, institutional sclerosis (lack of good governance), credit market imperfections, and lacking access to credit and investment (Meier, Stiglitz, 2001). Establishing exact models on the interaction between the various factors – and thus on the preconditions of a development model – will probably remain an area of scientific contention for decades to come.

An in-depth discussion of growth theory does not serve the purpose of this book. The nature and shape of growth regimes (at the national, regional and/or company level) can however be characterised as a number of core trade-offs. These trade-offs constitute not only neutral factors, but in practice also involve specific actors - representatives of all three societal spheres - that bargain over these trade-offs. The outcome of this bargaining process is often 'path-dependent' - strongly influenced by past decisions and institutional frameworks (Cf. Part I). When does a society create 'vicious' or a 'virtuous' growth cycles? At least two strongly interrelated trade-offs influence the supply-demand balance and the growth dynamics of an economy: (a) beween income and productivity (issues: income inequality, relative and absolute poverty, social security, minimum income,

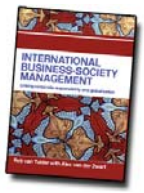


innovation, exports/imports), (b) between working and leisure time (issues: voluntary and unvoluntary unemployment, pension system, formal/informal labour).[2]

3. Trading-off income and productivity

The trade-off between income and productivity has arguably had the greatest impact on the nature of economic growth. Low total factor productivity (including labour productivity) generally combines with low income (poverty) and slow economic growth cycles, unless the economy can export its products to other countries with relatively higher incomes (and purchasing power). The growth cycle turns vicious in case all economies try to compete by lowering wages, which in the end does not leave any buying power to exert enough effective demand for consuming the created productive surplus. In case all governments actively try to lower wages to attract foreign investment, the outcome of this process is also referred to as a 'race to the bottom'. A few countries – as free riders on the purchasing power of rich countries – can get away with lowering wages, but in case all countries adopt the same strategy this triggers a vicious cycle of lowered worldwide income and slow or even negative growth. The vicious growth cycle is accompanied by deflation. For individual customers deflation (lower prices) might seem very positive, for whole economies deflation is a sign of mayhem.
High incomes require high productivity in order to facilitate (endogenous) virtuous growth cycles. In case incomes grow quicker than productivity, the danger of inflation looms large, which hollows out the growth model. There is a trade-off between unemployment and inflation (the *Phillips curve*), though, in which higher levels of unemployment can moderate inflationary pressure. The bigger the labour reserve, the more modest wage demands will be. But with modest wages comes also modest purchasing power, which (again) inhibits further economic growth. Relatively low wages also lower the incentives of employers to invest in capital goods (raising capital productivity as a substitute for labour) and to invest in innovation in order to come up with new products that could create higher value-added and pay for the increased wages. Hampered innovation and low total factor productivity growth have also been exposed as facilitators of 'vicious growth'.
Chapter 4 (section 4.4) already referred to the existence of vicious and virtuous growth cycles to explain for the important societal function of trade unions. Trade unions proved vital in influencing the trade-off between supply and demand by coupling high productivity (related to economies of scale) to high wages (and high effective demand). But trade unions and employer organisations when bargaining over the trade-off between productivity and wages, suffer from a prisoner's dilemma. The 'dominant' strategy of employer organisations tends to go for high productivity (or long working days) independent of the magnitude of the wages, whereas the dominant strategy of employees is to opt for high wages independent of the level of productivity. Game theory learns us

[2] There is a third key trade-off: between savings and investments (containing the issues: size of the money supply, inflation/deflation, access to credit, pension provision, capital markets). Income can be spent directly (effective demand) or saved. Postponed consumption, creates a financial reserve for investment or pension provisions. The savings-investment trade-off will be elaborated in a follow-up dossier.



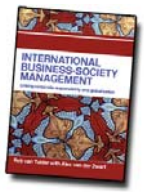
that this particular bargaining game results in a sub-optimal equilibrium if left to the parties directly involved: a combination of low productivity and low wages. Thus enter governments in the bargaining arena as an intermediary force necessary to create the preconditions for virtuous growth cycles. Governments for instance define a minimum wage, invest in infrastructure, design a welfare system or in some countries couple wages of the most productive sectors to less productive sectors. Firms are stimulated to increase productivity and innovate in order to pay for the higher wages. The extent to which governments should/could intervene in industrial relations is topic of heavy debate, but history has shown that many intervention types have been tried.

In the most successful growth models of the past, governments proved vital in facilitating "productivity coalitions' which triggered economic growth on very different institutional foundations (see chapters 2 and 4 and Ruigrok, Van Tulder, 1995). In the United States, the New Deal policies of the 1930s, triggered largely endogenous growth cycles coupling high productivity (economies of scale) with high purchasing power guaranteed by social security. In Japan in the 1970s, productivity coalitions were aimed at coupling high productivity with relatively low incomes – and low social security - in order to profit from export markets (and the buying power in the United States and Europe). The Japanese productivity coalition established a strongly exogenous growth regime. This contained risks, though: when the export strategy of the Japanese companies since the mid-1980s became faced with various forms of trade retaliation, they entered into a prolonged period of deflation (Cf. Van Tulder, 2004). In Europe, following the creation of the single European Market in the 1980s, the most successful neo-corporatist countries managed to combine high per capita productivity with high wage levels (either directly or indirectly through the social security system), thus creating a virtuous endogenous growth regime within the wider region.

A comparable vicious growth dynamics epitomises the practice of *mercantilism*. Initially intended to maintaining the lowest possible prices for agricultural products by discriminating rural areas in favour of urban areas in Renaissance Europe (Cohen, 1998), mercantilism soon became a feature of trade policy in specific. The basic scheme of mercantilism entails restricting imports and expanding exports in order to profit as much as possible from purchasing power abroad, while limiting as much as possible the leakages of purchasing power to imported goods and services. Mercantilist policies in the 1920s became associated with 'beggar-thy-neighbour' strategies and caused worldwide crisis. When all countries practice mercantilist policies at the same time, everybody is worse off and nobody will profit from the efficiency enhancing effects of trade on the basis of comparative advantages. This creates a typical prisoner's dilemma that leads to lower productivity and lower purchasing power, because wealth has to be created in a smaller market which lowers the potential for economies of scale, while efficiency gains from abroad can not be imported either. In the present era, mercantilism

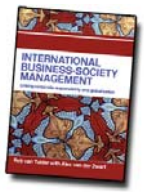
Core issue: the manifold dimensions of poverty

The manifold expressions of poverty in modern society represent the sometimes perverse effects of income-productivity trade-offs. Poverty lies at the heart of almost all interface issues. Poverty reduction is generally acknowledged to be the most important precondition for worldwide growth. The FAO calculated that the negative effect of absolute poverty on economic growth can be calculated at between 0.23 and 4.7 percent



less annual growth. A number of variables explain for this relationship. Poverty goes together with weak human assets, a high degree of economic vulnerability. Poverty leads to chronic malnutrition due to lacking purchasing power for (good/safe) food and water (FAO 2002). Poverty is associated with forced labour. Poverty causes child labour as children need to complement the insufficient income of their parents. The incident of child labour is strongly related to poverty: in the 43 countries with an average annual income below 500 dollars, 30 to 60 percent of children do often hard labour (Unicef, 2005). This number decreases sharply with higher income. Poverty breeds an unequal distribution of diseases in developed as well as developing countries. Poverty contributes to a lack in education (general and illiteracy in specific). Poverty leads to social and political unrest (Cornia and Court, 2001). Poverty triggers migration and is a breeding ground for terrorism. Poverty leads to lacking investment due to the low credit-worthiness of in particular poor people (De Soto, 2000). Poverty triggers unsustainable agriculture practices and a less than efficient use of other scarce resources. Poverty and corruption go hand-in-hand. To reach the poverty reduction as envisaged in the Millennium Development Goals and substantially reduce the number of people living on less than $2 a day, sustained economic growth is considered mandatory by many. But poverty remains a complex issues and comes in two forms: (1) absolute and (2) relative poverty.

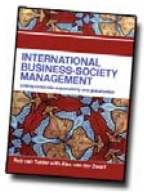
Absolute poverty is a relatively undisputed phenomenon as regards its size, impact on economic growth and human dignity. Most of the above statements refer in particular to problems associated with absolute poverty. Poverty measurements are usually based on incomes or consumption levels. The minimum level needed to meet basic needs is called the "poverty line". The preconditions for satisfying basic needs vary across time and societies. Therefore, poverty lines vary in time and place, and each country uses a yardstick appropriate to its level of development, societal norms and values (Worldbank, 2003; www.worldbank.org). Living on $1 a day represents a situation of extreme poverty, whereas the $2 a day margin still can be considered below the poverty line around the world. During the 1990s GDP per capita in developing countries grew by 1.6 percent a year. The proportion of people living on less than $1 a day fell from 29 percent to 23 percent of the world's population. The number of people in extreme poverty decreased by only 10 percent, but the number of people living on less than $2 a day increased to 2.5 billion. Poverty is unequally distributed over the world. The greatest absolute number of poor people live in south Asia, but the proportion of poor is highest in Sub-Saharan Africa. Due to civil conflict, negative economic growth (GDP per capita shrank 14% since 1980), and the spread of HIV/AIDS have left millions at the margins of survival; poverty rose from 41 to 46 percent in the 1980-2001 period, with an additional 150 million people living in extreme poverty (World Bank, World Development Indicators, 2004). Around half of humanity earns less than what is considered the minimum to sustain a decent life ($ 1,500 PPP per year). The least developed countries (LDCs) are a group of 49 countries that have been identified by the UN as "least developed" in terms of their low GDP per capita. Even when the biggest part of the world's poor are – by definition – located in the least developed countries, many of the industrialised countries contain substantial numbers of poor people. According to the UN Human Development Report 1998, the percentage of poor people in the US was 19%, in the UK (13.5%),



whereas in France it was registred at 7,5% of the population.

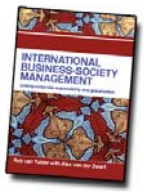
Relative poverty is a more controversial concept. It is related to an unequal distribution of income. The inequality in the world's aggregate income distribution increased more or less continuously since the beginning of the 19th century until World War II, after which it stabilized. But in the early 19th century income inequality arose mostly within countries, whereas at present more than half of it is found to be due to differences *between* countries (Bourguignon and Morrisson, 1999). Higher inequality in income and land distribution is associated with lower growth (Easterly, 2001: 265; World Bank, 2000). Income equality is proven to be inducing economic growth in particular at per capital income levels below U$ 2,000 (Barro, 1999). This income level represents the bulk of the developing countries. Research after catching-up strategies of in particular Asian economies has shown that the countries with the most successful growth strategy were those that had a relatively equal distribution of income groups in society. Income disparity (even more than absolute poverty) has been considered the source of many other human problems: sickness, criminality, wars, education, safety. Active income redistribution can help poor countries escape from the traditional dilemma that economic progress first breads inequality (for instance by shifting economic activities from rural/agriculture to urban/industry). This dilemma is represented by the so-called *Kuznets curve*. After a certain threshold, income inequality can go together with economic growth, not necessarily only because of an 'iron' correlation between inequality and growth, but because of the high transaction costs involved in income redistribution measures.
Income inequalities within societies are usually measured by the *Gini-coefficient* which can range from perfect equality (0, everyone has the same income) to perfect inequality (1, where one person has all the income). The United States has the highest Gini-coefficient of all high income countries (0.408 in 2004), whereas most corporatist European countries and Japan have a considerably lower Gini-coefficient (between 0.247 and 0.327) (UN, Human Development Report 2004) indicating a much more equal distribution of income. Around 50 countries in the world, however – all low income countries – have a more unequal distribution of income than the United States. Higher income inequality also breeds higher degrees of corruption (and vice versa). The liberal (Anglo-Saxon) countries have traditionally had the highest domestic income disparities amongst the developed economies. Income disparity in these liberal countries is generally considered to be instrumental to economic growth. According to the liberal paradigm, income inequality creates incentives for people to work harder in order to reap economic changes ('everybody a millionaire'). Measures to promote greater equality are always traded off against economic efficiency and economic growth. In the 1990s, this traditional view on the equality-efficiency trade-off became also disputed in the two leading liberal countries, the UK and the USA (Cf. Glyn, Miliband, 1994). Policies introduced by labour/democrat governments that were introduced in both countries to correct for some of the blatant inequalities, indeed seem to have been successful.

Income inequality in companies. Income disparity in society is strongly associated to the remunerations policies in leading companies. Consultants Towers Perrin regularly releases a Worldwide Total Remunerations Report. Their research shows that the income



inequality within firms is particular big in the United States, in particular because of the remunerations earned at the top of companies. An average CEO in the USA earned around $ 1.9 million in 2002, whereas in Thailand or China, CEOs earn on average 5% of that amount. The CEO of General Electric – the largest American company in 2002 – earned 74 times the remunerations of the CEO of Mitsubishi – the largest Japanese company at that time. The salaries of average employees, on the other hand, are much more comparable. The top management salaries of the United States have exerted considerable attraction to European managers, who started to engage in a *race to the top*, which in turn alienated their employees, customers and shareholders – thus creating considerable controversy (see chapter 10). The disparities in top income of CEOs around the world, affects the effectiveness of bargaining amongst governments. A classic case presents the 1991 trade dispute between the United States and Japan on cars. More than half of the sizable trade deficit of the United States with Japan constituted trade in cars. The Big Three American car producers (GM, Ford and Chrysler) suffered major loses due to the Japanese competition and joined president Bush sr. in a top meeting with the prime minister of Japan and the CEOs of the Japanese car majors. After the usual complaints of the Americans of 'unfair' trade practices, the Japanese CEOs had a polite but straight-forward reply: in case the CEOs of the Big Three would agree to receive the same remunerations as their Japanese counterparts, the whole deficit could be instantly cut by half! This diminished the legitimacy of the American CEOs. Consequently, the negotiations took a much more positive turn for the Japanese (Cf. Carillo *et al*, 2004).

Poverty trap and working poor. The sometimes paradoxical outcome of the trade-off between income and productivity is best exemplified by the existence of a poverty trap and the creation of a subclass of working poor. Working poor people are working a substantial number of hours (at least 27 hours in the United States) but earn an income below the poverty line. At the end of 2002, the number of working poor – defined as workers living on $1 or less a day – was assessed at 550 million. The real figure of 'working poor' should be adjusted upward because people living on $2 a day should be considered poor as well. Working poor represents also a substantial group of the workers in developed countries. In 2001, the US department of Labor registred about 6.4 million "working poor" people, representing around 5% of the work force. The measurement working poor is surrounded with considerable caveats. The US department of Labor claims that the number of working poor in the 1990s decreased – after which it increased again. Comparative data are difficult to find, due to largely differing definitions of the phenomenon. In Europe, the EIO (European Industrial Observatory) estimated on the basis of a different definition than in the United States, that 8% of employees in the EU can be considered as 'poor'. The highest levels of 'working poor' where registred in Germany and Italy, and the lowest in Denmark and Portugal.
Wage levels and union bargaining power are closely associated, according to European research. In industrialized countries, social security systems exist that can lead to the difficult trade-off between getting welfare or work at a salary below subsistency level. When a person disqualifies himself from claiming social security benefits or raises his/her tax liability by entering into a job, this consists the biggest dilemma of 'poverty trap'. If a large enough number of people fall victim to this poverty trap, the economy as a whole might get into a vicious cycle of growth – with low prices, but also low



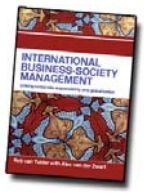
productivity, low wages and thus low economic growth. This could be the case when for instance large core companies in an economy put their employees in these kind of dilemmas. Some observers are starting to refer to this mechanism as the Wal-Mart effect (see box). This effect builds partly on the idea what the sociologist Ritzer (1993) called a "McDonaldisation of society". The latter referred primarily to the standardization/rationalization of society – with increased efficiency as the sole benchmark starting with food production and sales, and spreading to all areas of society like education. The Wal-Mart effect adds to this sociological perspective the danger of a vicious growth regime through lower wages and ultimately insufficient purchasing power.

Vicious Growth Regimes? - The Wal-Mart effect

On 6 October 2003, the American Business Week ran an article entitled "is Wal-Mart too powerfull?" With $ 245 million revenues in 2002, the US retailer is the world's largest company and by far the largest retailer (three time the size of the no.2 retailer France's Carrefour). With 1.6 million workers it is also the largest private employer in the world and has considerable power over the distribution of a large variety of articles like household staples. The company uses its core position in networks of distribution and sales also to diversify into banking for instance by offering customers credit card arrangements (Business Week, February 6, 2005). Business Week cannot be reproached of any ideological anti-business attitude. Nevertheless, the magazine has become disparaging of the Wal-Mart formula arguing that it threatens to pull the rug under the American growth regime. On the one hand Wall-Mart has a simple model that works out positive for consumers. Relentless efficiency pursuit has created bargain prices for shoppers (14% on average) and created hugely cost efficient supply chains. Economists even refer to a broad "Wal-Mart effect" that suppresses inflation. On the other hand, Business Week continues, is fraught with complications and perverse consequences. Wal-Mart is a family-controlled and strongly anti-union company and has managed to keep retail wages extremely low. Business Week claims that Wal-Mart sales clerks below the federal poverty lines. "Wal-Mart might well be both America's most admired and most hated company".
A number of academic studies are quoted by Business Week, debunking the notion that a new big-box store boosts employment and sales and property-tax receipts. Wal-Mart stores replace local stores, with some negative additions: shoppers have to travel farther (higher pollution), the wages go down not only at the supermarkets, but also with the suppliers. Critics also argue that Wal-Mart's intensifying global pursuit of low-cost goods is partly to blame for the accelerating loss of U.S. manufacturing jobs to China and other low-wage nations. The $12 billion worth of Chinese goods Wal-Mart bought in 2002 represented 10% of all U.S. imports from China. In the mid-1980s, Sam Walton founder of Wal-Mart started a "Made in America" campaign, which is now de-emphasized. "For obvious reasons", according to Business Week. The consequences of the Wal-Mart strategy have important spill-over or 'hedring' effects. Its core networking position and dominant place in retailing compels other retailers to operate within the same rules of the game. The Wall-Mart effect thus could also entail a slow erosion of the American growth model, because a growing number of people will not have sufficient purchasing power. A growing group of 'working poor' is created that has no way of escaping from their position in the system. Conversely, the Wal-Mart effect has also resulted in a – rather heterogeneous - 'stop Wal-Mart' social movement.

For more critical studies on the Wal-Mart effect,see: Bianco (2005), Lichtenstein (2005), Fishman (2006); www.globalinsight.com/walmart

Internationally, the poverty trap is even more pervasive. According to UNCTAD "the incidence of poverty is so high because most of the LDCs are caught in an international



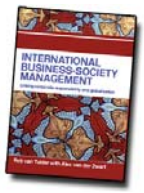
poverty trap. Pervasive poverty within LDCs has effects at the national level that cause poverty to persist and even to increase, and international trade and finance relationships are reinforcing the cycle of economic stagnation and poverty'. Unctad, however, is relatively optimistic, because they argue that "the current form of globalization is tightening the poverty trap." [UNCTAD, 2002]. This conclusion in turn is strongly disputed by an NGO like Oxfam. They point at the existence of an international *rural poverty trap*, which bares strong resemblance to the original vicious growth trade-offs under mercantilism in Renaissance Europe. In a 2004 report, Oxfam concludes that the problem of absolute and extreme poverty – people living on less than 1 dollar a day – is especially concentrated in rural areas of the LDCs. Their situation has deteroriated, not in the least because of the protectionist policies in the developed (urban) areas. "The situation of poor farmers and their dependants is intricately linked to agricultural trade rules, policies and practices. Since the late 1980s, most developing countries have been obliged under loan conditions from the international financial institutions to open their markets to imports and concentrate their development efforts on things they can sell abroad. But far from improving their export position, this policy has flooded many international markets with supplies and caused prices to fall. Under current trading arrangements, poor farmers are faced with falling crop prices, a falling share of the retail price of produce they sell, competing goods from rich countries dumped on their markets at subsidised prices, and a lack of meaningful access to those countries' markets for their own produce." (Oxfam, 2004).

4. Trading-off work and leisure

Historically, interest battles in capitalism have been as much about income and working conditions (chapter 8) as about absolute and relative working time. From seven day working weeks containing ten to twelve hours working days, some modern industrial societies like France have advanced into 35 hours working weeks. 19th century Utopist already thought of 'happiness' as that moment that work stopped. Welfare economist in general look at the trade-off between work and leisure time as an optimalisation decision. The United Nations Universal Declaration of Human Rights, proclaims that everyone is entitled to leisure and rest, including a "reasonable" limitation of working hours and periodic holidays with pay. But what is reasonable and economically viable?

The classic welfare trade-off between working time and leisure time contains at least four dimensions: (a) the absolute amount of working time needed to gain a decent living; this factor strongly depends on the income levels gained in particular jobs, the existence of working poor and the like; (b) the trade-off between voluntary and unvoluntary working time – the issue of unemployment and poverty; (c) the short-term trade-off between work and leisure time – the issue of 'secondary labour condition'; (d) the longer-term trade-off between short term work and long term leisure time – in particular pensions.

In an economy with a relatively high (labour) productivity, working time can theoretically decrease and leisure time increase, whilst income remains stable. People that work longer hours can expect to raise their income, at the price of having less leisure time at their disposal. Some people do this however, to create leisure time after a certain age – postponed leisure time consumed in a well-deserved pension. Because pensioners in



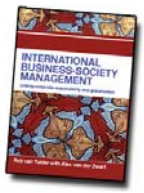
general are less productive, a properly functioning pension system also increases productivity levels in two ways: first by stimulating young people to work hard to earn a decent pension, and for older people to retire in time and leave the labour market open for more productive youngsters. This is the basic economic (efficiency) idea behind labour markets policies and public pension schemes.

But there remain many trade-offs between working hours, income and productivity levels that complicate the mechanism in practice and make it an issue of major and continued controversy. Firstly, beyond a certain number of hours worked, every additional hour worked tends to lead to diminished added productivity. The classical production function therefore shows a trade-off between labour input and total product or output. People do not like to work longer hours and tend to make more and bigger mistakes after they get tired or loose concentration. Longer working hours implies less time available to exercise and invest in health, which in turn lead to higher levels of stress, bigger incidence of heart attacks – as German research has shown (Reuters, 2003) – and thus of lower productivity. This applies in particular for poorer people who tend to work two of more jobs in order to earn above subsistence level. Poor people, are less productive despite the fact that they often work longer hours. A complicating factor is that commuting times of poorer people – not paid for, but necessary to obtain or keep a job - are often also longer, which further limits their time actually spend on leisure and recuperation. In welfare economic terms: there is a 'disutility' in working longer or having not enough leisure time. Besides, productivity advancements have been proven much more affected by innovation and new managerial techniques, than by increased labour hours.

Secondly, raised productivity levels do not automatically lead to higher income for instance because machines take over part of the work. The industries with the highest degrees of automation often need the lowest number of workers to produce turnover. Productivity raises in the petro-chemical industry for instance are almost independent from wages. Non location-specific industries with relatively low productivity levels and high labour input – service industries like software in particular – are the first to trigger a worldwide search for lower wages.

Thirdly, in case the trade-off between working and leisure time trips in favour of leisure time, but on an unvoluntary basis, economic and social effects are huge. Unvoluntary leisure time is also better known as 'unemployment'. High economic growth with high unemployment levels are generally less preferred than low economic growth with low unemployment levels. Strong economic growth that is the result of rapid innovation, however, always necessitates a certain degree of unemployment – better known as 'friction unemployment' - to facilitate the needed flexibility of society. A sufficiently large pool of reserve labour also can keep the level of wage inflation low. It lowers the bargaining strength of trade unions. But in case this pool of reserve labour consists of poor people, the negative effect on economic growth might be bigger than the negative effect on growth due to inflation.

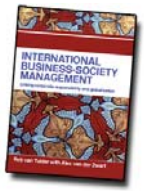
Fourthly, there are very strong industry effects that complicate the income-working hours trade-off. In case *all* workers in a particular industry work longer hours, the likely positive effect on their income remains marginal. Working longer hours only guarantees workers to keep their job, rather than earn higher incomes. The 'race to the bottom' in incomes gets complemented with a 'race in exhaustion' demanding longer working hours and minimum holidays. So, despite relatively high incomes, people work harder than ever



in order not to lose their income (and job). This is the case for countries like Japan and the United States were people are taking less and less holidays per year. Almost all countries in the OECD have started to reverse the general trend in shorter hours per week worked. Countries and firms are also starting to compete on hours worked.
Fifthly, the privatisation of pensions and/or the growing worries about the financial viability of the pension system in most countries, further stimulates longer working hours. In systems were there is no public provision of some form of pensions – as is the case in most developing countries, but also in Japan – the threatened loss of income from working shorter working hours is not only of importance for the short-run, but also for the longer run. Private companies that are capable (and willing) to contribute to leisure time in the future (through pensions) can impose upon their workers longer working hours and more loyalty than companies that operate in a system of generally good public pension provisions. The pension system, thus, can become part of the competitive strategy of an economy. The more the trade-off between short-term income and longer-term leisure (pension) is in the hands of individuals and companies, the bigger the incentive to work hard. Paradoxically, however, working hard in the end can negatively influence productivity and thus erode the competitive base and the growth engine of an economy.
Finally, there is another complicating factor in the working-leisure time trade-off. Leisure time represents a sizable industry – tourism, restaurants, sports, culture. In most countries the combined leisure industry represents the largest sector of society. In developing countries, the sector often represents the single most important source of foreign currencies. Pensioners increasingly represent a relevant economic group with substantial purchasing powers in a large number of countries. An economy that consists of a large proportion of people with enough 'leisure time' available (either as pensioners, as part of secondary labour conditions or even as unemployed), but with not enough purchasing power, experiences an immense drain on its growth potential.

Core sustainability issues: unemployment and pensions
The sustainability of short working weeks has come under pressure. Even the French are re-discussing their shorter working weeks – the benchmark being the total amount of hours worked per year that is much higher in countries like the United States or Japan, and even higher in most transition and developing economies. One part of the considerations relate to the international competitive position of the country. In particular in industries dependent upon exports, the playing field is international, and the pressure to follow the 'race to the top of exhaustion' in terms of longer working hours is mounting. In case the number of unemployed people – the labour reserve - is high the pressure to show a bigger loyalty to the employer mounts as well. This mechanism is further aggravated by a related consideration - the problems faced by the growing financial burden of pensions. The two biggest issues concerning the trade-off between working and leisure time, can thus be considered unemployment (as unvoluntary leisure time) and pensions (as postponed leisure time).

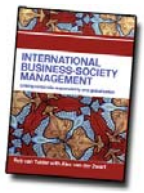
Unemployment. In paraphrasing C.Wright Mills (1995:9) the following observation can be made: when one person is unemployed, this is a personal tragedy, that however might be attributed to his/her own personal attributes (private trouble, private solution); when



large proportions of populations are unemployed, this is a structural issue closely linked to the nature of the growth regime for which no private solutions are available (private trouble, public issue). Beyond the levels of 'natural unemployment' - where certain levels of unemployment can be beneficial for economic growth (see above) - unemployment presents a waste of human talent and public means, endangering societal stability and inhibiting economic growth. Unemployment and poverty often go hand in hand. In 2000, nearly one-third of the world's labour force of about 3 billion was "either unemployed/underemployed in terms of seeking more work or earn less than is needed to keep their families out of poverty". At the end of 2002, worlwide official unemployment levels stood at approximately 180 people million, which was 40 million higher than before the peak of the Asian financial crisis in 1998 (ILO, 2004). The ILO notes that to absorb new entrants into the labour market and reduce working poverty and unemployment, at least one billion new jobs are needed to get anywhere near reaching the UN goal of halving extreme poverty by 2015. Particularly hard hit have been women and youth, who often have jobs that are particularly vulnerable to economic shocks, and/or workers in informal jobs. In particular the unemployment under youth has grown since the mid-1990s. Half the world's unemployed in 2004 are under the age of 24 (ILO, 2004). Youth unemployment rates are approximately twice as high as adult unemployment rates. Youth joblessness intensifies a number of social problems such as drug abuse, petty crime and one parent families. (www.ILO.org)

Unemployment growth in most developing countries, was also strongly linked to slower economic growth in industrialized nations. This implied that export-oriented, labour-intensive sectors like the garment industry (employing largely women) were particularly hard hit. Asia suffered most severely from the bursting ICT bubble, which cut exports to the industrialized countries. In the Middle East reductions in the size of the public sector pushed up unemployment to sometimes double digit levels. Gulf countries particularly responded by replacing migrant workers (from Asia) with their own nationals (ILO, 2003). In industrialized countries, official unemployment levels have been steadily rising after 2000, to 7.4 percent in the European Union and 5.6 percent in the United States. Japan registred more than 4% unemployment rates in 1998 for the first time after WorldWar II. Germany registred an postwar high unemployment figure of 12.6% of the working population in 2004. Note, however, that the official unemployment statistics are often an underestimation of the real jobless rates because unemployed are sometimes 'defined away' by national statistics bureaus.[3] Where employment grew in industrialized countries, it was at the cost of falling productivity. In industrialized countries, the poverty trap is partly complemented by an unemployment trap: people are deterred from taking a job because the reduction or removal of benefit will make them worse off. They move

[3] Unemployment statistics, due to their highly political nature, are amongst the most manipulated in the world. This is perhaps more so for unemployment ratios than for poverty Point of contention is what the total size of the 'working' population is, for instance. Next point is whether or not 'seasonal' unemployment should be included. Another point of contention is how to cover for 'structural' unemployment. In many countries, unemployed are not registred after a relatively short period. They fall out of the official unemployment statistics, and enter either the 'informal' sector or pop up in the 'poverty statistics'. Flexibilisation of labour is another dimension that leaves ample room for a downgrading of the actual unemployment figures. On the other hand, the German figures



from being unemployed (with benefits) to becoming a working poor (without benefits). A very difficult trade-off to make.

A sustainable (un)employment story?

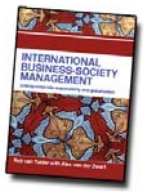
The sustainability challenge for societies is to keep unemployment ratios to an acceptable minimum (not necessarily zero) in order to keep the growth momentum. The sustainability challenges for companies are different, though. Do companies have a responsibility in hiring unemployed people or preventing lay-offs? In principle, companies should not have a responsibility in hiring unemployed people, but they can be held indirectly responsible for creating more beneficial circumstances under which unemployed people get a better change to re-enter the labour market, for instance by sponsoring re-training programmes, and exercise sufficient buying power. This argument is the more important in case companies operate on the lower end of the market in which the number of unemployed clientele can be substantial. For this category firms, good unemployment programmes are more important than for companies operating at the higher end of the market. It remains almost impossible for individual companies to take an individual responsibility for structural unemployment. This should be left to governments and communities, which however should also get the financial means to work on structural solutions. Companies that operate on the lower end of the market, and at the same time try to escape paying their 'fair share' of taxes to fund public employment programmes, indirectly contribute to their own vicious growth cycle.

In practice, however, most companies tend not to get overly worried by high unemployment rates because it moderates the wage demands and increases the loyalty of their own workers, whilst creating flexibility in the labour market. Unemployment creates a large labour reserve. Even companies with a bad reputation can get sufficient people to work for them in the presence of a large labour reserve. The sustainability challenge for companies is to determine what should be the conditions under which this pool of reserve labour should live, and what a good trade-off is between a large labour reserve with potentially lower wages, and the higher transaction costs involved in keeping social unrest at bay, and preventing the economy from getting into a downward growth spiral – which in the end affects all companies negatively.

Responsible lay-offs?

The unemployment challenge becomes more direct once companies can be held directly responsible for lay-offs. The announcement of lay-offs is of course always the moment for major societal battles, between trade unions and companies. In case companies have to fire people to remain competitive in the domestic market, creating a legitimate sustainability story can be relatively simple. In case companies engage in internationalization of production and therefore have relocate their plants to off-shore production sites, legitimating lay-offs becomes more complex. For instance, companies have to make the *counter-factual* argument: in case they would not have re-located the plant, their competitiveness would have been hurt even more seriously and other domestic employment would have disappeared. This is the challenge of multinational enterprises which will is dealt with in chapter 13 in more detail.

Publicly listed companies face a complementary and rather perverse logic: the announcement of (massive) lay-offs often has a more positive impact on the companies'



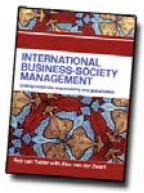
market capitalization than the announcement of bigger profits or the introduction of a new innovation. Laying-off employees has become part of the standard crisis management technique of listed companies – even when CEOs know that their longer term survival depends on the embedded knowledge in the heads of their personnel. One of the sustainability challenges of publicly listed companies thus is to break through this mechanism. It requires that the 'value' of workers and knowledge for the competitive position of a company is more appropriately measured and fed into the considerations of the stock analysts. Companies tend to stress the 'liability' side of a large number of workers, whereas they also represent a substantial 'asset' – albeit more difficult to measure than cash flow, buildings, machines or patents. A strategic partnership with trade-unions and governments seems a way out of some of these dilemmas. But the unemployment/poverty trap looms large for many unemployed; so a sustainable corporate story that addresses the issue of unemployment should come up with realistic alternatives for this problem.

Smaller and medium-sized as well as family owned firms have always shown the greatest absorptive capacity for unemployed workers, have often been the last to lay-off massive numbers of workers and are less confronted with complex legitimation exercises due to internationalization decisions. Companies that lay-off workers in a society with a good social safety net are in a different position than companies operating in societies where unemployment can be equated with poverty. The safety net sustains (part of) the purchasing power of unemployed and thus keeps the growth cycle of the economy virtuous. The lack of a safety net makes the lay-off decision more dramatic and the personal consequences the bigger. Should this affect the company? The strategic challenge of companies is to design a social security system that keeps the purchasing power of the inactive population intact, whilst keeping a sufficiently flexible labour market and sufficient incentives for people to invest in retraining to pick up other jobs and contribute to higher productivity after a period of unvoluntary leisure time.

5. Sustainability challenges for growth regimes

In order to create sustainable growth regimes, policy makers and business strategists have to find answers to the above specified trade-offs. The specific trade-offs chosen and their viability as economic model are part of the international rivalry between countries and systems. This final section of this dossier selects two types of challenges: aims (strategic) and statistics (operational) from the large number of challenges related to creation of sustainable growth regimes. Consecutive challenges can be the topic of complementary dossiers.

Getting the overall aims right. In order to address the key question on what is sustainable growth, new yardstick for 'progress' should be developed that move beyond the traditional – simplistic and even misleading – yardstick of Gross Domestic Product growth. Easterly (2001) when documenting for the painfully bad track record of official development assistance, calls this an 'elusive quest for growth'. New generations of growth theorists acknowledge that intervening variables such as political democracy, human rights (in particular the exploitation of women), health, education, the



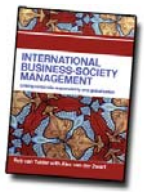
environment and equal access to opportunities strongly interact with econmic growth, but how to measure and operationalise these factors still presents major scientific challenges (Meier, Stiglitz, 2001). Some concrete initiatives have been taken to come to other definitions, the most important being the Human Development Index. This index was already used in chapter 2 to select relatively 'successful' models of economic growth. But this concept still contains serious limitations. So other concepts are viable, not only to stimulate further scientific debate, but also to 'structure' the bargaining process and feed it with relevant indicators to measure 'relevant growth' (see box)

CAN NATIONAL SUSTAINABILITY BE MEASURED?
ALTERNATIVE MEASURES FOR 'RELEVANT' ECONOMIC GROWTH

The economic development of a country is usually caught in one simple indicator: the growth Gross National Income (GNI) or Gross National/Domestic Product (GNP/GDP). When national statistical bureaus announce that the prospective growth of the GDP might turn out to be .1% less than expected the country is in disarray. The government feels obliged to 'do something', trade unions protests against what probably will be done, economists speak out loud against or in favour of the probable measures. But hardly anybody questions the reason for the whole ordeal: GDP measurement. The problem has two dimensions: (a) whether GDP provides an adequate measurement of the economy, (b) whether GDP growth is a good yardstick to measure 'progress'. The two are related and not undisputed. When firms are extremely polluting, this contains a considerable cost for society which is not measured in GDP statistics (negative externalities). In tackling the pollution new industries appear that increase the GDP. If pollution could have been prevented the economy would have grown less! So pollution and econoic growth are positively related. Another example: GDP measures accumulated wages. When someone has a housekeeper, this involves paying a fee for work done. When they fall in love and the two get married the housekeeping will probably continue, but with a negative effect on the national GDP because the housekeeping will be for free or not seperately registred as income. But, at the same time these people will share a higher degree of hapiness. So hapiness and economic growth can be negatively related. GDP measurement is therefore a highly inadequate and often misleading measure of 'progress'.

Four alternatives have developed for conceptualising and measuring GDP:

- ***The Human Development Index (HDI)*** is the best known alternative index developed by Nobel laureat Armatya Sen for the United Nations Development Programme; since 1980 this index is annually published in the Human Development Report (see chapter 2).
- ***Gross National Hapiness (GNH)*** is a concept developed by the state of Bhutan – one of the countries scoring extremely poor in international GDP comparisons. Next to economic development, GNH covers cultural, ecological and good governance factors. In the Gross National Hapiness measurement it is valued highly when a country has a rich and diverse cultural tradition, a high biodiversity and no overt expressions of blatant poverty. B
- ***Sustainable National Income (SNI)*** is a concept developed in the Netherlands by the institute for environmental matters (RIVM). Sustainable national income includes measuring what a 'green GDP' would involve by deducting the costs involved in recovering damages to the environment, instead of accounting the economic activities necessary to 'clean up' the country as a positive contribution to GDP. SNI has been heavily debated, but not yet applied by any government.
- ***Genuine Progress Indicator (GPI),*** was developed in 1995 by the Californian thinktank 'Redefining Progresss'. For the USA, the thinktank calculated for instance that in the 1995-2000 period wealth – as defined by GPI – did not progress, despite a considerable growth of GDP. Nova Scotia in Canada is applying the GPI – in a moderated version – to assess its own progress (Volkskrant, 8 May 2004).



Getting the statistics right. In particular unemployment and poverty statistics are a prime expression of the bargaining society. Numbers are regularly 'defined' away, which gives room for governments in particular to escape from taking their responsibilities. On the other hand, it also creates the problem that adequate approaches can not be developed because the nature of the problem is not adequately addressed. A sustainable growth regime, thus, tries to come up with as realistic as possible statements – preferably not on the basis of a single 'index'. Unemployment statistics, due to their highly political nature, are amongst the most manipulated in the world. This is perhaps more so for unemployment ratios than for poverty Point of contention is what the total size of the 'working' population is, for instance. Next point is whether or not 'seasonal' unemployment should be included. Another point of contention is how to cover for 'structural' unemployment. In many countries, unemployed are not registred after a relatively short period. They fall out of the official unemployment statistics, and enter either the 'informal' sector or pop up in the 'poverty statistics'. Flexibilisation of labour is another dimension that leaves ample room for a downgrading of the actual unemployment figures. The Netherlands for instance, registred all-time low unemployment figures in the 1990s, but this was also due to a large number of part-time workers. And a 'redefinition' of around one million people that were considered 'sick' rather than unemployed. The ILO statistics represent minimum assessments of unemployment levels. A more realistic (sustainable) course is chosen by the German government. Whereas the country would have 3,99 million unemployed in 2004 following ILO statistics, it changed its laws to include structurally unemployed and single mothers in the statistics, which resulted in an official figure of 5,2 milllion unemployed (Volkskrant, 2 March 2005). It put the (Schröder) government under increased political pressure, but also made the country better able to address the real issue and come up with a sustainable (un)employment story.

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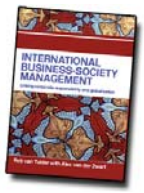

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