

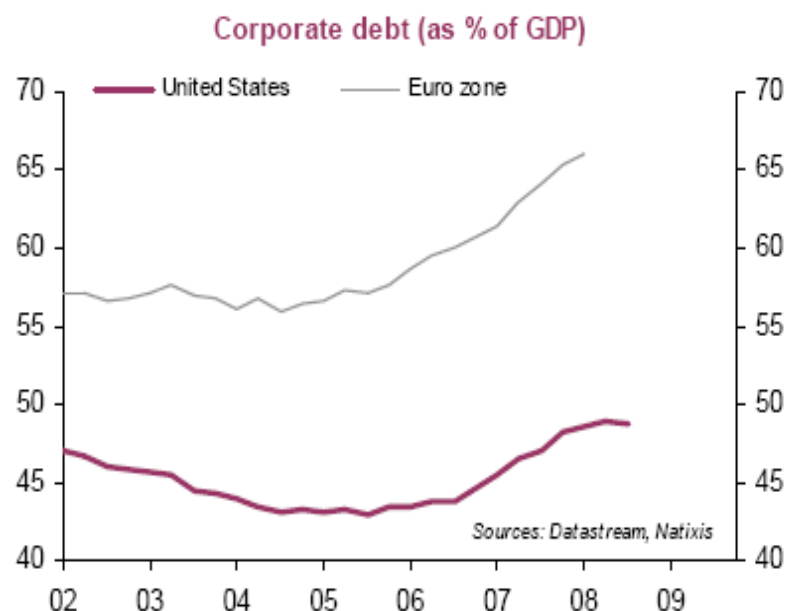


## WAGES AND CASINO CAPITALISM

### ETUC Collective Bargaining Information Bulletin 2009/2

#### *A financial time bomb waiting to explode*

European business is sitting on a financial time bomb waiting to explode. It's not only banks and other financial institutions which have been engaging in excessive borrowing. Casino capitalism's favourite technique of running up debts to speculate has also invaded the non financial corporate sector as well. Over the past years, corporate Europe has also been eager to take on high company debt burdens. Corporate debt in the euro area now stands at a hefty 11 trillion dollars<sup>1</sup>. Others sources put euro area corporate debt at 65% of GDP, higher compared to 2002-2003 (see chart) and also higher compared to the US (less than 50% of GDP.



Source: Natixis, Flash 2009 -70

<sup>1</sup> Business Week, 5th February 2009

Major parts of this stock of corporate debt are up for renewal in coming years, exactly at a moment when banks are cutting credit in order to drive down their own debt positions. As a consequence, many corporations fear they will find themselves in a very tough spot. Either business will be unable to find the new finance to renew the loans. And if business does find the money, the loans will carry much higher interest rates.

### **Corporate greed all over again**

Why did corporate Europe go on such a borrowing spree? From the side of financial supply, banks in Europe had plenty of liquidity to lend in the low inflationary era of European Monetary Union. On top of this, private equity funds were eager to pour in additional hundreds of billions.

However, developments on the demand side have been far more important. Besides the eagerness of European companies to undertake (foreign) acquisitions (an eagerness also explained by a strong euro making foreign acquisitions look relatively cheap), there are the usual but powerful elements of corporate greed and maximum 'shareholder value', with systems of stock options functioning as a driving force: Stock options provided CEO's the incentive to artificially boost the value of the company's stock. And the latter was done by systematically undercapitalising the company: High dividend payments and capital buy backs pushed company's equity down to

minimal levels while (interest bearing) debts burdens soared. The denominator effect of constant profits divided by a much reduced capital basis mathematically resulted in high and rising profitability rates supporting a boom in the value of the company stock. In turn, this enabled CEO's to cash in on their stock options. However, this result was obtained at the cost of increased risk for the company. With the equity basis much reduced, the company no longer disposes of a reserve or buffer to withstand negative shocks. And if company debt is up for renewal at much higher interest rates, the company is facing financial difficulties.

### **More pressure on wages**

With this financial time bomb ticking away, European corporations are slashing investment plans in an effort to hoard liquidity and reduce their debt exposure. According to research quoted in the Financial Times of 9th of February, business is cutting investment rapidly and companies domiciled in Western Europe would cut investment budgets this year by about 20%. Since business investment has a share of around 10% in GDP, this means a significant drag on demand and overall growth.

What does this imply for wages? There is little doubt that the company's weak financial position will be used to confront the workers with the usual form of

blackmail: To save their jobs, workers will be 'requested' to deliver wage moderation in order to pay for higher interest rate costs or the company's lack of liquidity and capital. This will certainly be the case in countries where wage bargaining is mainly done on the level of individual companies or where 'opening clauses' exist in sector collective bargaining agreements.

### **The perverse logic of casino capitalism**

Besides cutting investment spending, another way for business to restore their balance sheets is to draw in more capital from investors. However, with depressed stock exchange markets and with high risk aversion on investors' mind, companies will face fierce competition when trying to attract new capital. This may very well result in companies trying to attract new shareholders by paying out super dividends...

Arcelor- Mittal, the global steel company, is a case in point. Over the past years, the company also made the mistake of trying to ride the speculative boom by buying commodity supply lines with borrowed money. Highly indebted Mittal is now trying to boost profits, claiming that profit margins in Europe are much below the margins it realises in India. It has set a goal of an annual 25% profit margin for European operations and will probably be trying to reach that goal by making structural changes such as closing down capacity and cutting jobs for both

white as well as blue collar workers. However, and despite its indebtedness, Arcelor-Mittal was predicted to pay out a high dividend of 1.5 \$ but, also in reaction the pressure from the trade unions and the EMF's manifestation, the dividend was cut down to 0.75 \$ on the 11<sup>th</sup> of February..

So, the perversity of casino capitalism is that it may respond to crisis by resorting to the same techniques which generated the problems in the first place. Capital buy backs and high dividend pay outs have left companies undercapitalised. To recapitalise the company again management seeks to tempt risk averse investors by increasing dividend flows. Profits, which could be a basis for recapitalisation, are thus in danger of getting squandered away once again. Such is the logic of casino capitalism: 'The winner takes all' and workers who will be delivering most of the efforts (cuts in employment, cuts in wages) risk seeing their efforts evaporate in yet another tide of pay outs for capital owners.

### **How to stop the race for super dividends?**

Wages, as pointed out in the previous bulletin, will already be under much pressure from the downturn and from rising unemployment in general. Capital starved companies will add further to this pressure. Workers and wages will be 'requested' to bail over indebted companies out of the financial mess they have got themselves into.

However, and as was the case in the past, there are no guarantees that workers' efforts will not be squandered away. On the contrary, it may well be the case that individual businesses end up in taking each other hostage by engaging in a fierce competition to attract new capital by transforming wage and job cuts as super dividends.

Coordination or/and 'beneficial constraints' are possible ways out of this dilemma. Collective bargaining can provide the former. Especially in countries with strong collective bargaining tradition, collective agreements can be used to set a level playing field and limit the race towards super dividends. Practically this would imply that, probably in return for (temporary) wage moderation agreements, company management would also agree to put (temporary) limits on dividend payments and related systems such as manager pay and bonuses and stock options. In this way, the burden of crisis would be at least shared between labour and capital and there would be a kind of guarantee that workers' efforts do not end up in the pockets of capital owners as was too often the case in the past.

'Beneficial constraints' operated by economic policy are another possibility. One could go as far as to proclaim a European wide moratorium on dividend payments, thereby 'freezing' dividend payments at their existing level. In that way, the capital market 'playing field' would be levelled in Europe and this could perhaps also inspire

other regions of the world. Another possibility is to mobilize tax policy to cap the excesses in a more flexible way. This would involve a European wide tax on super dividends, taxing dividend payments exceeding well defined thresholds.

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