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**Policy responses to
the economic crisis**

**A decent work approach
in Europe and Central Asia**

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Policy responses to the economic crisis

A decent work approach in Europe and Central Asia

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Policy responses to the economic crisis: A decent work approach in Europe and Central Asia

1. The Director-General's reports to the Eighth European Regional Meeting were finalized in the autumn of 2008. Since that time the economic environment in the region has deteriorated at an alarming rate, with significant consequences for enterprises and labour markets. This paper therefore provides an update on the economic situation and a review of policy responses being discussed and pursued in Europe and Central Asia. It offers a preliminary assessment of the components of an integrated approach to placing decent work at the centre of crisis response measures.

Deepening recession in Europe and Central Asia

2. The speed and depth of the economic downturn are reflected in dramatic alterations in economic data and forecasts in the last few months. Output started to decline in the euro area and in many of the largest economies of Europe and Central Asia in the second and third quarters of 2008. Data for countries other than the EU-15¹ show that the economic crisis that started in 2008 was far more pronounced and widespread than initially thought.

3. Risk aversion intensified from mid-September 2008, capital flows to transitional economies all but dried up and equity markets in this group of countries crashed. The World Bank has recently noted that, of the 20 developing countries whose economies have reacted most sharply to the deterioration in conditions (as measured by exchange rate depreciation, increase in spreads and equity market declines), six are in Europe and Central Asia.²

4. Based on data now becoming available, the main regional and international financial institutions have made large adjustments to their economic forecasts. Forecasts by the European Central Bank (ECB) in September 2008 projected that euro zone output would increase by 1.2 per cent in 2009. A month later (October 2008) the International Monetary Fund (IMF) issued a *World Economic Outlook* predicting that the euro area would experience positive economic growth in 2009, albeit a very marginal 0.2 per cent.³ Less than a month later, however, in updated forecasts published in early

¹ The EU-15 are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and United Kingdom.

² World Bank: *Global Economic Prospects 2009: Commodities at the crossroads* (Washington, DC, 2009), p. 15. "Spread" is the term used for the extra interest above the most secure government bonds the market requires to lend to countries deemed to have a greater risk of default.

³ IMF: *World Economic Outlook October 2008: Financial stress, downturns, and recoveries* (Washington, DC, 2008).

November 2008, the IMF slashed its estimates of 2009 growth for the euro area by 0.7 percentage points,⁴ thus predicting a contraction in the area of 0.5 per cent in 2009. In December, the ECB warned that the euro zone economy could shrink by as much as 1 per cent in 2009.⁵ In January, the European Commission released forecasts of a decline in gross domestic product (GDP) of 1.8 per cent in the European Union (EU) in 2009, followed by a weak recovery to 0.5 per cent growth in 2010. This would result in a rise in the unemployment rate to 8.7 per cent in 2009 and 9.5 per cent in 2010.

5. Consequences of the financial crisis on labour markets are already visible across the whole region. For the first time since the mid-1990s, there has been a reversal in the trend towards a decrease in unemployment observed in Central and South-Eastern European (non-EU) countries and member States of the Commonwealth of Independent States (CIS). In 2008, unemployment in this area rose to 8.8 per cent.⁶ In the EU, employment is expected to decline by 3.5 million in 2008, with an increase in unemployment to 8.7 per cent in 2009 and 9.5 per cent in 2010, according to the January 2009 forecasts issued by the European Commission. In Turkey, the unemployment rate has risen from 9.7 per cent in the first ten months of 2007 to 10.2 per cent in the same period of 2008.

6. The degree of labour market slack that is emerging in the region is not fully reflected in official data. Moreover, in many countries there is mounting evidence that enterprises are responding to the downturn through reductions in working time, unpaid administrative leave and even wage arrears. The worsening economic crisis has sparked social unrest in some countries.

7. Countries in the region did not enter the crisis on an equal footing. Pre-crisis unemployment levels differed significantly across the region, and therefore the labour market consequences will not be uniform. Fiscal and current account balances also vary significantly, and some countries thus face greater constraints than others as they implement responses to the recession. However, on the whole there would appear to be considerable room for fiscal policy to help stave off the slowdown and stimulate recovery in much of the region.

8. The social and political repercussions of a deep and prolonged recession are difficult to assess with certainty, but the prognosis is clearly pessimistic. There has already been a dramatic deterioration in output and employment levels across the region. Starting in the financial services and construction sectors in the most affected countries, job cuts are now spreading throughout the manufacturing and service sectors of virtually all the countries in the region. It seems likely that the sudden freezing of credit to businesses in the autumn of 2008 forced sharp cutbacks in orders through the supply chain and hence in employment.

Policy responses to the crisis

9. Global imbalances are a major underlying factor behind the current economic crisis.⁷ Such imbalances include asymmetries between countries in their balance of payments situations, as well as the dramatic widening of income inequalities within

⁴ idem: *World Economic Outlook Update* (Washington, DC, 6 Nov. 2008).

⁵ idem: "More action needed to combat spreading world crisis, IMF says", in *IMF Survey Online*, 15 Dec. 2008.

⁶ ILO: *Global Employment Trends 2009* (Geneva, forthcoming).

⁷ See ILO, International Institute for Labour Studies (IILS): *A policy package to address the global crisis: Policy brief* (Geneva, 2008) and GB.303/WP/SDG/1.

countries over the last two decades. The latter is reflected in the declining share of wages in GDP in many countries, which has been discussed in a variety of recent ILO publications.⁸ It is imperative that these factors be borne in mind when discussing policy responses to the crisis and that reforms be implemented now to mitigate these global imbalances.

10. The pace and severity of the impact of the financial crisis on productive enterprises and employment appear to be linked to changes in methods of corporate finance. During the years of cheap and easy credit many companies, especially the largest, ceased keeping cash balance for working capital and issued short-term bonds, usually of three months' duration. This form of credit froze abruptly in September 2008, leaving many businesses facing sudden and severe cash-flow problems that in turn led to cuts in orders from suppliers and layoffs. Some governments have offered emergency finance to firms, while also encouraging banks to use the extra liquidity provided to restore credit lines. In the longer term, a sustained and stable recovery will require a re-engineering of international financial regulations to ensure less volatile credit conditions for productive enterprises.

Effect of and space for financial and monetary policy

11. Between September and December 2008, most countries eased their monetary policies markedly, but these measures have not, so far, succeeded in reversing the downward trends in the European economy. Some countries were obliged to tighten monetary and fiscal policies to obtain financial assistance from the IMF and other official sources.

12. Government authorities across Europe and Central Asia have had to take extraordinary measures to help stabilize financial markets and try to preserve lending to enterprises and households and hence employment and incomes. These interventions included significant cuts in interest rates, large injections of liquidity and easing requirements on collateral for refinancing operations by central banks. In several countries of the region, even more dramatic steps were required, including the takeover of financial institutions and/or public purchase of equity in commercial banks, and the establishment or enhancement of bank deposit guarantees. Despite these measures, growth has weakened.

13. First, official rate cuts have not been systematically passed on by commercial banks. This has engendered massive liquidity problems for firms that needed access to short-term finance at affordable rates. As a result, central banks had to take the extraordinary measures mentioned above, including offering unlimited short-term liquidity to commercial banks as a stopgap measure.

14. Second, worries about economic insecurity are leading many employees and employers to postpone decisions regarding consumption or investment. This raises the spectre of descent into deflation, which would have disastrous consequences for employment and decent work.

15. Third, the scale of bank losses continues to rise as the value of their assets tumbles.

⁸ See ILO: *Global Wage Report 2008/09: Minimum wages and collective bargaining – Towards policy coherence* (Geneva, 2008) and ILO, ILS: *World of Work Report 2008: Income inequalities in the age of financial globalization* (Geneva, 2008).

16. Counter-cyclical monetary policy is highly desirable for most countries in the region, and there is space for interest rate cuts before they reach their limit of zero, as they effectively have in Japan and the United States. However, the emphasis is shifting to measures of financial support to banks aimed at ensuring sufficient credit to businesses to reverse the slide in production, employment and consumption.

17. Not all central banks in the region have pursued a counter-cyclical monetary policy in recent months. Several post-transitional and CIS countries were faced with large levels of foreign debt, high inflationary pressures and massive capital flight, severely limiting their policy space to respond to the crisis.

18. The Central Bank in Hungary increased interest rates in October 2008 by a massive three percentage points (from 8.5 to 11.5 per cent) in an attempt to avoid depreciation of the domestic currency. Despite this move, the Government was forced just a few weeks later to seek emergency assistance from the IMF (along with the EU and the World Bank). Hungary has recently eased interest rates by half a percentage point, but they still remain well above their level of last October.

19. Ukraine has had to borrow from the IMF as a result of large capital outflows and high levels of foreign debt. In late 2008, the IMF and others provided the Ukrainian Government with an emergency loan of US\$16.4 billion. This came with conditions under which the authorities aim “to restore financial and macroeconomic stability by adopting a flexible exchange rate regime with targeted intervention, a pre-emptive recapitalization of banks, and a prudent fiscal policy coupled with tighter monetary policy”.⁹ According to the IMF, “resolute implementation of the program should help reduce inflation to single digits by the end of the program”.¹⁰

20. The impact of the devaluation of the hryvna on enterprises and workers, as well as the extent of capital outflow and pressure on the exchange rate, has been alarming. The hryvna to dollar rate almost doubled over the three months to late December. Such a large depreciation had adverse consequences for workers and other consumers, who must pay higher prices for many basic commodities that are imported. More importantly, many companies – but also many middle-income families – had borrowed money in foreign currencies in recent years. These firms and families now face huge increases in the local currency cost of their loan repayments.

21. Latvia chose not to devalue and hence had to borrow heavily from the IMF, which subsequently required draconian fiscal and incomes policy measures. The Government, which has expressed a desire to join the euro zone in the near future, decided to maintain the existing exchange rate peg between the domestic currency and the euro. To support the rigid exchange rate, the Government needed massive loans, which it obtained with IMF help from the EU and Nordic countries, as well as the IMF itself. The loan package provided to Latvia amounts to almost one third of the country’s GDP – compared to less than 17 per cent of GDP for Hungary and 9 per cent for Ukraine.

⁹ IMF: “IMF approves US\$16.4 billion stand-by arrangement for Ukraine”, Press release No. 08/271, 5 Nov. 2008.

¹⁰ *ibid.*

Fiscal policy

Fiscal policy in vulnerable countries

22. Fiscal policy responses to the economic crisis across the region have diverged dramatically. Countries like Belarus, Hungary, Iceland, Latvia and Ukraine have found it necessary to introduce deflationary policies to obtain emergency loans from the IMF. Such policies can restore a degree of confidence in national finance markets, but the price is an intensification of the recession, with negative impacts on employment, wages and investment.

23. Hungary had to borrow US\$25 billion from the IMF, the EU and the World Bank in early November 2008. The conditions attached to the IMF loan required the Government to reduce fiscal expenditures significantly, adjusting the target fiscal deficit for 2008 to 2.9 per cent of GDP. Further spending cuts are needed in 2009. These spending cuts come on top of austerity measures the Government was already implementing, which had reduced the fiscal deficit by almost six percentage points of GDP between 2006 and 2008. In implementing the IMF conditions, the Government has unilaterally introduced a freeze on public sector salaries and cancelled the payment of a 13th-month bonus for 2009. Announcing the loan, the IMF stated that “adjustment will need to include revisions of wages and pensions. Under the authorities’ program, expenditure restraint will be achieved in part through reductions in the overall government wage and pension bill. Nominal wage adjustments will be postponed and pension bonuses suspended”.¹¹

24. In Ukraine the IMF stand-by agreement includes a provision to cut the fiscal deficit for 2008 to 1 per cent of GDP.¹² Much of the fiscal tightening is expected to come through reduced expenditure on public sector wages and benefits, plus reductions in the overall level of social expenditure. The Government has agreed to a freeze on public sector wages during 2009 and a revision of indexation for various social transfers, which in a situation of falling inflation implies a significant decline in the real value of pensions and other transfer payments. The agreement with the IMF also requires the Government to postpone for two years a planned increase in the minimum wage.

25. In Latvia the programme negotiated with the IMF provides for a nominal reduction in public sector salaries by 15 per cent in 2009. In addition, employment in public administration is being reduced by 15 per cent over the next three years, and expenditure on goods and services procured for the State are to be cut by 25 per cent. The Government has also made commitments to reduce wages in the private sector, without specifying how this will be achieved.¹³ While the measures include reductions in personal income tax, substantial increases in value added tax (VAT) will have a severe impact on domestic demand. The European Commission forecasts a 6.9 per cent contraction in the Latvian economy in 2009.

26. Between 2004 and 2007, Latvia enjoyed buoyant conditions, with real GDP expanding at average annual rates of around 10 per cent. Much of this growth was financed by massive foreign borrowing in the private sector, which was largely devoted to speculation in the real estate market. The stock of foreign debt contracted by the private sector increased nearly fourfold between 2004 and 2008, and currently stands at

¹¹ IMF: “IMF approves loans for Hungary and Ukraine”, in *IMF Survey Online*, 6 Nov. 2008.

¹² IMF and Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, 31 Oct. 2008.

¹³ See Latvian Government’s letter of intent to the IMF, in *IMF Country Report*, No. 09/3, Jan. 2009.

about 140 per cent of GDP, while net public debt stood at a modest 7 per cent of GDP in 2008. However, public sector jobs and salaries are now paying a high price for this unsound speculation.

27. The terms of recent IMF loans contrast with the Fund's strong advocacy of heavy and quick fiscal spending to counter the economic slowdown.¹⁴ However, the IMF has also argued that "in some of the programs the Fund is supporting at the moment, we are calling for some fiscal retrenchment, despite our call for global fiscal stimulus. If there was fiscal room for maneuver in these program countries, we would say 'use it'. But often there is no room for maneuver".¹⁵ There is also a need to evaluate the content of IMF programmes against the Managing Director's promise to implement "social conditionality – helping countries develop or maintain safety nets for segments of the population that may be affected by an IMF program".¹⁶

Fiscal policy in the European Union

28. A European Economic Recovery Plan proposed by the European Commission was broadly endorsed by the 27 governments of the European Council on 12 December 2008.¹⁷ The Plan is designed to boost European Union GDP by 1.5 per cent.¹⁸ It includes a 30 billion euro increase in EU expenditure in a variety of areas, including small and medium-sized enterprises (SMEs), renewable energy, clean transport and the automotive industry.

29. The bulk of additional expenditure (170 billion euros) is expected to come from the governments of the Member States (the EU-27). The conclusions of the European Council summit set out general guidelines for this fiscal expenditure. They state that stimulus measures may take the form of increased public spending, reductions in tax burdens, a reduction in social security contributions, aid for certain categories of enterprises or direct aid to households, increased funding for investment and infrastructure, improving the competitiveness of enterprises and greater support for SMEs, and the promotion of employment, innovation, research and development, education and training.¹⁹

30. The impact of national stimulus packages on employment and decent work is difficult to assess at this stage. However, some general comments can be made. The effect on aggregate demand and employment will depend on a variety of factors, including: (a) the magnitude of the package; (b) the speed at which measures are implemented and the duration of the stimulus; (c) the extent to which any initial stimulus is saved or withdrawn from circulation; (d) the extent to which the stimulus leaks from the national economy through increased imports and the capacity of supply to respond to any increase in demand; and (e) longer-term consequences of a higher fiscal deficit.

(a) *Magnitude of stimulus package*

31. It is difficult to calculate the precise magnitude of the stimulus packages that have so far been announced at national level. This is partly because some governments have

¹⁴ D. Strauss-Kahn: "The IMF and its future", speech at the Banco de España, Madrid, 15 Dec. 2008.

¹⁵ *ibid.*

¹⁶ IMF: "IMF watching out for poor in crisis loan talks", in *IMF Survey Online*, 25 Nov. 2008.

¹⁷ Council of the European Union: *Presidency Conclusions*, 17271/08, Brussels, 12 Dec. 2008.

¹⁸ European Commission, Directorate General For Economic and Financial Affairs: *Quarterly Report on the Euro Area*, Vol. 7, No. 4 (2008).

¹⁹ Council of the European Union, *Presidency Conclusions*, *op. cit.*, para. 12.

included activities or expenditures that were already envisaged. Various academics and economic institutes have nevertheless examined these proposals and assessed them against the guidelines contained in the European Economic Recovery Plan. Estimates by one think tank²⁰ suggest that the initial stimulus packages varied significantly in size among the 13 countries. The largest were in Austria, Spain and the United Kingdom, where the estimated size of the proposed fiscal packages for 2009 slightly exceeds 1 per cent of GDP. As these estimates were made in mid-December 2008, events have moved rapidly since then, with many countries such as Germany and the United Kingdom augmenting the measures they had taken and other countries announcing their initial plans.

32. The conclusions of the European Council meeting in December 2008 make it clear that the expectation was that the measures implemented by national governments would total about 1.5 per cent of GDP for the EU. This is considerably lower than the 2 per cent magnitude suggested by the IMF Managing Director. More recently, there are signs that the IMF may support an even larger fiscal boost in the countries where it is not providing emergency loans. A statement by IMF staff argues that the precise magnitude of the stimulus should depend on the extent of the decline in private sector demand and should be reviewed in the light of developments.²¹ According to the statement, the fiscal stimulus should be “contingent, because the need to reduce the perceived probability of another ‘Great Depression’ requires a commitment to do more, if needed”. While many observers believe that the magnitude of the fiscal stimulus should vary from country to country, others have suggested that there should be a “floor” or minimum magnitude of fiscal stimulus in all countries.

(b) *Speed of implementation and duration*

33. The speed of implementation and duration of the stimulus will have significant consequences for economic growth and employment. Much of the initial international advice emphasized measures that could be rapidly turned on and then off again. For example, the EU and the European Council Presidency Conclusions referred to above argued that measures to support demand must aim to produce immediate effects and be of limited duration. The Organisation for Economic Co-operation and Development (OECD) and others have stated that the fiscal stimulus should be timely, targeted and temporary.²²

34. One type of stimulus that could be implemented rapidly is the intensive use of automatic stabilizers, for example raising the level or duration of unemployment benefits and/or widening eligibility for benefits, increasing other welfare payments and expanding social safety nets. This type of measure also has the advantage of being targeted at disadvantaged groups in society, and the fiscal cost of such measures automatically declines when unemployment and poverty levels fall back to more normal levels. These measures thus meet the “timely, targeted and temporary” criteria. As a result, many international organizations, including the OECD and the IMF, have strongly supported measures of this nature.

35. In practice only a limited number of countries in the region have significantly expanded the level, duration or eligibility criteria for unemployment benefits and other

²⁰ D. Saha and J. von Weizsäcker: “Estimating the size of the European stimulus packages for 2009”, Brussels European and Global Economic Laboratory (BRUEGEL), 12 Dec. 2008.

²¹ A. Spilimbergo et al.: *Fiscal policy for the crisis*, IMF staff position note, 29 Dec. 2008, p. 3.

²² OECD: “OECD strategic response to the financial and economic crisis: Contributions to the global effort”, Note by the Secretary-General, 23 Dec. 2008, p. 9.

welfare payments. Moreover, not all countries within the region have comprehensive social security systems which allow such expansion.

36. Tax reductions are being proposed in many countries because they can also be implemented rapidly. A wide variety of possibilities exist, including income tax cuts, VAT reductions and company tax cuts, with different impacts on demand and employment. For example, the Government of the United Kingdom has reduced VAT by 2.5 percentage points for a limited duration in the expectation that this would encourage consumers to bring forward purchases. Several other countries, including Germany and France, have opted instead for more targeted incentives, such as sizable cash transfers for the purchase of particular products, for example, new fuel-efficient cars.

37. By comparison with the expanded use of automatic stabilizers and tax cuts, other stimulus measures – such as increased expenditure on physical infrastructure, public works programmes or the expansion of social expenditure – generally take longer to implement. However, speed of implementation can be accelerated by focusing attention on upgrading the maintenance and repair of existing physical infrastructure or bringing forward construction activities and social expenditure programmes. Many countries in the region are including public investment programmes in their stimulus packages.

38. Alongside increasing estimates of the duration of the current economic downturn, views about the balance of fiscal packages are also shifting towards more enduring programmes rather than temporary boosts. The IMF is arguing in favour of frontloading existing public investment projects, increasing maintenance spending on infrastructure and encouraging governments to start planning new investment projects that can be implemented if the downturn continues.²³ Focusing on increased public investment can also advance critical public policy objectives such as promoting low-carbon economic growth and “green” jobs.

39. Measures that are employment-intensive and can be rolled out quickly include renovation of buildings to improve energy efficiency. Buildings account for 35 to 40 per cent of all energy use. Energy consumption can be reduced by around half through better insulation, installation of more efficient heating, air conditioning and lighting and integration of renewable energy generation into buildings. These measures are cost-effective and often profitable, with short pay-back times. They can be applied very rapidly to public buildings, including low-cost housing.

40. Work of this nature is typically carried out by local SMEs in the building sector, which currently have idle capacity owing to the financial crisis. Other areas for early generation of green jobs include: acceleration of public transport projects for which design and building permission have already been obtained; a faster roll-out of renewable energy projects at both large and small, decentralized levels; repairs to environmental infrastructure, such as water distribution systems; and environmental rehabilitation projects related to abandoned industrial sites, forests, rivers and coasts.

41. The EU also favours a focus on public expenditure rather than tax cuts, even though this may take longer to implement, because of its potential to boost the longer-term productivity of the economy. These considerations would support focusing public investment on education, plus research and development, in addition to physical infrastructure. Increased public expenditure on other labour-intensive social services such as health care and child care is equally important.

²³ IMF staff position note, *op. cit.*, p. 1.

(c) *Maximizing multiplier effects on employment*

42. The impact of any particular stimulus measure on output and employment will depend on how much of the additional initial expenditure is saved or withdrawn from the economy. This is one aspect of the multiplier effect, and one of the main arguments in favour of government expenditure increases rather than tax cuts. For example, income tax cuts will lead to higher disposable incomes of consumers, but it is unlikely that all of this increase in income will be spent immediately, as most people will save a proportion of the tax cut. This is particularly true in current circumstances, as workers fear for their jobs and are more inclined to delay purchases until the economic climate improves. Similarly, enterprises face a sharp reduction in demand for their products and services, costly credit and a high degree of uncertainty. In these circumstances, lowering company taxes, raising depreciation allowances or providing unconditional subsidies to firms may reduce enterprises' debts or improve their balance sheets, but will not necessarily increase investment expenditure, aggregate demand and employment.

43. Such considerations would suggest that government spending on physical infrastructure or other forms of social expenditure would have a larger initial impact on output and employment than general tax cuts for either consumers or enterprises. However, not all consumers or enterprises are on an equal footing. The poor are least likely to save increases in their disposable income, and raising the disposable incomes of those at the bottom end of the earnings spectrum will have larger multiplier effects than income increases that are applied equally across the entire population. These considerations have led the IMF and others to argue in favour of temporary increases in earned tax credits and lump-sum tax rebates targeted at low-income groups and credit-constrained consumers.²⁴

44. On the other hand, the IMF has argued strongly against reductions in corporate tax rates, dividends and capital gains taxes or the introduction of special incentives such as accelerated depreciation for enterprises. Nevertheless, consideration should be given to government support for enterprises facing particularly difficult circumstances that would lead to closure or very large employment reductions. However, public subsidies for enterprises should be linked to restructuring plans that preserve employment levels and result from social dialogue between management and trade unions. In addition, increased support for SMEs which cannot currently gain access to reasonably priced credit should be prioritized, since they account for a large share of total employment in most countries.

(d) *Increased imports and the domestic economy supply response*

45. Another way in which any stimulus measure may leak out of the domestic economy and thus not produce the desired impact on domestic demand and employment is through an increase in imports. The more open the economy, the greater the potential leakage through this channel. Fear of such effects may encourage a free rider problem and explain the reluctance of some countries to implement appropriate packages and rely rather on the stimulus measures in their trading partners to spur export-led growth. It should be noted, however, that countries with little scope for fiscal expansion are in effect obliged to rely on the spillover effects of stimulus measures by stronger neighbours. Without resources, freeriding is not a choice but a necessity. The only way to overcome such problems of international coordination is through collective commitment to action from all countries to a comprehensive international programme based on an agreed sharing of additional borrowing requirements.

²⁴ *ibid.*, p. 14.

46. Beyond such considerations, the impact of any stimulus package on employment will depend on how rapidly the local economy can respond to any increase in domestic demand. These factors lie behind the focused incentives and cash transfers that some governments are providing to consumers who are most likely to purchase locally produced products. The national impact of public investment programmes also depends on the degree of dependence on imported construction materials. A Europe-wide approach to employment-generating infrastructure investment would mitigate such concerns, as well as contributing to the longer-term goal of closer market integration.

(e) *Consequences of higher fiscal deficits*

47. Many international bodies, including the OECD, the EU and the IMF, have expressed concerns about the longer-term consequences of increasing fiscal deficits and have therefore encouraged governments to outline feasible medium-term plans to restore fiscal discipline. These considerations are important, and governments need to be mindful of the impact that a permanent increase in government borrowing could have on interest rates and/or inflation. In the current environment, however, concerns about inflation or any fears of crowding out the private sector through increased government expenditure are largely misplaced. On the contrary, in a recession, increased public investments in infrastructure, public transport and low-carbon technology are likely to crowd in private investment. With interest rates low and a serious risk that the recession could become deeper, longer and, in fiscal terms, more costly than anticipated, high levels of borrowing are warranted.

48. While this may be a valid general argument, an emerging issue is that governments of countries perceived to be relatively weak are having to pay significantly higher interest rates on their bonds than others deemed to be more stable. Even within the euro zone the spread between government bond prices has widened. Coordinated fiscal stimulus measures may therefore require a more collective approach to borrowing to ensure that all countries are able to contribute effectively to the implementation of an international recovery strategy.

Placing decent work at the centre of the policy response

49. The scale, depth and breadth of the crisis in Europe are much larger than even pessimistic commentators expected when the first signs of financial market stress began to emerge in the summer of 2007, and the situation has considerably worsened over the last six months. The impact on enterprises, employment and decent work is building up alarmingly. Current forecasts do not see a bottoming out of the recession until at least late 2009, and the likelihood is that recovery will be slow in 2010.

50. Furthermore, the crisis is global in reach. Europe is particularly affected by the slowdown in North America and Asia. Europe's partners in Africa, Latin America and the Arab world are also increasingly hit by the crisis. Policy responses must therefore have a specific European dimension while at the same time being part of a global effort to stave off a steepening downward spiral from recession into depression and stimulate a recovery which leads on to a more sustainable path for globalization.

51. A key responsibility of the ILO and its constituents is to help ensure that policy responses maximize the employment content of recovery measures. Restoring growth and making it less volatile in the future are essential to the successful pursuit of the Decent Work Agenda. In this respect, it is vital to ensure that:

- lasting damage to the productivity of the labour force is avoided and investment in future improvement maintained;
- the most vulnerable members of the labour force are well protected and do not become separated from the labour market;
- sustainable enterprises, particularly smaller firms, are assured of adequate financing and readied for the recovery; and
- institutions for social dialogue are fully utilized to share information and determine agreed policy responses.

52. As the Officers of the Governing Body emphasized in their November 2008 statement,²⁵ “Promoting employment, social protection, and fundamental principles and rights at work and social dialogue constitutes, through the ILO’s Decent Work Agenda, an effective policy package in response to the current economic crisis. The vision and strategy adopted in the 2008 ILO Declaration on Social Justice for a Fair Globalization is fully relevant in this context”. The Declaration²⁶ highlights the importance of coordination by member States of the positions they take in relevant international forums and of the vital contribution that other international and regional organizations have to make to the implementation of an integrated approach to decent work. Specific attention is drawn to the effect on employment of trade and financial policies and hence the role of the ILO in evaluating such effects. The 2008 Declaration thus provides a valuable framework for developing an integrated ILO approach to the crisis which places full and productive employment and decent work at the centre of economic and social policies.

53. Many of the aspects of the crisis the Regional Meeting may wish to discuss can be grouped under four dimensions of an integrated decent work approach:

- the coordination and development of fiscal policy packages designed to arrest the slowdown and stimulate recovery;
- financial measures to reactivate frozen credit lines to business and consumers and reform of regulatory systems to restore confidence in the stability of capital markets;
- the promotion of employment, labour market and social protection policies which maximize the impact of fiscal, monetary and financial market policies on enterprise development, job creation and social cohesion;
- improved mechanisms of international support to countries made vulnerable by severe balance of payments, capital flight or currency depreciation problems.

Fiscal policy coordination

54. Many countries in the region have recently announced stimulus packages to mitigate the consequences of the recession. The magnitude and content of the packages adopted to date vary significantly. Further attempts to promote coordinated action across the region are required to ensure that maximum advantage is gained from the multiplier effects of all countries moving at the same time to inject spending power into the European economy. Such measures should also be coordinated with the region’s global partners.

²⁵ ILO: “The global economic crisis”, Statement of the Officers of the Governing Body, Nov. 2008.

²⁶ ILO Declaration on Social Justice for a Fair Globalization, adopted by the International Labour Conference at its 97th Session, Geneva, 10 June 2008.

55. The IMF and the European Commission have argued that such measures will need to add up to a total of at least 2 per cent of world GDP or 1.5 per cent of European GDP. However, some countries have more policy space than others. This suggests that some could introduce measures exceeding 2 per cent, or that extra assistance could be provided to countries with limited fiscal space through increased international loans. The maximum magnitude of stimulus packages should be adjusted upwards if demand contraction exceeds current expectations.

56. In addition to the size of such fiscal stimulus measures, the content of packages affects their impact on employment. For example, increases in disposable incomes either through tax cuts or through social benefit increases are more likely to be spent by lower-income households and thus have a stronger effect on aggregate demand. Such measures yield relatively quick results. Infrastructure investments have a more direct impact on job creation, but can take longer to disburse unless project plans are far advanced. Infrastructure investment also pays off in the longer term by improving the overall productivity of the economy, reducing greenhouse gas emissions and promoting other forms of environmental protection.

57. The Regional Meeting may wish to request that the ILO, in collaboration with Members and the relevant regional and international organizations, evaluate the consequences for the Decent Work Agenda of the size and content of fiscal packages and provide a report to constituents at the time of the International Labour Conference.

58. In some countries the scope and content of stimulus measures have been the subject of consultations with social partners. The Meeting may wish to ask the Office to collect information to share with Members on the extent of social dialogue on counter-cyclical fiscal policies.

59. The issue of international policy coordination is under discussion in various forums including the EU, the OECD and the IMF. The Meeting may wish to request the ILO to review the possibilities for promoting decent work objectives through such coordination initiatives and advise Members.

Financial measures and reform of capital market regulations

60. Fiscal policy measures are, to a large extent, aimed at filling the holes in economic activity created by the freezing of credit flows from the financial system. Restoring normal access to credit is therefore essential. A number of countries have introduced emergency measures to prevent closure of significant financial institutions and to reactivate frozen credit lines to sustainable enterprises.

61. Alongside such short-term initiatives, governments are individually and collectively examining reforms to capital market regulations to prevent the sort of excessive risk taking and dubious innovations in securitization that seem to have been a root cause of the financial meltdown.

62. The conclusions concerning the promotion of sustainable enterprises, adopted by the International Labour Conference at its 2007 session, stressed that “A well-functioning financial system provides the lubricant for a growing and dynamic private sector. Making it easier for SMEs, including cooperatives and start-ups, to access financing, for example, credit, leasing, venture capital funds or similar or new types of instruments, creates appropriate conditions for a more inclusive process of enterprise

development. Financial institutions, particularly multilateral and international ones, should be encouraged to include decent work in their lending practices".²⁷

63. Stable and trustworthy capital markets for the supply of investment and working capital are vital to sustainable enterprises and decent work. The Meeting may therefore wish to request the Office to evaluate the impact on employment of emergency measures to normalize credit flows and the various reform proposals under consideration, in collaboration with the relevant international institutions.

64. The Meeting may also wish to suggest that the Office examine the scope for using the ILO Declaration on Multinational Enterprises²⁸ to expand dialogue along supply chains to ensure that the impact of the recession is mitigated.

Employment, labour market, social protection and rights at work

65. The November 2008 statement by the Officers of the Governing Body identified a number of employment, labour market and social protection measures required to protect people, support productive enterprises and safeguard jobs and address the impact of the crisis on the real economy. It also reaffirmed that, during times of crisis, vigilance is needed to ensure full respect for fundamental principles and rights at work, namely freedom of association and the effective recognition of the right to collective bargaining, the elimination of all forms of forced or compulsory labour, the effective abolition of child labour, and the elimination of discrimination in respect of employment and occupation.

66. Social dialogue and the practice of tripartism between governments and representative organizations of workers and employers within and across borders are especially relevant to achieving solutions and building social cohesion during the crisis. Reflection through dialogue on policy options and priorities for recovery is essential.

67. Consideration should be given to extending unemployment benefits, facilitating additional training and retraining opportunities, strengthening placement services, and enlarging or putting in place emergency employment schemes and targeted safety nets. Young women and men, informal and precarious workers, migrant workers and the working poor are among those most in need of such protection. Safeguarding pension systems is a priority, as is revising credit terms for indebted homeowners.

68. It is necessary to develop and enhance measures of social protection – social security and labour protection – which are sustainable and adapted to national circumstances, including the extension of social security to all, for example through measures to provide basic income to all those in need of such protection, and policies in regard to wages and earnings, hours and other conditions of work designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed persons in need of such protection. In times of financial turmoil, it may be particularly important to preserve the financial sustainability of pension systems and social security systems in general.

69. Sound employment relations systems which contribute to balanced economic growth are of particular value in the current crisis, not least to help avoid policies that

²⁷ ILO: *Provisional Record* No. 15, International Labour Conference, 96th Session, Geneva, 2007.

²⁸ ILO: Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, adopted by the Governing Body at its 204th Session, Nov. 1977.

will exacerbate global imbalances or increase income inequalities. Reducing wage levels in the current economic environment to gain a competitive advantage could provoke a downward spiral in disposable incomes, consumption expenditure, aggregate demand and employment levels. A more coordinated approach to wage bargaining could help stabilize the deflationary consequences of individual firms' temptation to cut labour costs.

Mechanisms of international support

70. National monetary, fiscal, labour market and wages policies differ substantially, partly because some countries have little policy space to finance measures commensurate with the social and economic impact of the crisis. One indicator of policy space is the ability of governments to borrow on international capital markets to finance fiscal deficits emerging as a result of the crisis and enlarged by measures to counter the slowdown. If international investors perceive a risk of default on such loans, the rate of interest demanded rises, the cost of insuring against default goes up and, in some cases, it becomes impossible to raise private loans at all. A further complication is that perceptions of risk are relative. Thus, if "safe" borrowers are issuing large volumes of government bonds, they can dry up the supply of loan capital available, leaving less safe borrowers to pay a premium.

71. The main official international lender of last resort to support countries unable to raise private loans is the IMF, often supplemented by other official loans from the World Bank, regional development banks and, in the case of Europe, various EU institutions. IMF support to countries in balance of payments difficulties is generally conditional on the adoption of specific national fiscal, monetary and other policies. In Europe, a number of countries have therefore adopted pro-cyclical policies that reduce public sector deficits (and thus aggregate demand), raise interest rates and further squeeze credit to qualify for loans. In some cases, minimum wages have been reduced or increases postponed.

72. In an increasingly interdependent economy, such as that of the European region, deflationary action during a recession by a number of countries serves to reduce the stimulatory effect of counter-cyclical policies in other countries. As the crisis deepens and spreads, it is increasingly likely that many countries will have to seek IMF support and/or resort to deflationary survival strategies. There is a real risk that the traditional "country by country" approach of the IMF will run counter to the Managing Director's recent call for a global stimulus and thus lead to the "beggar-thy-neighbour" policies that could all too easily deepen the recession. In this context it is also vital that Europe maintain development aid at current levels as a minimum and provide additional credit lines and support to enable low-income countries to cushion the crisis.

73. Looking to the conditions necessary for a stable and brisk recovery, the global imbalances that lie at the core of the current economic crisis must be addressed. The correction of these imbalances requires a new approach to coordination which, among other things, encourages countries with persistent surpluses in their trade accounts to boost domestic demand and allows deficit countries greater space to adjust without deflation. Part of the underlying causes of trade and current account imbalances between countries may lie in social imbalances, such as widening income inequalities and shifts in wage/profit shares, which can destabilize relationships between savings, consumption and investment – the foundations of a conducive environment for sustainable enterprises and stable growth in employment and living standards. The European Members of the

ILO may wish to seek opportunities to ensure that such considerations form part of the discussions on reform of the multilateral system.

74. The Meeting may wish to request that the Office evaluate the policies and responses to the crisis of the regional and international economic and financial organizations, with a focus on the cost and benefits for sustainable enterprises, decent work and social justice of improved international policy coordination and new approaches to structural adjustment. With its rich institutional structures for collective action, Europe is well placed to lead this re-examination of mechanisms of international support and coordination to underpin the goal of decent work for all across the region and design stronger mechanisms to shape a fair globalization.