A common economic crisis but contradictory responses: The European experience 2008-09

Working Paper No. 93

Robert Kyloh

and

Catherine Saget

Policy Integration Department
International Labour Office
Geneva

May 2009

Working papers are preliminary documents circulated
to stimulate discussion and obtain comments

Copyright © International Labour Organization 2009
First published 2009

Publications of the International Labour Office enjoy copyright under Protocol 2 of the Universal Copyright Convention. Nevertheless, short excerpts from them may be reproduced without authorization, on condition that the source is indicated. For rights of reproduction or translation, application should be made to ILO Publications (Rights and Permissions), International Labour Office, CH-1211 Geneva 22, Switzerland, or by email: pubdroit@ilo.org. The International Labour Office welcomes such applications.

Libraries, institutions and other users registered with reproduction rights organizations may make copies in accordance with the licences issued to them for this purpose. Visit www.ifrro.org to find the reproduction rights organization in your country.

Kyloh, Robert; Saget, Catherine

A common economic crisis but contradictory responses : the European experience 2008-09 / Robert Kyloh and Catherine Saget ; International Labour Office, Policy Integration Department. - Geneva: ILO, 2009
27 p. (Working paper ; no.93)

ISBN: 9789221224211;9789221224228 (web pdf)

International Labour Office; Policy Integration Dept

economic recession / fiscal policy / monetary policy / employment / social protection / Europe

03.04.3

ILO Cataloguing in Publication Data

The designations employed in ILO publications, which are in conformity with United Nations practice, and the presentation of material therein do not imply the expression of any opinion whatsoever on the part of the International Labour Office concerning the legal status of any country, area or territory or of its authorities, or concerning the delimitation of its frontiers.

The responsibility for opinions expressed in signed articles, studies and other contributions rests solely with their authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them.

Reference to names of firms and commercial products and processes does not imply their endorsement by the International Labour Office, and any failure to mention a particular firm, commercial product or process is not a sign of disapproval.

ILO publications and electronic products can be obtained through major booksellers or ILO local offices in many countries, or direct from ILO Publications, International Labour Office, CH-1211 Geneva 22, Switzerland. Catalogues or lists of new publications are available free of charge from the above address, or by email: pubvente@ilo.org

Visit our website: www.ilo.org/publns

Printed in Switzerland

Abstract: In the aftermath of the 2007 US initiated financial crisis, labour market conditions have deteriorated between mid-2008 and mid-2009 across all European countries with massive employment losses recorded in both advanced economies and emerging economies. However policy responses to mitigate the economic and social effects of the crisis have differed dramatically across European countries that are confronted by this common challenge. The present paper documents the employment effects of these policy responses and shows that the gap in employment performance between advanced economies and emerging countries of Europe could widen after years of slow convergence, with negative consequences for social cohesion. It argues that strengthening multilateral coordination is needed to avoid a reversal in social and economic progress.

JEL Classification: E61, E62, F59.

Résumé: Suite à la crise financière partie des États-Unis en 2007, la situation du marché du travail s'est détériorée entre mi-2008 et mi-2009 dans l'ensemble des pays européens, avec d'importantes pertes d'emplois à la fois dans les économies avancées et dans les économies émergentes. Cependant, les mesures visant à atténuer les impacts sociaux et économiques de la crise ont été très différentes dans les pays européens confrontés à ce défi commun. Le présent document décrit de manière détaillée les effets de ces mesures sur l'emploi, et montre qu'après des années d'une lente convergence des résultats en matière d'emploi, l'écart pourrait à nouveau se creuser dans ce domaine entre les économies avancées et les pays émergents en Europe, avec des conséquences négatives sur la cohésion sociale. Il affirme en outre la nécessité d'un renforcement de la coordination multilatérale afin d'éviter une régression sociale et économique.

Classification JEL: E61, E62, F59.

Resumen: Como consecuencia de la crisis financiera desatada en los Estados Unidos en 2007, las condiciones del mercado laboral se han deteriorado entre mediados de 2008 y el primer semestre de 2009 en todos los países europeos, lo que ha dado lugar a masivas pérdidas de empleo en las economías tanto avanzadas como emergentes. No obstante, las políticas aplicadas para mitigar los efectos económicos y sociales de la crisis han diferido sustancialmente en todos los países europeos que se ven confrontados con este reto común. En el presente informe se detallan los efectos que han producido en el empleo estas políticas y se muestra que el desfase existente en el desempeño del empleo entre las economías avanzadas y los países emergentes de Europa podría ampliarse tras años de lenta convergencia, con consecuencias negativas para la cohesión social. Se aduce que es necesario potenciar la coordinación multilateral para evitar que se revierta la tendencia del progreso económico y social.

Clasificación JEL: E61, E62, F59.

The Policy Integration Department

The Policy Integration Department pursues the ILO's decent work and fair globalization agenda from an integrated perspective.

The central objective of the Policy Integration Department is to further greater policy coherence and the integration of social and economic policies at both the international and national level. To this end, it works closely with other multilateral agencies and national actors such as Governments, trade unions, employers' federations, NGOs and universities. Through its policy-oriented research agenda, it explores complementarities and interdependencies between employment, working conditions, social protection, social dialogue and labour standards. Current work is organized around four thematic areas that call for greater policy coherence: Fair globalization, the global poor and informality, macro-economic policies for decent work, and emerging issues.

Director of the Policy Integration Department: *Stephen Pursey*
Deputy Director of the Policy Integration Department: *Alice Ouédraogo*

This paper draws on and updates analysis contained in a report prepared for the ILO European Regional Meeting (ERM) held in Lisbon 11-13 February 2009 and entitled “Policy responses to the economic crisis: A decent work approach in Europe and Central Asia”.

A common economic crisis but contradictory responses: The European experience 2008-09

Contents

Page

1. Introduction 1

2. Long-term trends in economic growth, employment and wages prior to the economic crisis 1

3. Economic and labour market developments since mid-2008 5

4. Policy responses to date 8

4.1 Effect of and space for monetary policy 8

4.2 Fiscal policy 13

4.2.1 Fiscal policy in countries requiring IMF assistance 13

4.2.2 Fiscal policy in other parts of the European Region 17

5. Conclusions and Recommendations 27

A common economic crisis but contradictory responses: The European experience 2008-09

1. Introduction

The financial crisis that began in August 2007 in the United States related to the increase in mortgage payment defaults began to be felt in Europe in the second half of 2008. By mid-2009 the "first green shoots" of recovery were beginning to emerge in China and to a degree in the United States. Yet in Europe the economic downturn has spread eastwards and continues to intensify at an alarming pace. Real output in 2009 will contract by an estimated 10 per cent in the Baltic States, 8 per cent in the Ukraine and 6 per cent in the Russian Federation.[1] The current crisis now represents the most pronounced recession across the European region in over sixty years and creates additional challenges for Europe. One of these challenges is the potential of the crisis to reverse the social and labour market progress which was achieved in the previous decade of steady growth in Western Europe and economic catch-up in the transitional economies of Eastern Europe and the Commonwealth of Independent States (CIS). The main objective of this paper is to document the policy responses to the crisis across Europe, show that that this risk exists, and propose alternatives solutions.

The outline of this paper is the following. Section 2 reviews long-term trends in economic growth, employment and wages prior to the economic crisis, while economic and labour markets developments since mid-2008 are addressed in section 3. Section 4 deals with the policy responses to the 2008 economic and financial crisis, including monetary policy and fiscal policy measures implemented in vulnerable countries assisted by the IMF, as well as in other parts of the European region. It draws attention to the general dichotomy in macroeconomic policy responses between the EU countries and the emerging countries of Europe: with the former pursuing expansionary counter-cyclical policies and the latter contractionary pro-cyclical policies. Section 5 concludes on the necessity for Europe to adopt a coordinated multilateral approach to avoid wider economic convergence with negative consequences for social cohesion.

2. Long-term trends in economic growth, employment and wages prior to the economic crisis

The countries of Europe and Central Asia have been on an economic "rollercoaster" since the early 1990s. There have been significant unsynchronized swings in economic growth within and across subregions. For example, in the latter half of the 1990s the EU-15 enjoyed relatively robust growth rates, with GDP increasing on average by 2.8 per cent p.a. compared to 1.6 per cent p.a. in the first half of the 1990s. Thereafter growth slowed in the EU-15 and averaged just 1.6 per cent p.a. over the period 2001-05 before bouncing back between 2006 and when the current recession hit in mid to late 2008.

Economic growth trends elsewhere in the region have fluctuated more dramatically. The former transition economies of Central and Eastern Europe experienced major economic contractions in the early 1990s. However to a large extent this had been overcome by the

[1] IMF. 2009. *Regional Economic Outlook Europe: Addressing the Crisis.*

mid-1990s for countries in Central Europe. Subsequently several countries in this subregion were hit by a secondary transition crisis. This was partly linked to difficulties with privatization and financial sector reform. In some countries this was also associated with severe monetary and exchange rate crises. The net effect was that, on average, economic growth in the Central and Eastern European economies remained moderate, and did not match the performance in the EU-15 countries, over the second half of the 1990s. Other countries in the European and Central Asian region also experienced economic difficulties in the late 1990s. For example, the Russian Federation was affected by structural and macroeconomic crises in 1998-99 and Turkey went through a similar experience in 1999.

Thus by the beginning of the new millennium there was no real evidence of economic convergence across the European and Central Asian region. On the contrary the economic gap between the EU-15 and the rest of the region had expanded. However, this trend was reversed from about 2000 onwards. Over the period 2000 to 2008 the EU-12 economies in general performed strongly. As a group the EU-12 countries established a substantial and persistent economic growth differential over the EU-15. Moreover, between 2002 and mid-2008 the CIS, the non-EU Balkan countries (with one or two exceptions) as well as Turkey also embarked on a sustained growth track, and recorded a substantial growth differential over the advanced economies in the EU-15.

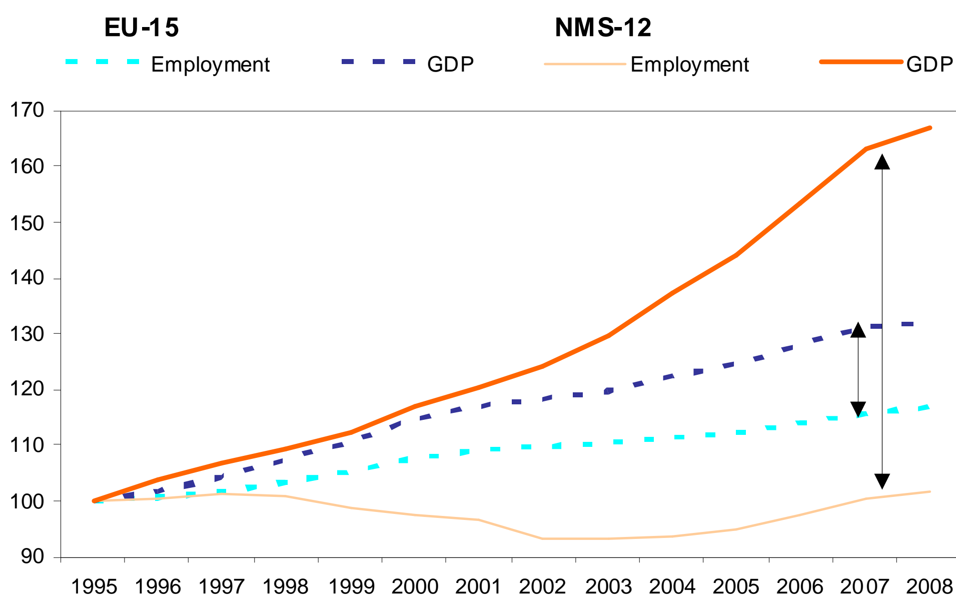
An important caveat is warranted. The relatively faster growth rates in the non EU-15 countries occurred from a low base following a decade of slow growth or economic contraction. It is relatively easy to record impressive growth percentages when the denominator in the equation has been debased. Nevertheless, the fact that the European and Central Asian region started the process of economic convergence in the last half decade is encouraging. One important factor facilitating economic catch-up is the great potential for rapid productivity growth in lower income economies. In the period prior to the current recession this potential was starting to be realized.

Longer term labour market trends across Europe also exhibit considerable diversity by subregion. For example, at aggregate level in the EU-15 employment and labour force participation rates had been improving steadily over a prolonged period prior to the onset of the recession: the former from 59.9 per cent in 1995 to 67.0 per cent in 2007, and the latter from 67.2 per cent to 71.6 per cent over the same time horizon. In other parts of the region labour market trends had been more erratic. The EU-12 countries made considerable progress in the last few years. But when examined over the longer term the employment picture within the EU remains diverse. This point is illustrated by comparing long run trends in economic growth and aggregate employment between the advanced EU-15 economies and EU-12 catching-up economies.

Figure 1 plots GDP and aggregate employment developments in the EU-15 and in the EU-12. What we see is a strong discrepancy in outcomes between the two subregions. The EU-15 had a moderate, cumulative GDP growth over the period 1995-2008 of slightly above 30 per cent while the EU-12 experienced cumulative GDP growth of over 60 per cent in the same period. But when we examine aggregate employment trends the situation is dramatically reversed. The EU-15 experienced a positive employment growth of about 17 per cent, while the EU-12 ended up in 2008 just about where they were in 1995. In other words over the medium-term there was zero employment growth, or what we might call "job-less growth", in the new Member States. These striking differences in relative output and employment developments between new and old members of the EU represent the flip side of the productivity trends in the various subregions.

Figure 1: Employment and GDP growth

1995 = 100



Source: The Vienna Institute for International Economic Studies. Annual Database incorporating national statistics available from www.wiiw.ac.at. Eurostat; 2008: European Commission (2009) Economic Forecast, spring 2009 (http://ec.europa.eu/economy_finance/publications/publication15048_en.pdf).

Employment trends in some of the other subregions over this extended period are even more diverse. The Russian Federation and Ukraine have enjoyed a substantial rise of employment after the crisis in the late 1990s. But countries in South East Europe have suffered from stagnation or deterioration. Turkey, as well as most of the West Balkan countries, has been plagued with job-less growth.

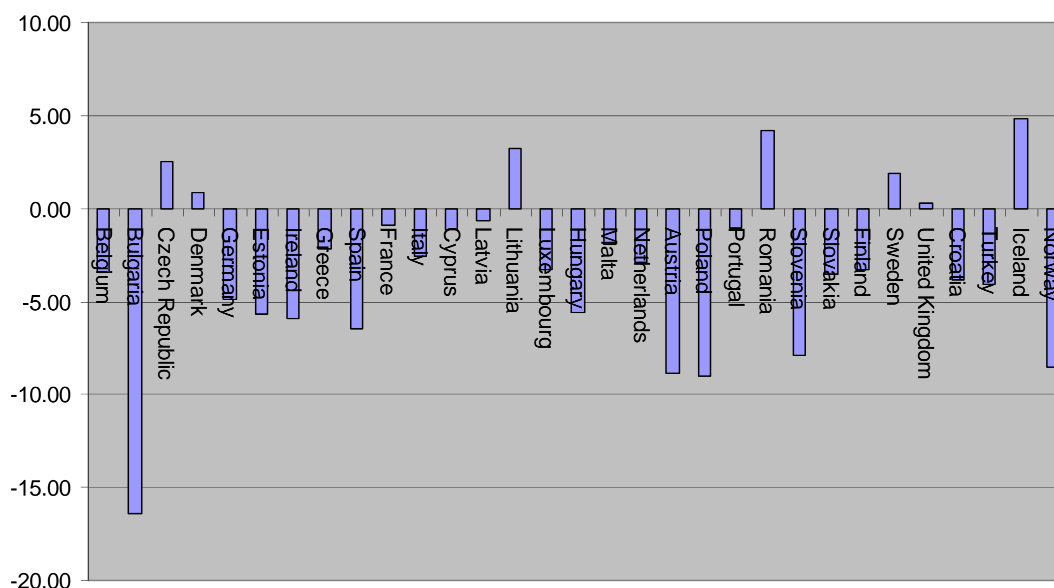
The fact that the EU-15 subregion exhibited such a positive employment record in recent years is at variance with pessimistic predictions about EU labour markets some five or ten years ago. If one examines the fluctuations in labour market performance among the EU-15 countries it would appear that assertions concerning "Euro-sclerosis" were proven wrong. For example, it would be difficult to attribute the strong labour market performance of the last few years to radical labour market deregulation or a significant weakening of trade unions. Even with comparatively high labour costs, the EU-15 has been able to compete with low labour-cost countries. Moreover, despite relatively high tax rates and large social security spending, Nordic countries lead the world on many indicators of competitiveness, current accounts surplus, solid public finance and sound labour market performance.

Despite relatively robust economic growth and tighter labour markets, real wage levels and labour costs remained moderate in most of Europe in the decade prior to the current economic crisis. In the vast majority of countries real wage increases did not increase in line with productivity improvements or the rate of economic growth. Workers are receiving a declining share of the total economic "pie", which is reflected in a falling wage share (that is the share of employee compensation in total GDP) and rising profit levels. For the EU-27 as a whole, the wage share in GDP declined from 59.6 per cent in 1995 to 57.1 per cent in 2007. This decline was particularly steep in the Eurozone where the wage share fell from 59.4 per cent to 55.8 per cent over this period. Moreover, the decline accelerated following the establishment of the EMU and enlargement of the EU.

Figure 2 shows trends in the wage share for those countries where data is available. In the period since 1995 the wage share has declined in 24 countries while it increased in just

seven countries. For example, in Bulgaria the wage share declined by a massive 15 per cent over this period, while in Poland, Austria, Norway and Slovenia the decline was close to 10 per cent. Very significant declines were also experienced in Spain, Ireland, Estonia, Hungary and Germany. On the other hand the wage share increased in Iceland, Romania, Lithuania, Czech Republic, Sweden and Denmark. It remained more or less stable in the United Kingdom.

Figure 2: Changes in the wages share of GDP, 1996-2007



Source: Annual Macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs (AMECO).

Comparable wage share data for countries beyond the EU is difficult to obtain. To help rectify this shortcoming the ILO recently prepared tentative estimates of the wage share in a range of developing countries based on the United Nations National Account Statistics. This included estimates for a number of CIS countries. This analysis compared the change in the wage share for two periods: 1995-2000 and 2001-07. This research revealed a dramatic decline in the wage share in Kyrgyzstan and Kazakhstan and more moderate declines in Armenia, Ukraine, Macedonia and the Russian Federation.[2] Two CIS countries to show an increase in the wage share were Belarus and Azerbaijan.

The general trend towards a declining wage share in the CIS countries emerged despite the fact that real wages had been increasing very rapidly in most of these countries over the period 2001 to 2007. It would therefore appear that in much of this subregion, labour productivity has increased even faster than the real wages.

Similar trends are evident in many of the EU-12 countries where real wages have been increasing since the second half of the 1990s. In both the former transition countries of the EU-12 and the CIS countries this recent experience has represented a period of “catch-up” after massive real wage declines during the first half of the 1990s. But as was observed previously this coincided with a period of strong productivity growth. For example, average annual productivity growth rates in Estonia, Latvia and Lithuania were close to 7 per cent over the period 2000 to 2007 and all the other former transition countries of the EU-12 (except Hungary) recorded annual productivity improvements of between 3 and

[2] ILO. 2008. Global Wages.

5 per cent since 2000. Consequently, for most of these countries labour productivity growth continued to exceed increases in real wages, thus allowing real unit labour costs and the wage share to decline.

Thus the emergence of significant real wage pressures in the former transition countries of the EU-12 and the CIS did not disrupt the trend towards economic convergence discussed previously. In fact for the EU-12 as a whole annual average productivity growth accelerated after 2000. There was no evidence in the pre-recession period at aggregate level that higher real wages were deterring the transfer of technology. In fact it could be argued that the pick-up in real wages was acting as a "hard wages constraint" and a spur to productivity improvements since it appeared to encourage enterprises to continue upgrading their technology to retain their competitive edge.

3. Economic and labour market developments since mid-2008

The slow and imperfect progress towards economic convergence and improved labour market outcomes that occurred over the last decade has been set back significantly in the last year. The speed and severity of the European recession is reflected in dramatic alterations in economic and employment outcomes since the middle of 2008. In fact output started to decline in the euro area, and in many of the largest economies of the European region, in the second and third quarters of 2008. But up until the September 2008 financial meltdown there was an expectation that the transition countries of Eastern Europe and the CIS, which were not directly connected to the sub-prime crisis in the United States, would avoid a recession.

However, this hope evaporated when risk aversion intensified alarmingly from mid September 2008. Capital flows to many transitional countries in central and Eastern Europe and CIS economies dried up and access to international capital markets was virtually blocked. Almost simultaneously many of these same countries experienced massive capital outflows which created or exacerbated current account deficit problems. This in turn led to significant currency depreciation in many of these countries. Depreciation increases the cost of capital for domestic firms and the cost of international debt servicing, a factor affecting both emerging countries and high-debt countries more severely. On the other hand, currency depreciation may stimulate the export-sector, unless competitors also depreciate, in which case there will be no gains.

An important additional mechanism that transmitted the crisis throughout Europe was the contraction of international trade. The volume of world exports has decreased for the first time since 1982.[3] Falling demand in OECD countries reduces export growth, while exports contributed almost half to GDP growth in recent years[4]. Complicating matters further the crisis has engendered a significant reduction in commodity prices, affecting both commodity exporters and importers in the wider European region. On one hand, the decrease in commodity prices has affected the export revenue of several countries in the CIS that are heavily dependent on commodity exports (including the Russian Federation and Ukraine). On the other hand, the steep decline in commodity prices should benefit energy and other commodity importers. Remittances and tourism are affected by the crisis. Small and poorer countries in Europe and Central Asia might face a decrease in remittance flows, and in the number of foreign tourists. Remittances represent more than 27 per cent

[3] In 2001, only the volume of exports of merchandise decreased (WTO, 2002, *Annual Report*).

[4] WTO database Trade Profiles available from: http://stat.wto.org/Home/WSDBHome.aspx).

of GDP in Tajikistan, Moldova and the Republic of Kyrgyzstan, amongst the highest percentage in the world.[5] This will add pressure on already large current account deficits of some of these countries.

It is now clearly evident that most policy makers did not fully appreciate the complex nature of the above transmission mechanisms in the early stages of the financial crisis and thus underestimated the severity and geographical spread of the crisis. Consequently, given the economic information that became available in the first half of 2009, the main regional and international financial institutions have been catching up with the speed of the downturn and making large adjustments to their economic forecasts. For example, when the European Central Bank (ECB) issued forecasts back in September 2008 it had projected Eurozone output would increase by 1.2 per cent in 2009. A month later (October 2008) the International Monetary Fund (IMF) issued its World Economic Outlook and it was still predicting that the euro area would experience positive economic growth in 2009, albeit a very marginal 0.2 per cent.[6] But less than a month later, in early November 2008, the IMF issued updated forecasts in which they slashed their estimates of 2009 growth for the euro area by 0.7 percentage points.[7] This meant they were predicting a contraction in the euro area of 0.5 per cent in 2009. Fast forward another month to December the ECB has warned that the Eurozone economy could diminish by as much as 1.0 per cent in 2009.[8] Clearly economic prospects were heading south at alarming speed in the winter months of 2008-09 because when the IMF released a further revision to their economic forecasts at the end of January 2009 they were predicting that euro area output would fall by 2 per cent in 2009. Three months later, at the end of April 2009, the consensus was that contraction would be twice as severe as had been predicted in January. Both the IMF and the European Commission now believe that real GDP will decline by around 4 per cent in the euro area and the EU as a whole in 2009.[9]

As can be seen from Table 1, among the largest European economies the decline in output in 2009 is now expected to be largest in Germany (-5.6 per cent) and the Netherlands (- 4.8 per cent). Two countries that had pursued an export led growth strategy in recent years and had accumulated substantial balance of payments surpluses in the pre-recession period. Interestingly the IMF is forecasting that the German economy will contract by twice as much as the United States in 2009, although the latter country was the epicentre of the financial crisis. The deterioration in the economic outlook appears equally dramatic outside the euro area. Among the large EU-15 countries the United Kingdom has witnessed a particularly rapid decline in economic activity with output declining at an annualised rate of 6 per cent in the final quarter of 2008. The IMF is now forecasting that real GDP in the United Kingdom will fall by just over 4 per cent in 2009. While among the smaller advanced countries Iceland and Ireland are both facing very deep recessions.

[5] World Bank. 2007. *Migration and Development Brief 3*, available at: http://siteresources.worldbank.org/EXTDECPROSPECTS/Resources/476882-1157133580628/BriefingNote3.pdf
and www.worldbank.org/prospects/migrationandremittances.

[6] IMF. 2008, World Economic Outlook., Oct.

[7] IMF. 2008. World Economic Outlook Update, 6 Nov.

[8] IMF. 2008. Survey Online, "More Action Needed to Combat Spreading World Crisis, IMF Says", 15 Dec.

[9] IMF. 2009. World Economic Outlook, Apr. forecast real GDP in the Euro area would decline by 4.2 per cent in 2009, while European Commission in their Economic Forecast, Spring 2009, predicted that real GDP would decline by 4 per cent in both the Euro area and the EU as a whole in 2009.

The rate at which economic growth prospects have deteriorated in the last six months is even more dramatic in the countries beyond the EU-15. Back in November 2008 the IMF were predicting that real GDP would expand by 2.5 per cent in Central and Eastern Europe in 2009. Now they are forecasting a decline in output of 3.7 per cent for this subregion,[10] a turnaround in economic growth of over 6 percentage points in less than six months. But the situation is not homogenous and for the moment some of the transitional (or post-transitional) economies, like Albania and Poland, appear to be in better shape than others. Interestingly, it is several of the small Baltic countries that had grown rapidly in recent years and had been applauded in some quarters for their market based reforms – like Estonia, Latvia and Lithuania – that have been particularly hard hit in recent months. The IMF is predicting a double-digit decline in real GDP for each of these three countries in 2009.

The reversal of economic fortunes is equally dramatic in the CIS countries. In 2007 and 2008 this subregion experienced an increase in real GDP of 8.6 per cent and 5.5 per cent respectively. Now the IMF is forecasting a decline in GDP of just over 5 per cent for the CIS in 2009. Here the situation varies dramatically between countries with Ukraine and the Russian Federation facing the deepest recession with expected output declines in 2009 of 8 per cent and 6 per cent respectively, yet some other countries in the subregion (such as Turkmenistan and Uzbekistan) are expected to record robust economic growth rates in 2009 and 2010.

Consequences of the financial crisis on labour markets have been dramatic across the whole of Europe. For the first time since the mid-1990s, there has been a reversal in the trend towards a decrease in unemployment which took place in Central and South Eastern Europe (non-EU) & CIS countries. In 2008, the unemployment rate in this area increased to 8.8 per cent.[11] With regard to the European Union, employment is expected to reduce by 2.5 million in 2009 after a modest 0.7 million growth in 2008. Unemployment started to rise in the course of 2008 up to 7 per cent of the labour force. The unemployment rate is expected to rise to 9.4 per cent in 2009 and 10.9 per cent in 2010, according to the spring 2009 forecasts issued by the European Commission. In Turkey, the unemployment rate has risen from 9.7 per cent in 2007 to 10.2 per cent in 2008.[12] Job cuts that commenced in the financial services and construction sectors in the most affected countries are now spreading more widely throughout the manufacturing and service sectors of virtually all countries in the Region. As regards sector employment in EU-27, the share of employment in financial intermediation in total employment decreased from 3.1 per cent to 2.7 per cent between the last quarter of 2007 and the third quarter of 2008, while the share of employment in real estate, renting and business activities decreased from 9.7 to 8.8 per cent of total employment over the same period (Escuerdo, 2009).[13] Turning to total employment, many European Union countries registered employment losses in 2008, including Lithuania, Hungary, Ireland, Spain, Italy and the United Kingdom, while Slovakia, Slovenia, Cyprus, Poland, Bulgaria, and Luxembourg recorded employment gains above 2 per cent.[14] According to the European Commission forecasts, prospects for 2009 are gloomy with all

[10] IMF. 2008. World Economic Outlook, Apr.

[11] Source: Global Employment Trends (Geneva, ILO, 2009).

[12] http://www.ilo.org/global/Themes/lang--en/WCMS_101130/index.htm

[13] Escuerdo, V. 2009. “Effects of the crisis on the financial sector: Trends and policy issues.” Discussion Paper 197, International Institute for Labour Studies (Geneva, ILO).

[14] European Commission. 2009. Economic Forecast, Spring 2009 (http://ec.europa.eu/economy_finance/publications/publication15048_en.pdf).

EU-27 and candidate countries forecasted to lose employment. The OECD Economic Outlook Interim Report of March 2009 is equally pessimistic with unemployment rates reaching 11 per cent in 2010 (11.5 per cent according to the European Commission).[15]

It is also important to appreciate that the official labour market data and therefore ILO forecasts significantly underscore the real degree of labour market slack that is emerging in Europe. For example, in many countries the unemployment statistics do not fully capture all those that are being made redundant. While in many countries, particularly in the CIS, there is mounting evidence that companies are responding to the downturn through reductions in working time and unpaid administrative leave. These are traditional means of meeting a reduction in labour demand in this region.

But all 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 thus some countries are confronted by greater constraints than others as they implement responses to the recession. Moreover, the credibility of some Central Europe and CIS countries in international financial markets is low. Consequently, across the European region policy responses to the economic crisis have varied considerably. Below some specific examples are reviewed for changes that have been made to monetary, fiscal, labour market and social policies in response to the crisis. It is impossible in this short paper to definitively describe or assess the measures taken in all 51 countries of the Region, however examples of the most common policy responses are examined.

4. Policy responses to date

4.1 Effect of and space for monetary policy

In September 2008 the implications of the US sub-prime crisis started to hit the largest economies in Europe. Fears about large losses on US assets held by the major European banks caused a freeze in the wholesale finance sector with banks refusing to lend to each other. Government authorities in several major European countries took action to in an effort to help stabilise the situation. These interventions included large injections of liquidity and easing requirements on collateral for refinancing operations by Central Banks. In several countries of the Region 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.

However on reflection the full economic and social implications of the financial crisis were perhaps not fully appreciated among key policy makers in Europe. According to the IMF:

> “Initially, problems were concentrated in a few banks, and their causes varied. The macroeconomic implications were generally not considered large, and thus fiscal and monetary policy responses were initially limited….. Remedial financial policies were put in place quickly but, as elsewhere, have not been (and still are not) sufficiently comprehensive and coordinated, undermining rather than reinforcing their cross- country effectiveness”.[16]

In fact the European Central Bank (ECB) was initially more concerned about inflation and rising wages and had been in the process of tightening monetary policy for some time

[15] OECD. 2009. Economic Outlook, Interim Report, Mar. 2009, Paris.

[16] IMF. 2009. World Economic Outlook, Apr., p. 75-76

when the crisis hit. In fact the ECB began raising interest rates at the beginning of 2006. It increased interest rates eight times in the following 18 months, and again in July of 2008 when many observers were calling for interest rate cuts and Central Banks in key countries such as the United States and the United Kingdom were already pursuing an expansionary monetary policy. Fortunately the ECB eventually reversed policy, and has subsequently cut interest rates on several occasions since the latter months of 2008. By early May 2009 the main policy rate of the ECB was down to 1 per cent.

Some Central Banks outside the Eurozone were far more aggressive and rapid in their approach to monetary policy over the last year. The Bank of England is a prime example, having cut interest rates on several occasions from 5.75 per cent in 2007 down to 0.5 per cent in early 2009. The bank of England has subsequently followed the US Federal Reserve in introducing less conventional credit-easing measures.

Other members of the European Union, which are non-part of the 15-country Eurozone have followed closely the European Central Bank's decisions to raise or decrease key rates. For instance, the Danish National Bank always follows the European Central Bank decisions, and did so following the recent European Central Bank cuts of March and April 2009. Turning to Sweden, the central bank has also cut its key interest rate by a record 1.75 percentage points to 2 per cent in April 2009.

As regards Poland, its central bank adopted an aggressive monetary policy, cutting its key interest rate in December 2008, January 2009, March 2009, and April 2009 to 3.75 per cent – a level not seen since 1990. The last two revisions were a similar quarter-point reduction, followed deeper reductions in December 2008 and January 2009. The central bank hoped to dampen the fall in production and employment by cutting rates. But smaller cuts were adopted in the recent period as the country's currency, the zloty, has weakened against the euro and the US dollar.

Cuts in interest rates are designed to help economic activity and stimulate employment through a number of channels. First and foremost they are designed to reduce the cost of borrowing for both large and small firms caught in the credit crunch and unable to find short-term finance at reasonable rates. Second, they are designed to reduce the incentive for consumers to save and encourage consumer spending, thus boosting demand. Third, other things being equal, interest rate reductions in a particular country (or area) should discourage capital inflow, thus placing downward pressure on the domestic exchange rate and possibly leading to some positive impact on export and import competing industries.

The extent to which these various mechanisms are operating in the current environment is problematic for a number of reasons including the fact that official rate cuts have not been systematically passed on by commercial banks to their customers, be they firms, mortgage borrowers or other consumers. In fact not only have commercial banks not fully passed on interest rate cuts to their customers, but prior to this the banks and financial institutions lost confidence in each other and short-term inter-bank lending froze. This engendered massive liquidity problems for firms that needed access to short-term finance at affordable rates. This forced Central Banks to take the extraordinary measures mentioned above, including offering unlimited short-term liquidity to commercial banks as a stop gap measure.

Another factor limiting the impact of monetary policy on economic activity and jobs is overall fear for economic security, resulting in the postponement of consumption or investment decisions until better times. Despite interest rate reductions, ordinary consumers may choose not to borrow money and postpone the purchasing of goods and services because they fear for their own economic security and/or expect prices of goods and services to decline further in the future. This raises the spectre of deflation which would have disastrous consequences for employment and decent work.

Finally, while an export-led recovery - facilitated by interest rate cuts that induce currency depreciation - may be feasible for a single country this is not a solution for the global economy. In fact beggar-thy-neighbour devaluations during the Great Depression of the 1930s only exacerbated problems. Exchange rates between currencies of major trading partners reflect global imbalances that can be linked to the present crisis. However, beggar-thy-neighbour policies can be brought about through mechanisms other than currency depreciation. A prime example is attempts by individual countries to lower their labour costs through excessive wage restraint to secure a competitive advantage over their trading partners. If all countries pursue such policies a further contraction in aggregate demand is assured. In addition, the current crisis is not a competitiveness crisis, in other words it is not due to excessive labour or production costs. Consequently, all forms of beggar-thy-neighbour polices must be eschewed in the current environment. We return to this point in the conclusions.

That said it is important to recall that the euro had appreciated by about 33 per cent against the US dollar and significantly against the yen between the beginning of 2006 and the third quarter of 2008. So from the perspective of the European region it might be argued that exchange rate imbalances had built up in the period prior to the current crisis and some readjustment is required. But so far the reductions in interest rates within much of the European Region - and particularly within the euro area - have not matched the interest rate cuts in competitor countries. Thus for most of the largest economies of the Region there has been no relief for export or import competing industries from exchange rate movements. The United Kingdom might be an exception.

For these and other reasons the reductions in official interest rates, plus massive injections of liquidity by Central Banks into financial institutions, have not been sufficient to kick start an economic revival. However, counter-cyclical monetary policy is highly desirable for most countries in the Region and an important complement to the fiscal stimulus that most governments are now starting to pursue. In late 2008 some highly respected observers of monetary policy had called on the ECB and other Central Banks to go much further and faster in cutting interest rates and to set their official policy rate at zero forthwith.[17] It was around the same time (mid December 2008) that the Bank of Japan and the Federal Reserve in the United States effectively complied with such suggestions and cut interest rates at levels approaching zero. By comparison, up until very recently the ECB has been behind the curve with its interest rate policy, initially because of an exaggerated fear of inflation and wage pressures. In the future a fundamental re-think of the ECB mandate may be warranted if monetary policy is to place greater emphasis on employment, decent work and concerns for the real economy.

Not all Central Banks in the Region have pursued an anti-cyclical monetary policy in the last year. The first post-transitional country in the European region to suffer in the current global economic crisis was Hungary. As the financial difficulties in the United States and other advanced economy countries produced a decline in global liquidity and increased risk aversion, investors started differentiating among emerging markets. Perhaps because Hungary had relatively high external debt levels the country was one of the first to witness capital outflow and strong downward pressure on the exchange rate. The Central Bank in Hungary had increased interest rates from 7.5 per cent to 8.5 per cent in early 2008 to fight inflation. Then in October 2008 when the global crisis hit the Central Bank increased rates by a massive 3 percentage points (from 8.5 per cent 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 (as well as from the EU and

[17] Buiter, W. 2008. «It is time for the monetary authorities to jump into the liquidity trap», 2 Dec.

World Bank). Hungary has recently eased interest rates but they still remain well above the level that existed last October.

Several other post transitional countries including Bulgaria, Latvia, Lithuania, Serbia, Romania, Poland, and a number of CIS countries including Armenia, Belarus, Georgia and Ukraine have faced extreme economic difficulties including massive capital outflows or problems related to a loss of funding or FDI. As a result many of these countries have sought assistance from the IMF and/or the European Investment Bank, the European Bank for Reconstruction and Development and the World Bank. Given the level of capital outflow most of these governments have not adopted an anti-cyclical monetary policy.

There are significant differences in the space for monetary policy between countries in the European and Central Asian region. In the United Kingdom, as noted above, the Bank of England slashed interest rates over the last two years. In doing so the focus of the Bank was clearly on boosting aggregate demand. It has not worried excessively about the value of the UK currency, which has depreciated substantially in that period. In fact, the UK Government has probably viewed a declining pound as desirable in the last year because it lowered the foreign price of British exports and helped provide a boost to domestic firms in the export and import competing sectors.

But policy makers in CIS countries like the Ukraine and Belarus or some post-transitional countries like Latvia and Lithuania have had less scope to ignore the consequences of monetary policy for their exchange rates. In these countries with relatively high inflation rates it could be argued that a stable exchange rate is required to help anchor prices. However, more important is the large stock of foreign debt that such countries hold. Much of this debt was short-term and must be repaid in euros or US dollars. Since the intensification of the global financial crisis countries like those mentioned above have witnessed a sharp reduction in access to new external borrowing and thus difficulties in rolling over their debt or meeting their repayment obligations. In these circumstances a precipitous fall in the currency could make foreign debts insupportable. Thus unlike the Bank of England, central banks in some post transitional and CIS countries have had to adopt a pro-cyclical monetary policy and raise interest rates to defend their currency.

In the Ukraine the IMF has encouraged this pro-cyclical monetary policy stance while also encouraging the Government to gradually move towards a floating exchange rate.

In the second half of 2008 Ukraine experienced a dramatic decline in equity prices (down 80 per cent from their peak) and economic activity plus massive capital flight and extreme pressure on the exchange rates. Problems in the real economy were triggered by rapid declines in global steel prices and signs of domestic political instability. But these problems were overshadowed by declines in investor confidence, outflow of capital and pressures on the currency after news leaked that one of the largest commercial banks (Prominvestbank) was close to bankruptcy in October 2008. These events resulted in the National Bank of Ukraine (NBU) taking a range of exceptional measures including banning the pre-term withdrawal of bank deposits and the Ukraine Government turning to the IMF for emergence assistance in late 2008.

In November 2008, the IMF and others provided the Ukrainian Government with an emergency loan of 16.4 billion US dollars. This came with conditions which, in the words of the IMF: "aims to restore financial and macroeconomic stability by adopting a flexible exchange rate regime with targeted intervention, a pre-emptive recapitalisation of banks, a prudent fiscal policy coupled with tighter monetary policy".[18] According to the IMF:

[18] IMF. 2008. Press release No. 08/271, 5 Nov.

"resolute implementation of the programme should help reduce inflation to single digits by the end of the programme."[19]

Unfortunately the documents made public do not provide any detailed evidence that the Government or the IMF carefully considered the consequences of this policy package for employment and decent work. However, even from an employment and social perspective a case can be made for a tightening of monetary policy in extreme circumstances like those prevailing in the Ukraine. The extent of capital outflow and the pressure on the exchange rate have been alarming. The authorities made a decision to try and support the currency to some degree, and this required them to drastically deplete their hard currency holdings. Questions have been raised about whether this approach was implemented in a transparent and objective manner. In any case despite these interventions the hryvna to dollar rate almost doubled over the three months to late December 2008. 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 massive hikes in the local currency cost of their loan repayments. It is likely that the degree of capital outflow and the necessary depreciation would have been greater if the Central Bank had pursued a more accommodating monetary policy and cut interest rates.

In Latvia the IMF pursued a different approach and endorsed a government decision to maintain the existing exchange rate peg between the domestic currency and the euro. Latvia has expressed a desire to join the Eurozone in the near future. So unlike the Ukraine there will be no gradual movement towards a floating exchange rate in Latvia. However, to support the rigid exchange rate the Government of Latvia required massive loans which the IMF helped it acquire from the EU and various Nordic countries plus 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. In return for loans of this magnitude the Government of Latvia has been required to implement draconian fiscal and incomes policy measures.

Other things being equal, in current circumstances a relaxation of monetary policy and lower interest rates would be better for boosting domestic demand and therefore employment in all countries across the European region. However, there are respectable economic reasons for accepting that not all countries have the same scope for counter-cyclical monetary policy. Not all international organisations promoting development agree that this economic case is as strong as the IMF argues. UNCTAD, for example, has warned countries struggling with declining currencies to resist raising interest rates to prevent devaluations. UNCTAD has argued that "raising interest rates and falling government expenditure will only re-invite speculation and worsen matters in the real economy." UNCTAD cited several countries in the European region – including Hungary, Iceland, Romania and Turkey - when giving this advice.[20]

[19] ibid.

[20] UNCTAD. 2008. Development, Policy Newsletter, Dec.

4.2 Fiscal policy

4.2.1 Fiscal policy in countries requiring IMF assistance

Fiscal policy responses to the economic crisis across the European region have diverged dramatically. At one extreme are many of the countries mentioned above which have found it necessary to seek emergency loans from the IMF or are in discussions with the IMF because of large capital outflows, runs on domestic currencies and major balance of payments problems.

As noted above Hungary was one of the first casualties of the global crisis in Europe and had to borrow 25 billion dollars from the IMF, EU and World Bank in early November 2008. The conditions attached to this loan required the Government to reduce fiscal expenditures significantly. The target fiscal deficit for 2008 was 3.8 per cent of GDP; this has been reduced to 2.9 per cent of GDP. On the basis of the agreement further spending cuts are required in 2009 to bring the fiscal deficit to 2.6 per cent of GDP. These spending cuts come on top of austerity measures the Government was already implementing, which had reduced the fiscal deficit by almost 6 percentage points of GDP between 2006 and 2008. In announcing the loan the IMF stated:

> "… adjustment will need to include revisions of wages and pensions. Under the authorities' programme, 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."[21]

In implementing the IMF conditions, the government introduced a freeze on public sector salaries and unilaterally cancelled the payment of a 13-month bonus for 2009. These provisions were implemented without negotiations with public sector unions and despite the fact that an existing collective agreement makes provision for a 4 per cent salary increase this year and the bonus mentioned above. These measures were expected to cut real public sector remuneration by around 10 per cent in 2009.

In the Ukraine the original agreement with the IMF required the Government to cut expenditures in the last two months of 2008 and to ensure that in 2009 the government budget was in balance (this has subsequently been altered significantly, see below for details).[22] Much of the fiscal tightening was originally expected to come through reduced expenditure on public sector wages and benefits plus reductions in the overall level of social expenditure. The original memorandum of understanding between the Government and the IMF in October 2008 stated:

> "We will change the course of our incomes policy. …Our adjustment strategy will thus be to limit the increase in both the minimum and average public wage and pensions, and other social transfers, in line with projected inflation in 2009 (average and end period basis). This will include the following measures: (1) in December 2008 - January 2009, the average wage level for the first grade public sector employees will remain constant; (2) postponing for two years the planned equalization of the minimum wage with the much higher minimum

[21] IMF. 2008. Survey Online, 6 Nov.

[22] IMF. 2008. "Ukraine: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding", 31 Oct.

> subsistence level; and (3) revising backward looking indexation arrangements for various social transfer (and refocusing increases on forward looking inflation measures)."[23]

Given the introduction of the above reforms at a time when the inflation rate was expected to decline from around 25 per cent in 2008 to an estimated 14 per cent in 2009 due to the contraction in domestic demand, this implied a significant decline in the real value of pensions and other transfer payments. Moreover, the agreement with the IMF to postpone for two years a planned increase in the minimum wage to the minimum subsistence level and rescind an agreement to increase public sector salaries contravened an existing collective agreement (General Agreement) and overturned provisions contained in the 2009 draft budget which had been made public one month earlier. Other measures adopted to help achieve the fiscal contraction include a phased increase in energy prices. This would also obviously have important implications for low income earners.

As mentioned above the fiscal and income policy conditions attached to IMF loans with Latvia appear more extreme than those in Hungary or the Ukraine. According to the IMF:

> "The program … will also require a substantial tightening of fiscal policy, including a headline fiscal deficit of less than 5 per cent of GDP in 2009, compared to a deficit of 12 per cent of GDP if no additional measures were taken …. Supporting structural reforms and wage reductions, led by the public sector, will further strengthen competitiveness and facilitate external adjustment."[24]

The IMF has made it clear that public sector job cuts and wage reductions across the economy are required to bring about a real depreciation of the currency, given the decision to maintain the nominal exchange rate through the peg to the euro. The Government published an "Economic Stabilisation and Growth Revival Programme", which provided details on how these conditions would be implemented. On the expenditure side this programme provided for a nominal reduction in public sector salaries by 15 per cent in 2009. In addition employment levels in public administration were to be reduced by 15 per cent over the next three years, and expenditure on goods and services procured for the State were to be cut by 25 per cent. The Programme stated that there will be no increases in social allowances until economic growth resumes. The Government also made commitments to reduce wages in the private sector of the economy without specifying how this will be achieved.[25]

Tax reforms were also part of the Government programme in Latvia. This included reductions in personal income tax but substantial increases in consumption taxes. The main rate of the value-added tax was to be increased from 18 per cent to 21 per cent, while the so-called reduced VAT rate was increased by a massive 5 percentage points. These reforms will obviously make the tax system more regressive and have a major negative impact on domestic demand which had already declined dramatically. In fact at the time of the agreement the IMF were predicting that GDP in Latvia would contract by 5 per cent in 2009. But by April 2009 the IMF had revised this forecast dramatically and was suggesting that real GDP would fall a massive 12 per cent in 2009.

It is worth examining why a country like Latvia found itself in this situation. One of the main reasons Latvia required IMF assistance was the high level of foreign debt it held.

[23] ibid., p 7.

[24] IMF. 2008. Press Release No. 08/332, 19 Dec.

[25] See, "Latvia's Economic Stabilisation and Growth Revival Programme", Ministry of Finance, Latvia, public web site.

Between 2004 and 2007 the country enjoyed buoyant conditions with real GDP expanding at annual average rates of around 10 per cent. Much of this growth was financed by massive foreign borrowing in the private sector and much of this was devoted to speculation in the real estate market. In fact, the stock of foreign debt increased nearly fourfold between 2004 and 2008 and reached at about 140 per cent of GDP in late 2008. Yet over the same four year period, net public debt as a proportion of GDP was halved and stood at a modest 7 per cent of GDP in 2008. It is ironic that the public sector workers are now being forced to paying a high price (through either the loss of their jobs and or salary cuts) for this unsound speculation in real estate and expansion of private sector foreign debt.

The IMF has been a strong advocate of large and quick fiscal spending to counter the economic slowdown. Therefore some of the specific IMF conditions contained in these emergency measures might appear inconsistent with the general advice the IMF has been providing in other forums. This general IMF advice strongly favours the adoption of an anti-cyclical fiscal policy. For example, on 15 December 2008 the Managing Director of the IMF called for a global fiscal stimulus of about 2 per cent of GDP (see below for details).[26] The IMF has subsequently elaborated on this initial advice about the magnitude of the stimulus and has argued coherently that the optimal fiscal package should be timely, large, lasting, diversified, contingent, collective and sustainable.[27] More recently, the IMF has argued that the general fiscal stimulus should be extended into 2010.

However, the IMF also argued from the outset of the crisis that some emerging market economies would not be able to follow this general advice because they would face very high costs in financing a deficit. According to the IMF Managing Director:

> "….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 manoeuvre in these program countries we would say "use it". But often there is no room for manoeuvre."[28]

Presumably the Ukraine, Hungary, Latvia and Iceland were examples of the type of countries that the IMF Managing Director had in mind. However the fiscal position in several of these countries was not at all extreme when the crisis hit. Latvia actually ran a fiscal surplus in 2007, and the expected fiscal deficit in 2008 was a modest 2 per cent of GDP. The Ukraine also entered the crisis with a sound fiscal position. The IMF acknowledged this fact in its Memorandum of Understanding with the Ukrainian Government, noting that:

> "A combination of factors places us in a good position to meet our fiscal targets. The starting point is sound: we have a close-to-balanced budget to-date in 2008".[29]

In other words at the time when the emergency loans were negotiated with the IMF, the Ukraine and Latvia were in very healthy fiscal positions. Some countries requiring IMF assistance, like Hungary, had higher fiscal deficits than Latvia or the Ukraine and therefore more limited fiscal space. However, it can be questioned if the conditions being imposed to reduce government expenditure are the most appropriate.

[26] Strauss-Kahn, D. 2008. "The IMF and its Future", Speech at the Banco de España, Madrid, 15 Dec.

[27] IMF. 2008. Staff Position Note «Fiscal Policy for the Crisis», 29 Dec. SPN708/01

[28] ibid., p. 3.

[29] IMF. 2008. "Memorandum of Economic and Financial Policies", 31 Oct., p. 7.

The IMF had promised that the conditions attached to loans with governments in response to the current crisis would take into account the impact on the poor and most vulnerable.[30] According to Mr. Strauss-Kahn:

> "The Fund is trying to implement what I call "social conditionality"- helping countries develop or maintain safety nets for segments of the population that maybe affected by an IMF program."[31]

It is true that the IMF has tried to preserve, and in some specific cases to increase, government expenditure on social programmes targeted at the very poor. Moreover there are indications in some countries, like the Ukraine, that the IMF have moderated their original conditions and provided additional flexibility with fiscal policy when they have reviewed implementation of the loans. In early May 2009 - after several months of delay, speculation and intense negotiation with the Government - the IMF finally approved the disbursement of the second "tranche" of the Ukrainian loan. In so doing the Fund granted waivers of non-observance of various performance criteria including the budget deficit.[32] The IMF has now indicated it will accept a fiscal deficit of 4 per cent of GDP in 2009. Despite this the Fund has maintained heavy pressure on the Ukraine to cut expenditure on social security.[33]

It is also evident from the most recent agreements within Eastern Europe that the IMF has not fundamentally altered its stance of trying to curtail wages and social spending when providing Stand-By-Agreements. In early May 2009, the IMF reached an agreement with the Government of Romania for a 17 billion dollar loan. In assessing recent economic developments in the country the IMF concluded:

> "Romania experienced an economic boom over the past five years that led to overheating and unsustainable imbalances…. Loose fiscal and incomes policies also contributed to the overheating of the economy and to its current vulnerabilities, with excessive spending, especially on wages and pensions, as the main culprit."[34]

As mentioned previously an economic case can be made for monetary policy tightening in some of the emerging and transitional countries of Eastern Europe and the CIS that face critical balance of payments and currency pressures, although there is no unanimity within the international community that this is the best or fastest route to economic recovery in the region. Differences of opinion over the appropriate stance of fiscal policy are even more intense. For instance the Commission of Experts established by the UN General Assembly to consider reforms of the international monetary and financial system recommended that:

> "While funds within the International Financial Institutions are limited, it is imperative that more funds be provided, and that they be provided without the usual conditionalities,

[30] IMF. 2008. Survey magazine, "The IMF watching out for the poor in crisis loan talks", 25 Nov.

[31] ibid.

[32] IMF. 2009. Press release No. 09/156, 8 May.

[33] IMF. 2009. Survey magazine: Interview "Policy Adjustments Move Ukraine Forward", 8 May, p. 2-3.

[34] IMF. 2009. Press Release No. 09/148, 4 May.

> especially those that force these countries to pursue pro-cyclical policies or to adopt the kinds of monetary and regulatory policies which contributed to the crisis."[35]

At the G20 London Summit in April 2009 global leaders did decide to significantly increase the funding available to the IMF. But the G20 leaders also committed themselves:

> "… to support those affected by the crisis by creating employment opportunities and through income support measures. We will build a fair and family- friendly labour market for both woman and men."[36]

Given this compromise legitimate concerns remain about some of the specific fiscal, social and income policy conditions the IMF has issued in countries that have accepted emergency assistance. Any conditions and policy advice that will have a negative impact on decent work or are inconsistent with a fair and family friendly labour market should be reconsidered. In addition, restrictive fiscal policies in these countries were largely implemented without negotiation with the social partners, which could put pressure on social cohesion and reduce the very much needed acceptance of such policies by the population (Rychly, 2009).[37]

4.2.2 Fiscal policy in other parts of the European Region

At the European Union level there were detailed discussions about the need for a coordinated fiscal stimulus as early as mid-2008. These discussions resulted in the European Economic Recovery Plan proposed by the European Commission which was broadly endorsed by the 27 Governments of the European Council on 12 December 2008.[38] The Plan was designed to boost European Union GDP by 1.5 per cent.[39] The Plan included a 30 billion euros increase in expenditure by the European Union in a variety of areas including SMEs, renewable energy, clean transport and the benefit of the automotive industry.

However, the vast bulk of additional expenditure (170 billion euros or about 1.2 per cent of European Union GDP) was expected to come from the EU-27 national Governments (see Box 1 for national examples). The Conclusions from the European Council summit set out very general guidelines for this fiscal expenditure at national level. These guidelines stated that stimulus measures could 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; plus the promotion of employment, innovation, research and development, as well as education and

[35] The First Meeting of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System, Recommendations for Immediate Action, 4-6 Jan. 2009, New York, p. 2.

[36] G20 London Summit Communiqué, para. 26, 2 Apr. 2009.

[37] Rychly, L. 2009. "Social dialogue in times of crisis: Finding better solutions", Industrial and Employment Relations Department, Paper No. 22, ILO, Geneva, May.

[38] Council of the European Union, Presidency Conclusions, (17271/08) 12 Dec. 2008.

[39] European Commission. 2008. Directorate-General for Economic and Financial Affairs, «Quarterly Report on the Euro Area», Vol. 7, No. 4, p. 5.

training.[40] Clearly the guidelines contained in the European Council conclusions provided scope for national Governments to fashion domestic stimulus packages as they saw fit. No guidance was provided at that stage about which measures should be prioritised or which may have the largest impact on economic growth, employment or other economic objectives. On the whole, fiscal measures in the European Union have been relatively low: fiscal stimulus as a percentage of global GDP is around 1 per cent in major countries of the European Union, as opposed to the 2 per cent of GDP advocated by the IMF. The composition of fiscal package varies widely within European countries with tax cuts representing between 0 per cent (Spain) and 50 per cent of the package.[41] With the exception of the United Kingdom, employment measures represent an insignificant share of total spending.

[40] Council of the European Union, Presidency Conclusions, op. cit, para. 12.

[41] Khatiwada, S. 2009. "Stimulus packages to counter global economic crisis: A review", Discussion Paper 196, International Institute for Labour Studies (Geneva, ILO).

Box 1
Overview of fiscal stimulus in 5 European Union countries, February 2009

Spain lost one million jobs in 2008, while unemployment is expected to rise to 15 per cent in 2009 and the budget deficit will reach 3 per cent of GDP.[42] To address the difficult economic and social situation, the government announced an ambitious four-tier action plan, including i) supporting workers and employers, ii) creating employment iii) restoring financial market stability and iv) boosting productivity (Spain having one of the lowest labour productivity levels in the EU). The Spanish government estimated that this plan would create 300,000 jobs over the whole territory.

France has unveiled a 26 billion euros stimulus package -- equivalent to 1.3 per cent of gross domestic product. The plan has three components: the first concerns corporate liquidity, especially in SMEs. The second consists of launching public-sector investment programmes, including energy-saving schemes. Finally, measures to support workers and employment, including in sectors experiencing great difficulties, such as the automotive and construction industries.[43] The French economy minister said the plan should create 80,000-110,000 new jobs, making up for the expected disappearance of some 90,000 jobs next year due to the crisis. However, following the increase in unemployment (7.8 per cent during the last three months of 2008), the government has pledged to spend a further 2.6 billion euros in 2009 to help the country's struggling households.

In the Netherlands, economic activity is expected to decrease sharply in 2009, as the Netherlands is set to be severely hit by the sharp fall in world trade and the financial crisis. The Dutch government adopted two fiscal packages, in November 2008 and January 2009, corresponding to 1 per cent of GDP. The threefold objective was to foster private investment, protect employment and improve credit supply.

In Germany, fiscal measures were announced in October and November 2008. However, a sizeable package of 50 billion euros was only put together in January 2009. By this time, and led by the fall in exports, growth was projected to contract by 2.5 per cent in 2009, a post-war historic record. Germany, which ended 2008 very close to budget balance, committed to a stimulus above the amount pledged to the European Commission for a coordinated stimulus (1.2 per cent of GDP). A stimulus corresponding to 0.5 per cent of GDP is also planned for 2010.

The United Kingdom took a different approach to the Eurozone countries. Indeed, the United Kingdom might run a budget deficit of up to 10 per cent in 2009-10. The UK package which was announced in November 2008 includes tax cuts and measures to increase public and private spending in the hope of preventing a recession from spiralling into a slump. The UK package includes reduced taxes for consumers, households and employers, as well as measures to support low-income households. To compensate for the decrease in government's revenue, duties on alcohol, fuel and tobacco have been raised. However, the November 2008 announced fiscal stimulus (0.09 per cent of GDP) might not be sufficient to boost the economy. In the three months to December 2008, the number of Britons out of work rose by 146,000 to 1.971 million, taking the rate up to 6.3 per cent - its highest since 1998.

From an ILO perspective we are mainly interested in the impact of the various stimulus packages on employment and decent work. Assessments of these impacts are difficult and no definitive conclusions are possible at this stage. However, some general comments can be made. The impact on aggregate demand and employment will depend on a variety of factors including: (1) the magnitude of the package; (2) the speed at which measures are implemented and the duration of the stimulus; (3) the extent to which any initial stimulus is saved or withdrawn from circulation; (4) the extent to which the stimulus leaks from the national economy through increased imports and the supply capacity to respond to any

[42] OECD. 2008. Economic Survey Spain, Paris.

[43] Source: Office of the French Prime Minister http://www.premier-ministre.gouv.fr/chantiers/plan_relance_economie_1393/, and Crédit Agricole (2009) "France: What effects should we expect from the fiscal stimulus?" Economic Research Department, No. 120 – 8 Dec. 2008, http://www.credit-agricole.com-EtudesEconomiques.

increase in demand; and (5) longer term consequences of a higher fiscal deficit. Each of these factors is examined in turn.

(a) Magnitude of Stimulus

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 many governments have included activities or expenditures that were already envisaged. Nevertheless, various academics and economic institutes have been examining these proposals and assessing them against the guidelines contained in the European Economic Recovery Plan. One such group is the Bruegel think tank which produced estimates about the magnitude of fiscal measures taken in the largest 13 EU economies as of 12 December 2008.[44] These estimates would 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 exceed 1 per cent of GDP. Based on the Bruegel data it would appear that several of the largest EU countries had not announced stimulus packages by mid December 2008.

However, events have moved rapidly at the beginning of 2009 with many countries like Germany and the United Kingdom augmented the measures they had previously taken and other countries announcing their initial plans. As of February 2009, fiscal packages of varying sizes were announced with Germany announcing the biggest package as a percentage of GDP (2.8 per cent over two years). Other European countries have committed to implement a fiscal package, such as the United Kingdom (1.3 per cent), France (1.1 per cent), Portugal (1.1 per cent), the Netherlands (0.8 per cent) and Spain (0.8 per cent). These are rough estimates as there is a certain degree of uncertainty regarding the precise size and timing of the packages.[45] In addition, for some countries such as Germany and the United Kingdom, the time frame is 2 years.

Nevertheless it seems that the size of the national stimulus packages remains diverse across the region. Indeed the conclusions of the Economic Council Summit meeting in December 2008 make it clear that there was no expectation that the magnitude of stimulus measures will be exactly equal across all EU-27 countries. Rather the expectation was that, in aggregate, the measures implemented by national governments would total approximately 1.2 per cent of GDP for the EU. This is considerably lower than the magnitude suggested by the IMF Managing Director, who as noted above, initially suggested a fiscal stimulus on average of 2 per cent of GDP. 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. IMF staff have argued that the precise magnitude of the stimulus should depend on the extent of the decline in private sector demand and should be reviewed in light of developments.[46] Indeed IMF staff have stated that 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". Given that most indicators of domestic demand in the European Region have deteriorated further since the IMF Managing Director floated the 2 per cent of GDP figure, it might be concluded that the IMF will now support fiscal stimulus packages larger than 2 per cent of GDP in many countries. The OECD (2009) has very much adopted a similar stance and advised major

[44] Saha, D.; von Weizsacker, J. "Estimating the size of the European stimulus packages for 2009", 12 Dec. 2008.

[45] ILO. 2009. The financial and economic crisis: A Decent Work response, http://www.ilo.org/public/english/bureau/inst/download/tackling.pdf

[46] IMF, Staff Position Note, p. 3.

countries of the European Union, with the exception of Italy, to be ready to use their fiscal space.[47]

> "If economic circumstances deteriorate significantly more than projected, further fiscal measures would be warranted". (p. 86)

In the case of Germany, "... given the rapid deterioration in activity, further temporary stimulus measures are needed and should be implemented rapidly." (p. 77)

While many observers may believe that the magnitude of the fiscal stimulus should vary from country to country, there are other points of view on this issue. On the one hand, as mentioned above, economic conditions across the Region are not homogenous, and clearly some countries have entered the crisis in better fiscal and trade balance shape than others. Thus there are grounds for arguing that the scope for responsible fiscal expansion is not uniform across the European region and it makes sense that the magnitude of the stimulus may vary. On the other hand, it is not clear that those countries with the lowest fiscal and current account deficits will be those that implement the biggest stimulus packages. Several observers have pointed out that within the European region there exists a classic collective action problem, with strong incentives for each country to "free ride" on the fiscal policy measures of other countries.[48] Those highlighting this problem have suggested that there be a "floor" or a minimal magnitude of fiscal stimulus in all countries.[49] For example, if the required political will existed it might be desirable to contemplate an agreement whereby all countries in the European Region agreed that they would implement a fiscal stimulus of no less than 2 per cent of GDP.

(b) Speed of implementation and duration

The speed of implementation and the duration of the stimulus will have significant consequences for output and employment. Much of the initial international advice emphasised measures that could be rapidly turned on and then off again. For example, the European Union and the European Commission Presidency Conclusions, referred to above, argued that measures to support demand must aim to produce immediate effects and be of limited duration. While the OECD, along with others, has stated that the fiscal stimulus should be timely, targeted and temporary.[50]

The intensive use of automatic stabilisers, such as an increase in the level or duration of unemployment benefits and /or widening eligibility for benefits, plus increases in other welfare payments and the expansion of social safety nets, are one type of stimulus that could be implemented rapidly. This type of measure also has the advantage of being targeted at disadvantaged groups in society, and the fiscal cost of any automatic stabiliser obviously declines when unemployment and poverty levels fall back to more normal levels. They thus conform to the timely, targeted and temporary criteria. As a result many international organisations, including the OECD and the IMF, have strongly supported measures of this nature. The ILO also strongly recommends the extensive use of such stimulus measures.

[47] OECD. 2009. Economic Outlook, Interim Report, Paris, Mar.

[48] Watt, A. 2008. "The economic and financial crisis in Europe: Addressing the causes and the repercussions", ETUI-REHS, Dec., p. 12.

[49] ibid., p. 15.

[50] OECD. 2008. "OECD Strategic Response to the Financial and Economic Crisis: Contributions to the Global Effort", Note by the secretary General, 23 Dec., p. 9.

However, the counter-cyclical effect of automatic stabilisers such as unemployment benefits is limited even in advanced countries as many unemployed workers are not covered by the unemployment benefits system. Even in countries like France and the United Kingdom where coverage is greater, respectively 18 and 40 per cent of all unemployed do not receive unemployment benefits.[51] Access to unemployment benefits is more limited in emerging countries of the region; only 4 per cent of unemployed in Turkey are entitled to receive unemployment benefits, against 9 per cent in the Slovak Republic and 12 per cent in Poland.[52]

As a result, the impact of increased social security expenditure on aggregate demand and employment is limited by the relatively small size of the population that receives unemployment benefits and welfare payments even in a very depressed labour market. Increased use of automatic stabilisers therefore represents a necessary but far from sufficient stimulus measure in current circumstances. Unfortunately, it appears that 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 welfare payments. For example, Germany has extended the coverage of unemployment benefits, while France and Switzerland have also put in place more generous systems of unemployment benefits for temporarily laid-off workers. However, not all countries within the European region have comprehensive social security systems that can be expanded. For such countries, now is the time to take urgent steps towards expanding their social safety nets.

Amongst social measures targeted at low-income households and other vulnerable groups affected by the crisis, several countries including Spain and the United Kingdom have implemented support to households who experience difficulties in repaying their home credit and other housing policy measures. Spain has also increased the minimum old-age pension, the minimum wage, the level of social assistance. As a whole, support to workers and their families affected by the crisis amounted to14 billion euros in Spain. 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 like new fuel efficient cars.

Another kind of support to workers is short-time working subsidies. On average, 20 per cent of the decrease in hours worked during a downturn comes from reduction in hours for persons remaining employed, rather than transiting to unemployment or inactivity.[53] Short-time working subsidies are designed to prevent enterprises facing temporary business difficulties to lay-off workers, by providing financial incentives to employers to reduce working time instead. In general, workers are compensated partially or fully for the loss of earnings induced by shorter hours. As emphasized by the OECD, such subsidies may play a useful role by preserving viable jobs in the context of temporarily low product demand.[54] However, the OECD also warned that they should be temporary and well targeted on both firms and workers. The package adopted by the Netherlands provides for companies to receive a subsidy to compensate employees who will cut down on their working hours.[55]

[51] ILO. 2009. The financial and economic crisis: A Decent Work response, GB 204-ESP-2.

[52] OECD. 2008. Employment Outlook, p. 110.

[53] OECD. 2009. Forthcoming, Employment Outlook, Paris.

[54] OECD. 2009. Forthcoming. Employment Outlook, Paris.

[55] Source: European Commission, Feb. 2009.
http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/273.

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 diverse impacts on demand and employment. For example, the UK Government moved rapidly to reduce VAT levels by 2.5 percentage points for a limited duration in the expectation that this would encourage consumers to bring forward purchases. VAT has decreased to 15.0 per cent - from 17.5 per cent - the lowest level allowed by the European Union. Many observers have questioned whether the impact of such a small VAT cut would alter the final price of goods and services by a sufficient amount to significantly impact on consumption expenditure. Other types of possible tax reductions are discussed below. In France, there will be an employer's contributions reduction for all low-wage new hires next year in businesses employing fewer than ten staff (for example, 14 percentage points of payroll taxes for minimum wage earners, or 180 euros per month). The measure will cost an estimated 700 million euros. In Germany too, reductions in social security contributions were also announced as part of the plan and are expected to provide more short-term stimulus. The Spanish plan contains a provision for tax reduction for households. The German fiscal stimulus also contains reductions in income tax. As suggested before, the stimulus effect of reduction in income tax might be small as many consumers are likely to save part of any additional income. In fact, in Germany, only the richest half of households pay personal income taxes.

The French plan also contains special measures to sustain sectors affected by the crisis such as the construction sector, at an estimated global cost of 1.6 billion euros, which includes social housing as well. The automotive sector will benefit from financial incentives provided by the State to replace old models with environmentally-friendlier ones. The State will also offer refinancing facilities to the sector. Measures to support businesses (see Box 2) as well as support to construction and automotive industry are expected to have a short-term impact, notably improving the financial situation of businesses and minimising job destruction. The global impact on growth will mostly depend on confidence among economic agents.

Box 2
Support to employers in France, December 2008

The measures aimed at companies are mainly designed to improve their financial situation in the short term through postponing tax payment and anticipating VAT credits (cost: 11.4 billion euros). The research tax credit, which is usually refundable over three years, will be refunded in one lump sum in early 2009, for a total of 3.8 billion euros. This measure should benefit around 5,000 businesses, over 90 per cent of them SMEs. VAT credits should also be repaid early in 2009, for a total of 3 billion euros. The deficits offset against profits will be repaid early in 2009, for a total of 1.8 billion euros. At present, companies can offset their losses against the profits of the last three years and the resulting credit is refunded by the state after five years. This measure is thought to concern around 16,000 companies, most of them SMEs. As a one-off measure, businesses will be able to request the refund of corporation taxes they have overpaid on a one-off basis in January 2009, instead of April. Because this measure has no impact on the budget, it is not included in the total cost of the stimulus. Businesses will be able to accelerate the pace at which they depreciate their investments made in 2009. This measure will cost 660 million euros in 2010 and 800 million euros in 2011. On a one-off basis, all state departments will be required to make an advance payment of 20 per cent on all public contracts worth over 20,000 euros in 2009, instead of the present 5 per cent on contracts over worth over 50,000 euros – a measure estimated to cost 1 billion euros.

Source: Office of the French Prime Minister http://www.premier-ministre.gouv.fr/chantiers/plan_relance_economie_1393/, and Crédit Agricole (2009) "France: What effects should we expect from the fiscal stimulus?" Economic Research Department, No. 120 – 8 Dec. 2008, http://www.credit-agricole.com-EtudesEconomiques

By comparison with the expanded use of automatic stabilisers and tax cuts some other possible stimulus measures - such as increased expenditure on physical infrastructure, public works programmes or the expansion of social expenditure - generally take longer to implement. This was initially a major argument against stimulus measures of this nature. 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 that have been carefully designed and were scheduled for some future date. Many countries within the Region are now starting to include public investment programmes in their stimulus packages.

This is perhaps because the importance of focusing on so-called timely stimulus measures is now being reassessed. This is also because expectations about the duration of the current economic slump are changing. In the last quarter of 2008 most international organisations were forecasting that the recession would be of limited duration and that a turnaround could be expected in the second half of 2009. Given such assumptions it was logical to emphasise measures that could be implemented very rapidly and which were temporary. However, it now appears that the economic slump will be both deeper and longer than previously expected.

This has prompted the IMF to argue that the fiscal stimulus can rely more than usual on spending measures. Thus rather than promoting "temporary" measures like the EU or OECD, the IMF has argued that the stimulus measures should be "lasting because the downturn will last for some time".[56] This has prompted the IMF to strongly support the frontloading of existing public investment projects, to increase maintenance spending on infrastructure and to encourage governments to start planning new investment projects that can be implemented if the downturn continues.[57]

The ILO concurs with this advice. Downgrading the initial emphasis on timely and temporary measures is particularly relevant when it is recalled that the recovery in employment and income levels will delay the pick-up in output by up to several years.

Focusing on increased public investment can also advance other critical public policy objectives, such as promoting low-carbon economic growth and "green" jobs. Measures that are employment intensive and can be rolled out quickly include renovation of buildings to improve energy efficiency. Buildings account for 35-40 per cent of all energy use. Energy consumption can be reduced by around half through better insulation, installation of more efficient appliances for heating, air conditioning and lighting and by integrating renewable energy generation into buildings. These measures are cost-effective, often profitable with short pay-back times. They can be applied very rapidly to public buildings, including low-cost housing. Work of this nature is typically carried out by local small and medium sized firms in the building sector which currently have idle capacity due 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 scale; repairs to environmental infrastructure like water distribution systems, and environmental rehabilitation projects related to abandoned industrial sites, forests, rivers and coasts.

Public investment measures to support employment creation have also been announced by several countries. In Spain, such measures focus in the field of infrastructure building and more efficient vocational training and employment services (11 billion euros). The French

[56] IMF. Staff Position Note, op. cit., p. 1.

[57] ibid., p. 13.

plan also includes a sharp increase in public sector investment in 2009 for an additional cost of 10.5 billion euros. As part of this programme, there will be increased investment in transport and energy infrastructure, and postal services (cost 4 billion euros) which represents an increase of 35 per cent with respect to 2008. In addition, the state will invest 4 billion euros directly in strategic areas (sustainable development, higher education and research, defence industries). Local authorities will invest an additional 2.5 billion euros in 2009.

The European Union has also favoured a focus on public expenditure rather than tax cuts, even though this may take longer to implement, because of the potential this provides 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. The French plan contains measures in this sense as active labour market policies will receive an additional 500 million euros. Increased public expenditure on other labour intensive social services like heath care and child care are equally important.

According to the IMF, just under a quarter of the German stimulus is directed at public investment.[58] Public investment has the best multiplier effect but it is limited to projects in the pipeline, whose starting date can be move ahead.

(c) Maximising the multiplier effect to boost employment

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 so-called 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 the case in current circumstances because 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 as well as a large degree of uncertainty. In these circumstances, measures to lower company taxes, increase depreciation allowances or provide unconditional subsidies to firms, may not have the desired impact on private investment expenditure. Instead, measures of this nature may be used to reduce the debts of enterprises or improve the balance sheet of the firm. In which case, the impact on aggregate demand and employment will be muted.

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 indiscriminate 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 any increase in their disposable income and therefore it is commonly thought that increasing the disposable incomes of those at the bottom end of the income spectrum will have larger multiplier effects than income increases that are applied equally across the entire population. This is another argument favouring extensions of automatic stabilisers like unemployment benefits and welfare payments, but it would also suggest that if reductions in income taxes are considered they should be targeted at those on low incomes. These considerations have led the IMF and others to suggest that lump sum tax rebates or

[58] Carare A., Mody, A.; Ohnsorge, F. 2009. The German fiscal stimulus package in perspective, VoxEU.org, http://www.voxeu.org/index.php?q=node/2835.

temporary increases in earned tax credits, which are targeted at low income groups and credit constrained consumers, should be desirable in current circumstances.[59]

On the other hand the IMF have 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. Nonetheless, several countries have introduced acceleration of depreciation of investment such as Germany, the Netherlands and Spain. As an example, more than one-tenth of the German fiscal package is directed at measures designed to boost private investment. However, incentives for private sector investment such as acceleration of depreciation of investment and tax reduction on investment are likely to have small effects in the current context of low or even negative investment growth.

Nevertheless, government support for enterprises that are facing particularly difficult circumstances that would lead to closure or very large employment reductions should be contemplated. In these circumstances 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 small and medium sized enterprises which cannot currently gain access to reasonable priced credit, and which have a proven record of providing opportunities for decent work, should be prioritised. A number of countries have taken steps in this direction. In Spain and France, support to businesses especially SMEs, included credit lines (see Box 2 for a deeper discussion of the French plan). In Spain, enterprises were granted the possibility of early repayment on VA tax contributions. Businesses in the United Kingdom will also benefit from a longer period of time to pay their tax payments. Finally, foreign dividends were exempted from taxes to give incentives to big companies to retain their tax domicile in the United Kingdom.

(d) Increased imports and the domestic economy supply response

Another way that 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 encourage the free rider problem mentioned previously and the reluctance of some countries to implement appropriate packages and rather rely on the stimulus measures in their trading partners to spur export led growth. As noted above the best way to overcome such problems is through collective action and a commitment from all countries to a minimum level of fiscal expansion.

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 considerations lie behind the focused incentives and cash transfers that some governments are providing to consumers who purchase locally produced products. For example, the initial stimulus package in Germany devoted considerable support to the local car industry through such arrangements. These considerations are also important when designing public investment programmes. Countries that import a large proportion of construction materials will be mindful of this impact. This is precisely why historically the ILO has encouraged the use of labour intensive construction techniques in developing countries. This technology would not be appropriate in the majority of countries in the European region but nevertheless all countries should aim to enhance the employment intensity of any public investment programmes they implement in current circumstances.

[59] ibid., p. 14.

(e) Consequences of higher fiscal deficits

Many international organisations including the OECD, 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 the ILO is mindful of the impact that a permanent increase in government borrowing could have on interest rates and /or inflation. However, in the current environment concerns about inflation, or any fears of crowding out the private sector through increased government expenditure, would obviously be misplaced. In fact increased public investments in infrastructure, public transport and low carbon technology are more likely to crowd in private investment. Moreover, because of the substantial reductions in interest rates most governments in the EU-27 can currently borrow for long-term debt at a reasonable cost. Also, as mentioned above, the current recession is likely to be much deeper and longer than most international organisations initially anticipated. Also, even once economic output starts to rebound, labour markets will remain depressed and it will be several years before employment and income levels are restored to their pre-crisis levels. These considerations should dominate when governments are considering their medium-term fiscal strategies and the time frame for the required fiscal stimulus. The UK package also includes a new and higher 45 per cent tax rate on high incomes up from the current top rate of 40 per cent (if Labour wins the next election). In addition, a rise in employers' social security contributions from 2011 on all employees but the lowest paid was announced.

5. Conclusions and Recommendations

The broad conclusion of this paper is that of a mixed picture. On the one hand, workers across Europe have been in a difficult situation with regard to the labour market in 2008 and 2009. For the first time since the mid-1990s, there has been a reversal in the trend towards a decrease in unemployment which took place in Central and South Eastern Europe (non-EU) & CIS countries. In 2008, the unemployment rate in this area increased to 8.8 per cent. With regard to the European Union, employment is expected to reduce by 2.5 million in the European Union in 2009 after a modest 7 million growth in 2008.

On the other hand, policy responses to mitigate the economic and social effects of the crisis have differed widely across Europe in front of a common challenge. Regarding monetary policy, central banks in the region have pursued counter-cyclical monetary policies as an attempt to boost the economy except for those countries facing massive capital outflows. Turning to fiscal policy, policy responses to the economic crisis across the European region have diverged dramatically. For those countries which have had to seek emergency loans from the IMF, fiscal packages included wage restraint (in particular in the public sector) and employment reduction in the public sector. The aim was to reduce public deficits and restore the credibility of these countries in international financial markets. For countries belonging to the European Union, the focus has been on anti-cyclical fiscal policies, but the magnitude of the public stimula has varied considerably. The picture that emerges from recent studies is that the employment effects of the fiscal policy packages depend on multiple factors. These include (i) the size and duration of the package; (ii) the speed at which measures are implemented; (iii) the "multiplier effect", e.g. extent to which an initial stimulus is saved or withdrawn from the economy; (iv) the size of linkages from the national economy through increased imports, and the supply capacity to respond to any increase in demand; and (v) the long-term consequences of fiscal deficits.

This raises the question of why there has been such a divergence in fiscal policies between the EU countries and the emerging countries of Europe. Were the latter group of countries badly managed with a poor macro-economic performance? While to some extent, countries

with sound macroeconomic and macro prudential policies have fared better, it is also true that countries like Ukraine, which had a very low fiscal deficit and public debt prior to the crisis have been hit hard. Moreover, most of the other countries did not perform so badly and achieved some Maastricht criteria. By mid-2009, the fiscal and debt criteria of the Maastricht treaty are not met by all EU members while only the fiscal criteria is not met in several of the emerging countries. However the real difference is that the emerging countries do not enjoy the credibility of Eurozone members in financial markets. In this context, countries with exchange rate pegged to the euro face big challenges.

Policy responses to the crisis could potentially widen the gap in employment performance between advanced economies and emerging countries of Europe. Fiscal restraining in the latter group raises other concerns as well. To address these challenges, it is important that all countries focus on measures that have the largest multiplier effects and thus the biggest impact on aggregate demand. Policies that provide additional disposable income to the poorest sections of society should be prioritised. Given the expected duration of this recession the main focus of stimulus packages should be on public spending increases. Labour intensive physical infrastructure projects - including renovation of buildings to cut energy consumption, repairs to environmental infrastructure and improved public transport facilities - should be high priorities. Increased public investment in social services such as health, education and child care are equally important. Increases in this type of public expenditure will also help boost productivity and serve longer term public priorities in the environmental and social policy fields.

Equally important is the design of policies which address social imbalances in the region. Governments could contemplate supporting this process through the establishment or strengthening of minimum wage legislation, thereby providing a firmer wage “floor” in the economy. Public sector wage negotiations often set a pattern for bargaining in other parts of the economy. In the current environment governments should use whatever influence they possess to ensure wage outcomes that will boost consumption expenditure rather than depressing domestic demand further. More generally wage adjustments should move in line with price movements and medium-term productivity trends. In a period when inflation is muted and deflation a possibility, linking nominal wage adjustments to a prices plus productivity formula will keep labour costs moderate but prevent destructive labour cost competition.

In conclusion, what is therefore needed is a coordinated multilateral approach for Europe in order to boost the multiplier effect and avoid any form of beggar-thy-neighbour policy. Sharing information and analysis on the crisis would be a first step in this direction. Designing public investment programmes in the field of transport and energy at the regional rather than at the national level would also help to mitigate the labour market consequences of the crisis and pave the way for future growth.

Policy Integration Department

Working Papers*

No. 1 ILO activities on the social dimension of globalization: Synthesis report

No. 2 Measuring decent work with statistical indicators – *Richard Anker, Igor Chernyshev, Philippe Egger, Farhad Mehran and Joseph Ritter*

No. 3 Globalization and decent work: Options for Panama – *Philippe Egger*

No. 4 Globalización y trabajo decente: Opciones para Panamá – *Philippe Egger*

No. 5 Indicators of social dialogue: Concepts and measurements – *Lane Kenworthy and Bernhard Kittel*

No. 6 Assessing the impact of the attacks of 11 September 2001 on women's employment in the United States – *Gertrude Schaffner Goldberg and Helen Lachs Ginsburg*

No. 7 Decent work and the informal economy in Central America – *Juan Diego Trejos Solórzano and Miguel Del Cid*

No. 8 Poverty initiatives in the ILO: A review of past and present approaches – *Pat Holden and Dagmar Walter*

No. 9 Whither the International Standard Classification of Occupations (ISCO-88)? – *Debbie Budlender*

No. 10 Improving occupational classifications as tools for describing labour markets: A summary of recent national experiences – *Debbie Budlender*

No. 11 Recent developments in China's labour economy – *Thomas G. Rawski*

No. 12 The Impact of economic liberalization on employment and wages in India – *Sonia Bhalotra*

No. 13 The impact of trade liberalization upon inequality in developing countries – *Donald J. Robbins*

No. 14 The impact of liberalization and globalization on income inequality in developing and transitional economies – *Giovanni Andrea Cornia*

No. 15 The impact of technology transfer on employment and income distribution in developing countries: A survey of theoretical models and empirical studies – *Mariacristina Piva*

No. 16 International finance: Meeting the needs of people in developing countries – *José Guilherme Almeida dos Reis*

No. 17 The gender dimensions of globalization of production – *Stephanie Barrientos, Naila Kabeer and Naomi Hossain*

No. 18 Social exclusion in the context of globalization – *Jan Breman*

No. 19 Gender and globalization: A macroeconomic perspective – *Çağatay Nilüfer and Ertük Korkurt*

No. 20 Globalization, social exclusion, and work: With special reference to informal employment and gender – *Marilyn Carr and Martha Chen*

No. 21 Resources for social development – *Antony Clunies Ross*

No. 22 Does the new international trade regime leave room for industrialization policies in the middle-income countries? – *Alisa DiCaprio and Alice Amsden*

No. 23 Social dimension of globalization in Latin America: Lessons from Bolivia and Chile – *lvaro García Hurtado*

No. 24 The social dimension of globalization: A review of the literature – *Bernhard Gunter and Rolph van der Hoeven*

No. 25 The social dimension of global production systems: A review of the issues – *Susan Hayter*

No. 26 Reforming global economic and social governance: A critical review of recent programmatic thinking – *Jeremy Heimans*

No. 27 Corporate social responsibility: An issues paper – *Michael Hopkins*

No. 28 Upgrading in global value chains – *John Humphrey*

* Working Papers 16-38 prepared for the World Commission on the Social Dimension of Globalization.

No. 29 Implications of globalization and economic restructuring for skills development in Sub-Saharan Africa – *Richard K. Johanson*

No. 30 The outcome and impact of the main international commissions on development issues – *Frédéric Lapeyre*

No. 31 Globalization and structural adjustment as a development tool – *Frédéric Lapeyre*

No. 32 Globalization and perceptions of social inequality – *Malte Lübker*

No. 33 The changing structure of international trade linked to global production systems: what are the policy implications? – *William Milberg*

No. 34 Corporate social responsibility: An overview of principles and practice – *Jill Murray*

No. 35 Inclusive development strategy in an era of globalization – *Ignacy Sachs*

No. 36 Social consequences of the globalization of the media and communication sector: some strategic considerations – *Seán Ó. Siochrú*

No. 37 Globalization, history and international migration: A view from Latin America – *Andrés Solimano*

No. 38 Towards a different kind of globalization, or how the anti-globalists view the world – *Gijsbert van Liemt*

No. 39 How do trade union rights affect trade competitiveness? – *David Kucera and Ritash Sarna*

No. 40 Statistics on the employment situation of people with disabilities: A compendium of national methodologies – *ILO Bureau of Statistics in collaboration with the In Focus Programme on Skills, Knowledge and Employability*

No. 41 Employment in the informal economy in the Republic of Moldova – *ILO Bureau of Statistics in collaboration with the Department for Statistics and Sociology of the Republic of Moldova*

No. 42 Decent work in a least developed country: A critical assessment of the Ethiopia PRSP – *Graeme J. Buckley*

No. 43 Unemployment and labour market institutions: The failure of the empirical case for deregulation – *Dean Baker, Andrew Glyn, David Howell and John Schmitt*

No. 44 Women's access to occupations with authority, influence and decision-making power: Women as legislators, senior officials and managers around the world – *Richard Anker*

No. 45 The world of work in the context of economic integration and trade liberalization – *Daniel Martínez*

No. 46 Poverty reduction in Pakistan: The strategic impact of macro and employment policies – *Moazam Mahmood*

No. 47 Trends in work stoppages: A global perspective – *L. J. Perry and Patrick J. Wilson*

No. 48 Generating decent work for poverty reduction in Cambodia: The voice of workers, employers and the Government – *Moazam Mahmood*

No. 49 The social dimension of regional integration in ECOWAS – *René Robert*

No. 50 Measuring trade union rights: A country-level indicator constructed from coding violations recorded in textual sources – *David Kucera*

No. 51 Patterns of job quality attributes in European Union – *Joseph A. Ritter*

No. 52 Child labour, education and export performance – *David Kucera and Ritash Sarna*

No. 53 Measuring the informal economy: From employment in the informal sector to informal employment – *Ralf Hussmanns*

No. 54 Indicators of labour standards: An overview and comparison – *Richard N. Block*

No. 55 The pattern of globalization and some implications for the pursuit of social goals – *Gerry Rodgers*

No. 56 Statistical indicators of social dialogue: A compilation of multiple country databases – *Anne Chataigner*

No. 57 Trade unions and informal workers' associations in the urban informal economy of Ecuador – *Catherine Vaillancourt-Laflamme*

No. 58 Decent work, standards and indicators – *Monique Zarka-Martres and Monique Guichard-Kelly*

No. 59 Social dialogue indicators: Trade union membership and collective bargaining coverage. Statistical concepts, methods and findings – *Sophia Lawrence and Junko Ishikawa*

No. 60 Informality and gender in Latin America – *María Elena Valenzuela*

No. 61 Labour developments in dynamic Asia: What do the data show? – *David Kucera and Anne Chataignier*

No. 62 Sources and Methods: Labour Statistics – Volume 5: Total and economically active population, employment and unemployment (Population censuses), Third edition

No. 63 Desarrollo local en América Latina: Oportunidades y desafíos para el trabajo decente – *Francisco Alburquerque*

No. 64 Bangladesh decent work statistical indicators: A fact-finding study – *Mustafa K. Mujeri*

No. 65 The impact of globalization on poverty in Bangladesh – *S. R. Osmani*

No. 66 International labour migration from Bangladesh: A decent work perspective – *Tasneem Siddiqui*

No. 67 Globalization and decent work: A report for the Decent Work Pilot Programme in Bangladesh – *Sukti Dasgupta and Amelita King Dejardin*

No. 68 East Africa reduction poverty and gender inequality: Selected strategies and issues

No. 69 Sources et méthodes: statistiques du travail – Volume 5: Population totale et active, emploi et chômage (Recensements de population), Troisième édition

No. 70 Fuentes y Métodos: Estadísticas del Trabajo – Volumen 5: Población total y económicamente activa, empleo y desempleo (Censos de población), Tercera edición

No. 71 The quantification of respect for selected core labour standards: Towards a social development index? – *Ludo Cuyvers and Daniel van den Bulcke*

No. 72 A new methodology for estimating internationally comparable poverty lines and living wage rates – *Richard Anker*

No. 73 Issues in macroeconomic and financial policies, stability and growth – *Yilmaz Akyüz*

No. 74 From liberalization to investment and jobs: Lost in translation – *Yilmaz Akyüz*

No. 75 Financial openness and employment: The need for coherent international and national policies – *Rolph van der Hoeven and Malte Lübker*

No. 76 Socio-economic security and decent work in Ukraine: a comparative view and statistical findings *Igor Chernyshev*

No. 77 Global Production Systems and Decent Work – *Stephanie Barrientos*

No. 78 Globalization and the illicit market for human trafficking: an empirical analysis of supply and demand – *Gergana Danailova-Trainor and Patrick Belser*

No. 79 Employment Creation, Real Wages and Job Quality: How Much Aggregate Economic Growth Delivers? The Case of Chile – *Andrés Solimano*

No. 80 Growth, Investment and Employment in Ghana – *Ernest Aryeetey and William Baah-Boateng*

No. 81 Globalisation, Industrial Revolutions in India and China and Labour Markets in Advanced Countries: Implications for National and International Economic Policy – *Ajit Singh*

No. 82 Growth and Employment Dynamics in Botswana: A Case Study of Policy Coherence – *Happy K. Siphambe*

No. 83 Beyond the Employment/Unemployment Dichotomy: Measuring the Quality of Employment in Low Income Countries – *Sabina Dewan and Peter Peek*

No. 84 The Impact of Institutions and Policy on Informal Economy in Developing Countries: An econometric exploration – *Diego Rei and Manas Bhattacharya*

No. 85 Gender, Informality and Employment Adjustment in Latin America – *Rossana Galli and David Kucera*

No. 86 The Unpaid Care Work- Paid Work Connection – *Rania Antonopoulos*

No. 87 Global Rules and Markets: Constraints Over Policy Autonomy in Developing Countries – *Yilmaz Akyüz*

No. 88 Value Chains and Decent Work for Women: What Is To Be Done? – *Ann Zammit*

No. 89 Rural Migrant Workers in China: Scenario, Challenges and Public Policy – *Li Shi*

No. 90 Employment, unemployment and informality in Zimbabwe: Concepts and data for coherent policy-making – *Malte Luebker*

No. 91 Decent work and informal employment: A survey of workers in Glen View, Harare – *Malte Luebker*

No. 92 Gender (in)equality, globalization and governance – *Amelita King Dejardin*

No. 93 A common economic crisis but contradictory responses: The European experience 2008-09 – *Robert Kyloh and Catherine Saget*

Regional and Country Policy Coherence Reports

No. 1 Implementing the GPRGS in Vietnam through Decent Work – *Moazam Mahmood*

No. 2 Policy Coherence and Sequencing for Post-Conflict Recovery in Liberia – *Moazam Mahmood*

No. 3 Macro Policy Coherence for Decent Work in the Caribbean – *Moazam Mahmood*

No. 4 Employment, Decent Work and Poverty Reduction in Urban China – *Zhang Junfeng and Moazam Mahmood*