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PERSPECTIVE

Employment Policy in Times of Crisis

From a Job-Rich Recovery to Sustainable Structural Change

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- As a consequence of the crisis employment rates declined virtually all over the world, but in some countries the labour market withstood the downturn better than in others. It appears that the right policies – timely stimulus packages, measures that strengthen demand as well as social dialogue – do make a difference.

- The experience of countries such as Korea, Poland, Brazil and Germany shows that crisis response measures have been particularly effective when they are aimed at saving or creating jobs and at strengthening the social safety net. Untargeted tax cuts and wage deflation, by contrast, tend to be counterproductive.

- The most immediate challenge at this point is finding a balance between the need to protect jobs through economic stimuli and the necessary fiscal consolidation. Long-term challenges to be addressed include getting more women and youth into employment, coping with the effects of an ageing society, building a basic floor of social protection, fighting informality and improving international policy coherence.

- »Green« stimulus measures like investments in energy efficiency, renewable energy or water management have been used to counter the current crisis, but the long term employment potential of an environmentally sustainable structural change must not be underestimated, either.

Dialogue on Globalization

Internationally coordinated policy efforts adopted by the G20 governments saved or created an estimated 21 million jobs in the financial and economic crisis, according to a report by the International Labour Organization (ILO). A round table conference jointly organized by the Friedrich Ebert Foundation and the ILO on May 6, 2010 in Berlin looked into which crisis response policies employed in different countries proved to be most effective in promoting a job-rich recovery. What worked and how did it work? – was the guiding question. This article is largely based on the discussions held at this conference.

1. Crisis Management Policies

Labour Market Policies

Economic and labour market developments since the onset of the financial crisis were uneven and susceptible to downside risks. Thus the economic recovery in 2010 was strong in Asia, but only moderate in the US and very modest in Europe. Equally the impact of the crisis on labour markets has been rather diverse in different countries. In general employment rates declined virtually all over the world, although the decline was less marked than could have been expected given the overall GDP contraction. In some countries, such as Germany, the labour market withstood the downturn considerably better than in others, such as the US.

Reasons for these diverse developments include different institutions like dismissal protection, different types of jobs – for instance a concentration in the construction industry as in Spain or the US where the effects of the crisis were most severe – but most importantly different policies. Programmes in the industrialized countries consisted in almost equal shares of infrastructure investment, social protection, tax cuts and other expenditures such as expanding access to credit for small and medium-sized companies, whereas emerging economies concentrated their spending strongly on infrastructure and housing.

Several policies can be singled out as having been particularly successful in creating a job-rich and inclusive recovery:

- countries with large fiscal stimulus packages (3 to 4 per cent per cent of GDP), for example China, Korea and South Africa, seem to have reversed the downturn more quickly than others,
- the stimulation of demand, for example by means of extended unemployment benefits as in the US or strengthened social protection as in Brazil, contributed to a job-centred recovery, and
- the rapidity of the response proved to be a crucial factor.

The International Policy Arena

The ILO's constituents in June 2009 passed a Global Jobs Pact in support of the crisis management efforts that offers a portfolio of around 25 policy options to accelerate employment creation and to strengthen social protection systems, social dialogue and the respect for international labour standards. The ILO itself has focused its efforts, besides supporting national policy responses and capacity building, on international policy dialogue, notably in the G20, to make sure that employment policy is firmly rooted in the international policy response to the crisis.

The communiqué of the G20 labour ministers' meeting in April in Washington contains a strong call for employment creation and poverty alleviation measures, for strengthening domestic demand as well as social safety systems that proved to be an important automatic stabilizer during the crisis and for sharing productivity gains with workers. The communiqué makes clear that the issue is not just the creation of more jobs at any cost but the quality of jobs or, in other words, decent work.

The active involvement of the ILO in the G20 summits as well as in the labour ministers' meeting is a welcome sign that in response to this crisis the approach to global economic governance has considerably broadened to encompass not just the financial point of view but labour and social issues as well. The G20 labour ministerial should therefore not remain a one-time event but become a regular institution. The ILO could play a prominent role in this by forming a link between the G20 and the developing countries not represented in that group. Moreover, ILO norms should not only be considered in the G20 process but as well in the WTO negotiations.

The Timing of Exit Strategies

The most immediate challenge ahead of governments at this point is the right timing of an exit from stimulus packages. There can be no doubt that a fiscal consolidation is necessary as public debt has soared in a unprecedented pace between 2007 and 2009: from 62 per cent to 75.1 per cent of GDP in the G20 countries, from 70.9 per cent to 81.8 per cent in the Euro Zone, and from 61.8 per cent to 83.9 per cent in the US.

A premature exit, however, would endanger a return to positive rates of employment growth in the foreseeable future and in the longer term it could even harm fiscal consolidation, too, because tax revenue would be diminished while social spending would tend to increase. One example of this »exit dilemma« can be observed in the US, where the employment situation is still troubling. While labour market improvements are high on the administration's agenda, pressure is mounting to radically address the fiscal deficit.

The question is, therefore, how to balance measures against the jobs crisis with those against the fiscal crisis. It appears that the pace of budget consolidation is crucial, depending on initial conditions such as the level of indebtedness, as is the content of the exit measures – for example raising additional revenue from green taxes, concentrating necessary spending on measures with a high employment impact, and avoiding wage deflation that would harm aggregate demand.

2. Case Studies

Korea

South Korea saw a decline in employment in the current crisis comparable to the situation in the currency crisis of 1997. The official unemployment rate has been rising into 2010 to reach 5 per cent in January, up from 3.5 per cent at the end of 2009. Even though the Korean government reacted by setting aside a large supplementary budget for job creation, the dramatic loss of jobs in the private sector has been compensated only partially by the creation of new jobs in the public sector.

Social partners reached a »grand social consensus« in February 2009 that contains a wage freeze, the pledge to refrain from layoffs and an expansion of the social safety net. In June 2009 the government invited employers to join its job sharing campaign, whose main elements are wage cuts – thus the 30 largest Korean corporations cut starting salaries of university graduates by up to 28 per cent – and the so-called wage peak system, i.e. reduced wages for older workers in return for longer employment. The package was aimed at the creation of additional jobs with the help of the saved wages, improved employment security for older workers and dampening the cost of unemployment benefits and public pensions.

However, there are reasons for scepticism about the results. Employment has continued to shrink, while applications for unemployment benefit in January 2010 were up by 8.6 per cent compared to a year earlier. Moreover, most of the newly created jobs are irregular ones, particularly internships. Critics also claim that workers' motivation and loyalty have been harmed by the wage cuts.

Poland

Poland went into the current crisis on the one hand with a relatively stable economy thanks to the difficult reforms and austerity measures in the 1990s, but on the other hand with high levels of unemployment to begin with (around 20 per cent and even up to 48 per cent in some regions). Another problem was that legal and economic tools to combat the crisis still had to be developed, while clear sources of financing and an autonomous social dialogue were lacking. Immediate reactions to the crisis, therefore, were limited to the government concentrating on avoiding a financial panic, while many employers used the crisis as an excuse for job cuts.

In this situation, which was deteriorating rapidly, an anti-crisis package was worked out autonomously by the social partners with two main objectives: the protection of jobs as well as a stabilization of companies' economic condition. The package contained 13 points – among them better social protection for workers and their families, a minimum wage increase, funds for training measures, limits on fixed-term contracts and subsidized employment to avoid lay-offs – of which only six were picked up by the government.

On the plus side, employers now for the first time can receive financial assistance to retain workers in the crisis by having part of their wages covered during stand-by periods. Moreover, social dialogue has been strengthened as decisions about the introduction of anti-crisis measures must be negotiated with the trade unions.

The outcome is nonetheless seen critical by trade unions. Thus assistance to workers affected by the crisis was not included in the package; no solution was offered for securing pension rights during stand-by periods; strict criteria and complicated administrative rules make it impossible for many companies to apply for assistance; and some of the measures might be used to weaken the protection of workers permanently. In the end, more than 300,000 jobs were lost in spite of the measures, and the number of fixed-term contracts in fact increased, hurting not only workers but also demand and thereby impeding the economic recovery.

Brazil

A first response to the financial crisis, which hit Brazil with some delay, was negotiated in 2008 to avoid mass lay-offs, including collective vacations, a temporary reduction of working hours and the use of the lay-off insurance fund that provides severance payments to workers in the formal sector made redundant. In spite of these measures, the previous trends towards lower unemployment rates, higher wages and a shrinking informal sector were reversed.

However, Brazil may have weathered this crisis better than earlier ones because this time the state had considerably more fiscal room for manoeuvre mainly because the public debt situation had improved dramatically. Additionally, financing for active labour market policies has been available from the so-called Workers Support Fund (FAT), which is fed from payroll taxes and whose use is partly co-determined by the social partners.

Industrial production dipped in 2009, but eventually recovered due to the anti-cyclical policy adopted by the government, including the provision of liquidity by the central bank, a minimum wage increase, public infrastructure investments, lower taxes for durable consumer goods and for credit transactions as well as an extension of unemployment benefits and an expansion of the number of families receiving *Bolsa Família*, a cash transfer conditional upon children's school attendance and participation in vaccination programmes. Additional policies, especially to fight the high rate of informality, include a simplified tax system for small and medium-sized companies and lower taxes for self-employed persons covered by social security.

It was a whole set of policies working together that proved successful, most of which were focussed on strengthening aggregate demand. The increase in social assistance, for example, has had a high multiplier effect on demand as it is targeted towards households with a higher propensity to consume.

Germany

Despite an unprecedented 5 per cent drop in GDP in 2009, mainly due to the country's high export dependency, the unemployment rate in Germany has remained stable, which has sometimes been dubbed the »German job miracle«. The government responded to the crisis with a fiscal package to the tune of 4 per cent of GDP, which included public investment programmes and, as these take some time to become effective, a car scrapping bonus (cash-for-clunkers), which can be considered highly targeted given the importance of the automobile industry in Germany.

The most effective element of the package that helped to safeguard many jobs was short-time compensation, i.e. a reduction of working hours for which the workers receive wage compensation from the federal labour office, while employers get a partial relief from social security contributions.

This programme, which has been extended into 2012, not only saved jobs but also worked as an economic stabilizer as it sustained aggregate demand and tax revenues while keeping social expenditures at bay. It therefore serves as a good example of a labour market instrument that, while generating costs in the short run, saves money in the long term by giving a boost to demand and revenues. Another advantage was that employers were able to immediately take advantage of the economic recovery as they had retained their skilled workforce. The strict dismissal protection in Germany proved to be a boon in this context because the fact that employers could not quickly save costs with lay-offs was an additional incentive to use short-time compensation as an alternative. One drawback was that little use was made of existing programmes to use short-time work periods as an opportunity for further training.

3. Lessons Learned

What Works and What Doesn't

Several factors can be singled out that made crisis management policies successful. Thus measures work best when they are timely, temporary and targeted (»the 3 Ts«): a fast reaction to the crisis has been important to avoid an economic downturn that would have resulted in a further deterioration of the employment situation; economic stimuli have to be temporary in order to avoid prolonged fiscal problems; and the cost-benefit ratio is particularly good when expenditures are targeted at the needs of a particular country such as a car scrapping programme for countries with a large automobile sector.

Crisis response measures have been particularly effective when they are aimed at saving or creating jobs. The same holds true for strengthening the social safety net. What both types of measures have in common is that they support aggregate demand, because the less workers need to worry about unemployment and the more they can rely on support in case they do lose their job, the less consumption will be compromised.

An inventory of policy responses that helped accelerate an employment intensive recovery was compiled by the ILO for the G20 labour ministerial in April 2010. Four types of measures stand out:

- stimulating labour demand with the help of fiscal packages, infrastructure investments, support for small and medium-sized companies and working time reductions,
- extending social protection, including income support measures and employment programmes or employment guarantee schemes,
- active labour market policies, such as employment services and training measures, and
- social dialogue.

Anti-crisis measures that can be considered counterproductive are untargeted tax cuts, labour deregulation and wage deflation. Lower wages may save costs in the short term, but due to the negative effects on demand the economy is in danger to remain below its potential in the longer run.

In industrialized countries additional spending on average made up 65 per cent of their total stimulus packages, while over a third of the total was used for tax cuts. In emerging economies 83 per cent of the packages were earmarked for additional spending compared to only 17 per cent for tax cuts. As it turns out, additional public expenditures have been more efficient in stimulating output than tax cuts, whose capacity to boost demand is limited because the beneficiaries are too a high degree middle to high income earners who tend to save any additional income rather than spending it. Moreover, tax cuts may permanently lower public revenues, which not only reduces the potential for public investment programmes but also makes the necessary fiscal consolidation all the more painful.

The Revival of Keynesianism and Social Dialogue

Whereas up to the current crisis demand-oriented policies were out of favour among most economists and governments, the need to fight the crisis brought a revival of Keynesian ideas as one result of the crisis was the realization that economy is not inherently stable and stabilization policies may be necessary. In this situation many governments began using labour market and social policies explicitly for stabilization purposes.

In all the countries represented in the case studies the consequences of different measures on aggregate demand proved to be an important factor. A successful crisis response typically involved strengthening social safety and social dialogue as well as quick and flexible economic stimulus packages – which is interestingly quite the opposite of what most international organizations used to prescribe. That is one reason why the formulation of an internationally coherent policy approach is considered so important.

Many developing countries, however, are lacking the financial capacity to carry out demand-oriented policies for economic stabilization. It is therefore all the more important that poorer countries receive support from developed economies for employment creation and social programmes, particularly in times of crisis.

In many countries governments and social partners worked together to find a common approach to combating the crisis. Especially the German case appears as a showcase for the benefits of tripartism, as the retention of workers by employers was facilitated by intensive dialogue between the government and social partners as well as mutual trust.

4. Towards Sustainable Structural Change

Long-term challenges

So far few manifestations of discontent vis-à-vis the crisis and crisis management strategies have occurred (Greece being a major exception). But this could change if employment prospects do not improve significantly or if crisis response strategies become less inclusive and are perceived as unfair.

Moreover, the financial crisis may have been the trigger, but not the sole cause of the employment crisis. In the labour markets, there was a crisis before the crisis, such as the perennially high unemployment rates reported in Poland or the persisting poverty and inequality in Brazil. The financial crisis that broke out in 2007 served as an additional setback for efforts in these areas. The roots of this crisis must be tackled in order to come to a long-term economic and labour market stabilization.

This means that efforts should not stop at fighting the immediate effects of the current crisis. Instead a number of longer-term challenges need to be addressed including

- shortening the time-lag between economic and job recovery in order to limit the loss of human and economic potential,
- creating the right macroeconomic framework for employment-oriented growth, including a better balance between productivity growth and wages,
- stemming the steep rise in youth unemployment,
- getting more women into employment,
- building a basic floor of social protection and strengthening the social state where it already exists,
- coping with the effects of an ageing society on the workforce and on the financing of social security systems, and
- strengthening international policy coordination.

A reform of the financial system has been considered an important prerequisite for future economic growth. Policy makers must not only address the instability of the system. They should also institute reforms that profits accruing predominantly to the financial sector as this leads to an impairment of real investments, resulting in fewer jobs and lower wages and, in extension, in lower aggregate demand and lower growth rates. Stricter regulation of the financial sector could also ease access to credit by enterprises and reduce capital supply fluctuation thereby supporting sustainable enterprises.

International policy coherence should be improved as the task of putting the financial sector at the service of the real economy cannot be achieved by individual countries alone. Better coordination should, however, go beyond international financial markets regulation to also include education and training, gender issues and environmental policies in order to secure a sustainable development.

As the economy restructures, the labour force needs to restructure as well. Governments would therefore be well advised to develop policies such as lifelong learning strategies or training grants for »green jobs« (see below). The structural changes also mean that states must engage more in activating important labour force potentials, notably women, and to better integrate young persons in the labour market. This requires, among other things, investments in childcare as well as in schooling and training measures.
Another issue to be addressed is the persistence of precarious employment and the informal sector. The Global Jobs Pact as well as the ILO's Decent Work Country Programmes explicitly include the informal sector and also propose measures to tackle the problems of working poor and vulnerable employment. Given the experience that economic growth alone does not reduce informal work, it is clear that the right kind of growth and industrial policy must be promoted, i.e. one that is centred on the creation of decent work.

Innovative Ways Out of the Employment Crisis

In spite of its terrible implications for many workers who lost their jobs, the financial and economic crisis could also represent a chance to set the course for a more sustainable and inclusive long-term development to solve what has been dubbed the crisis before the crisis, including the shortfall of decent jobs and the negative effects of climate change especially on poorer countries.

»Green« stimulus measures – investments in energy efficiency, renewable energy or water management, just to name a few – have already been used to counter the current crisis. On average they amounted to between 10 and 15 per cent of total stimulus packages in the G20 countries. Countries that invested heavily in these measures include China and South Korea. Beyond immediate crisis reactions, however, governments ought to initiate environmentally as well as socially sustainable structural changes to achieve a long-term stabilization. A proactive climate policy could play an important role in this.

According to the Stern Report, the total annual cost of climate protection amounts to 1 per cent of global GDP or US$ 543 billion. However, without an effective climate protection policy and a projected average temperature increase of 2° C, the annual cost could reach 5-20 per cent of world GDP, i.e. up to US$ 11 trillion. The benefits of climate protection have to be also taken into account, notably with regards to the labour markets. According to the ILO, the notion of »green jobs« is about the transformation of economies, companies and labour markets into a sustainable low-carbon economy providing decent work.

The job potential in Germany has been calculated with the help of the so-called PANTA RHEI forecasting model, based on the Integrated Energy and Climate Programme passed by the German government in 2007. The results, which take indirect impacts and multiplier effects into account, show that 33,500 jobs may be created by 2020 in the CO_2 building renovation programme, 74,000-100,000 in the renewable energy technologies, 44,800 as a consequence of a carbon emissions based motor vehicle tax and an increased heavy vehicles road toll, and up to 22,000 jobs in the corporate consultancy sector. Other side-effects are a GDP increase by €0.8 billion in the same period because of lower energy imports and a reduction of the public debt by €5.7 billion due to higher economic performance.

Worldwide sectors with high job creation potential also include energy efficiency (as opposed to renewable energies), agriculture, forest restoration as well as waste and water management. These sectors can be a major source of green jobs particularly in developing countries. According to ILO estimates, investments in infrastructure for agriculture; water management; flood, storm and drought protection, etc have the potential to create 100 million jobs a year in developing countries.

Environmental protection and climate policy are not only important factors for employment, but also for intra- and intergenerational justice as well as sustainable development, i.e. improved quality of life, especially for developing countries that often suffer most from climate change and possess the least resources for adapting to it. In response to the question of possible drawbacks for competitiveness that has often been raised by developing countries, the positive by-products of green policies especially on the labour markets that in lower social costs should be highlighted.

There are important caveats that policy makers as well as social partners need to address: Firstly, jobs in the environmental sector are not per se decent work. Decent wages, adherence to the core labour standards, a social safety net and social dialogue must be ensured separately. Secondly, job gains are by no means an automatic outcome of climate protection and other environmental measures. Thus, for instance, efficiency gains will not lead to higher employment if the gains are primarily used to boost corporate profits or higher wages for the existing workforce.

Policies need to converge and be coherent in order to achieve the full employment potential of a greening economy. Thus the greening of enterprises requires social dialogue as well as active cooperation between management and workers. Enterprises and workers must be prepared and skilled to make use of the benefits of new environmental technologies. Skills shortages are a major constraint not only in developing countries. Training must therefore be provided to prepare the workforce for a changing industrial structure. This is all the more important as the necessary change in industrial structure will not only create winners. There will be losers as well, for instance in industries not considered environmentally sustainable.

To maximize transparency about the structural changes and their effects the formulation of common international goals might be useful, in analogy to the Millennium Development Goals, by which progress and issues still open can be measured. In the process scientific support by international organizations such as the ILO and UNEP could be helpful.

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