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Tackling Unemployment and Growing Public Debt

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While global economic recovery remains anaemic, most industrialised countries continue to face growing unemployment and public debt. Average unemployment in the Organisation for Economic Co-operation and Development (OECD) countries rose from around 5% in 2007 to over 8% in 2012. The Eurozone is faring worse, with unemployment over 11%, and still rising in some countries. The unemployment rate in Spain rose to 26% in 2012, with youth unemployment surging to 55%. In Greece, it stood at 26.8%, the highest in the European Union (EU) with youth unemployment edging towards 60%.

After the Great Recession hit developed countries in 2009, the public debt situation deteriorated rapidly. The average public debt in industrialised economies increased from around 70% of GDP in 2007 to about 110% in 2012.

When the crisis first hit, world leaders, including those in the largest economies in the G-20, acted decisively with large fiscal stimulus packages totalling about $2.6 trillion during 2008 -2010. The International Labour Organization (ILO) estimates that 7 to 11 million jobs were created or saved in G20 countries by such stimulus packages in 2009.

But with the emergence of supposed 'green shoots' of recovery from mid-2009, financial markets and media shifted attention to the ballooning public debt, especially in the Eurozone, where countries borrow in Euros, rather than in national currencies. Thus, governments have been successfully pressured to take drastic measures to curb government debt and deficits. Such drastic actions, it is claimed, would engender investor confidence and thus bring about economic recovery.

The Fallacy of Fiscal Austerity

However, market confidence has not been restored. The advocates of this ostensible 'market confidence' view conveniently overlook the fact that when the austerity measures adversely affect growth, jobs, incomes and tax revenue, they reduce rather than raise market confidence.

The International Monetary Fund (IMF) recently admitted that together with many others, it had seriously underestimated multipliers, thus contributing to the depth of the resulting contractionary impact of austerity policies. The IMF also warned that: "Frontloaded consolidations tend to be more contractionary and, hence, delay the reduction in the debt-to-GDP ratio relative to smoother consolidations."[1]

In fact, earlier IMF research had warned that "slamming on the brakes too quickly will hurt the recovery and worsen job prospects. Hence the potential longer-run benefits of fiscal consolidation must be balanced against the short- and medium-run adverse impacts on growth and jobs".[2] Over the past three decades, fiscal consolidation has raised short- and especially long-term unemployment, hurting wage-earners disproportionately more than profit- and rent-earners.

But IMF research seems to have little influence on its operations and policy advice and conditionalities. Hence, policymakers are still refusing to reconsider their approach to dealing with unemployment and debt. Instead, when the promised effects have not materialised, they have introduced yet more cuts, further choking economic recovery prospects.

New Social Compact

Austerity champions also believe that growth will come from a major expansion of export demand; but obviously, global economic recovery cannot be based on all countries finding external markets for their output. Hence, the response to growing unemployment and public debt has to focus on reinvigorating domestic demand, especially in developed economies.

This would entail both immediate policy actions to expand domestic demand as well as medium-term policies to address structural issues (such as infrastructure bottlenecks, which have been hampering productivity growth), and longer-term challenges such as climate change. This requires national consensus among government, business and workers.

The immediate task is to restore consumer and business confidence which depends on sales and profits prospects. This would require boosting spending which can be quickly achieved by reversing social protection and public employment cuts.

Governments should expand public services including active labour market programmes, subsidised childcare, universal healthcare and education. Such public provisioning enhances the 'social wage', taking pressure off wage demands as businesses strive to recover. These measures also help mitigate inequalities and enhance the welfare of all, thus contributing to social and political stability.

Such labour market policies typically come at modest fiscal cost. Increased spending on active labour market programmes costing 0.5% of GDP can be expected to increase employment by between 0.2% and 1.2% over the medium term by raising aggregate demand and better matching jobseekers with vacancies.[3] Moreover, well designed unemployment benefits and active labour market programmes not only provide much-needed income support, but also prevent skill erosion by keeping workers employed and providing training.

As the government fulfils its side of the bargain, there will be fewer wage demands not supported by productivity gains. This will not only remove the need for contractionary monetary policy to contain inflationary pressure, but also lower borrowing costs for investors. As restrained wage demands and borrowing costs help repair the balance sheets of businesses, investors must be induced with appropriate measures to invest in the real economy, instead of financial speculation.

Global Green New Deal

Almost eight decades ago, President Franklin Roosevelt introduced the New Deal for a strong and sustained economic recovery. Not only did it lift the United States out of the Great Depression, but it also addressed unsustainable agricultural practices that had caused widespread environmental, economic and social distress, and helped usher in a new era of economic growth and prosperity, especially in some poorer regions.

The current crisis also needs a New Deal type response, but after decades of globalisation and environmental deterioration, it must also involve international cooperation and coordination as well as a collective global commitment to sustainable development. The current crises are global in nature, and appropriate and adequate responses are needed in all countries.

Such a Global Green New Deal (GGND) would have elements including public works programmes in line with the Global Jobs Pact[4] and support for social protection contributing to the Global Social Protection Floor.[5] The GGND should, therefore, be central to the broader international counter-cyclical response to the crisis complemented by national stimulus packages in all countries aimed at reviving and greening national economies.

Back to Public Debt?

The GGND will inevitably increase public debt in the near term; but this should not pose a longer-term problem as it will engender sustained economic growth and employment recovery - as the New Deal did eight decades ago.

Many countries had huge public debts when WWII ended. Despite similar calls then for drastic expenditure cuts, governments spent a great deal more on economic reconstruction and social protection measures. If they had caved in to the fiscal hawks of their time, post-war European recovery would have been delayed and the Cold War could have been lost.

As governments continued with massive expenditure to rebuild their countries, economies grew all over the world, and debt burdens diminished quickly with rapid economic growth and fast growing tax revenues. These experiences show that deficits and surpluses should be adjusted counter-cyclically over the course of business cycles[6] rather than, say, annually.

There is, of course, one big difference between then and now. The financial sector is much more powerful now, with governments often held hostage by financial markets and the whims of rating agencies. The record of rating agencies before the 2008 global economic crisis is now widely recognized as abysmal, with even the US Congress seriously debating whether they should be prosecuted.

To make matters worse, there is still no agreed procedure for sovereign debt work-outs.[7] The protracted difficulties in resolving the Greek crisis underscore the urgent need for a fair and orderly sovereign debt work-out mechanism for all countries.

Concluding Remarks

Harsh fiscal measures, without offsetting efforts to foster growth and job creation, typically fail to induce growth, create jobs, raise incomes and restore investor confidence. Instead, they exacerbate unemployment and social unrest, and are politically unsustainable.

A better way out is by deepening tripartite social dialogue among investors/employers, employees and governments. Only genuine social dialogues can reconcile competing demands on meagre resources as all parties can clearly see and address the costs and benefits as well as trade-offs among various difficult policy options.

1 Batini, N., Callegari, G. and G. (2012). 'Successful Austerity in the United States, Europe and Japan'. IMF Working Paper WP/12/190, International Monetary Fund, Washington, DC. (www.imf.org/external/pubs/ft/wp/2012/wp12190.pdf)

2 Ball, L., Leigh, D., and P. Loungani (2011). 'Painful medicine'. *Finance & Development*, September, p. 20. (www.imf.org/external/pubs/ft/fandd/2011/09/ball.htm)

3 ILO (2012). *Global Employment Outlook*, September; (www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_188810.pdf)

4 www.ilo.org/jobspact/lang--en/index.htm

5 (www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_183286/lang--en/index.htm)

6 The five cyclical stages of fluctuating levels of economic activity that an economy typically experiences are: growth (expansion), peak, recession (contraction), trough and recovery.

7 The process of working out a satisfactory method to enable a debtor country to recover or grow in order to repay external debt, typically involving restructuring, adjustment and provision of new finance. See IMF (2003). *External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary*. IMF, Washington, DC. (www.imf.org/external/pubs/ft/eds/Eng/Guide/index.htm)

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