4. Policy options for growth with jobs

A recap of jobs lost to the crisis

The world faces a serious jobs challenge and widespread decent work deficits. As the world enters 2012, 1.1 billion people – one out of every three people in the labour force – are either unemployed or living in poverty. After three years of continuous crisis conditions in global labour markets and against the prospect of a further deterioration of economic activity, global unemployment has increased by 27 million, and more than 400 million new jobs will be needed over the next decade merely to avoid a further increase in unemployment. Half of the jobs lost were in the advanced economies, 5 million in East Asia, 3 million in Latin America and the Caribbean and 1 million in South Asia. At the same time, the global unemployment rate rose from 5.5 per cent in 2007 to 6.2 per cent in 2009, with advanced economies the hardest hit as their unemployment rate rose from 5.8 per cent to 8.3 per cent over this period. In Central and South-Eastern Europe (non-EU) and CIS the unemployment rate rose from 8.4 per cent to 10.2 per cent, whereas in East Asia it rose from 3.8 per cent to 4.3 per cent, and in Latin America and the Caribbean from 7.0 per cent to 7.7 per cent. Also, discouragement has risen sharply, with 29 million fewer people in the labour force than expected. As a consequence, the employment-to-population ratio went down globally from 61.2 per cent to 60.3 per cent, and more dramatically for the advanced economies, where it dropped from 57.1 per cent to 55.5 per cent, implying that current global unemployment figures actually understate the extent of labour market distress.

Entering the fourth year of global economic turmoil, there is now evidence of a three-stage crisis. The initial shock of the crisis was met by coordinated fiscal and monetary stimulus, which led to recovery in growth but proved insufficient to bring about a sustainable jobs recovery, most notably in advanced economies. In fact, between 2009 and 2010 a further 2 million jobs were lost in advanced economies and, globally, job creation barely kept pace with labour force growth. In developing economies, the number of working poor – a better indicator for the state of the labour market in these countries than registered unemployment – had stopped its downward trend, with 50 million more working poor in 2011. Also, vulnerable employment, comprising unpaid family labour and own-account workers, whose increase in absolute numbers to 1.52 billion had arrested at 2007, began increasing again after the crisis, with 23 million added since 2009. Evidence cited in this report shows that the failure of growth to create more employment is related to the targeting of the stimulus towards a rescue of the financial sector, especially in the advanced economies. This may have been much needed, but prevented targeting the real economy and jobs.

In the second stage, burdened public deficits and debt, combined with weak growth, led to calls for increased austerity measures to pacify capital markets and counter rising bond yields. As a consequence, fiscal stimuli started to wane, and support of economic activity in advanced economies concentrated on quantitative easing monetary policies. The combined impact appears to have been a weakening of both GDP growth and employment. GDP growth dropped globally, from 5 per cent in 2010 to 4 per cent over 2011, led by advanced economies, whose forecast for 2011 was revised downwards by the IMF in September 2011 to 1.4 per cent. In the meantime, this has also started affecting emerging economies, where growth remained strong throughout 2011, although the first signs of weakness were seen in the last quarter

of 2011 with lower industrial orders. The deceleration of growth also meant that the unemployment rate remained elevated throughout 2011, further increasing the number of jobs required to return to pre-crisis unemployment rates.

The tightening of policies and the persistently high levels of unemployment have increased the potential for a dangerous third stage, characterized by a second dip in growth and employment in the advanced economies, exacerbating the severe labour market distress that has emerged since the onset of the crisis. In such a double-dip scenario, the global unemployment rate would raise again to 6.2 per cent in 2013, where it had been in 2009, after a moderate drop to 6 per cent in 2011.

A worsening youth employment crisis

Young people have suffered particularly heavily from the deterioration in labour market conditions. The rate of youth unemployment rose globally from 11.7 per cent in 2007 to 12.7 per cent in 2011, the advanced economies being particularly hard hit, where this rate jumped from 12.5 per cent to 17.9 per cent over this period. In addition to the 74.7 million unemployed youth around the world in 2011 – a growing number of whom are in long-term unemployment – an estimated 6.4 million young people have given up hope of finding a job and have dropped out of the labour market altogether. Young people who are employed are increasingly likely to find themselves in part-time employment and often on temporary contracts. In developing countries, youth are disproportionately among the working poor.[15]

The global prospects for jobs

Against this gloomy outlook, the G20 Cannes summit in September 2011 noted the mounting downside risks of a slowdown in recovery of GDP, which would leave unemployment at unacceptably high levels. In the summit declaration, G20 countries committed to combating unemployment and promoting decent jobs, especially for youth and others most affected by the crisis. To this end it set up a G20 Task Force on Employment, calling on the IMF, OECD, ILO and World Bank to report to the Finance Ministers on a global employment outlook, and how an economic reform agenda under the G20 framework would contribute to job creation.

Macro policy options to promote growth with jobs

The crucial policy question of the moment then is: Does revival of growth and jobs require a revival of stimulus measures? When considering this question, it needs to be borne in mind that at current levels of stress on international sovereign bond markets, nearly any country that undertakes uncoordinated stimulus is likely to face immediately high costs of borrowing, independently of the concrete policy action. At the same time, it appears that targeting job growth with stimulus measures has a particularly strong impact on the long-term chances for recovery. Indeed, the evidence presented in this report shows that the recovery in emerging and developing economies has been strong not only thanks to their lower initial impact from the crisis, but also due to the fact that a greater proportion of fiscal stimulus in developing countries was spent on supporting the real economy, while advanced economies, in contrast, largely supported the financial sector. This underlines the efficacy of appropriately targeted stimulus measures in reviving both growth and jobs, and the policy option of a stimulus remains valid and important, albeit bounded by budgetary macro prudence in the medium term.

[15] The youth employment crisis will be the subject of the ILO's International Labour Conference in June 2012.

At the same time, policy space has reduced substantially since the beginning of the crisis, particularly in advanced economies. With most of the available public money used up to safeguard the financial sector – with, as argued in Chapter 1, only limited success – public finances have been seriously depleted, leaving little room to initiate a second round of stimulus measures. More importantly, this transfer of debt from private to public hands has led to another build-up of crisis conditions as governments face serious challenges in paying back their debt without further harming the economy. The irony of the earlier public intervention is therefore that it perpetuated an environment of high uncertainty without paving the way for a more sustainable recovery, leaving the world now facing a jobs double dip with limited capacity to react.

1. Global policy coordination is key

In this environment of reduced policy space and daunting economic challenges, a recollection of the experiences at the beginning of the crisis might be useful. Indeed, the initial policy response to the crisis was unprecedentedly coordinated, with the G20 group of advanced and emerging economies substantially gaining importance. Monetary policy reacted first, with a slashing of interest rates and the opening of special liquidity facilities for banks to avoid a financial sector meltdown. As regards public finances, the overwhelming policy response took the form of fiscal stimulus undertaken by the G20 countries and, through a strong demonstration effect, other affected economies, advanced, emerging and developing. A final policy response came in the form of automatic stabilizers to cushion the unemployed in advanced economies, and extending and devising protection for jobs and incomes in advanced, emerging and some developing economies. Both fiscal forms of policy response led to deficit-financed public stimulus that helped stabilize the global economy and engineered a quick recovery in economic activity, if not in job growth.

As argued in Chapter 1, this simultaneous use of deficit-financed public spending and monetary easing is no longer a feasible option for all countries concerned. Indeed, following the first stages of the crisis, recent developments have been marked by increasing risk of default on sovereign debt. This risk has raised bond yields – the borrowing costs – for countries perceived by capital markets as having a higher risk of default on their debt. The initial list of such vulnerable countries – Greece, Ireland, Portugal and Spain – now includes Italy, with yields rising perceptibly in France as well. In contrast, several large economies still have room for manoeuvre, including Germany, which weathered the crisis well, the United States, despite its recent sovereign debt downgrade, and China, which benefits from a low public debt-to-GDP ratio.

What is therefore needed now is a consensus among the countries that still have room for manoeuvre to resist any further uncoordinated austerity measures and rather to allow for additional public spending to support both the domestic and the global economies. Global spillover effects from these large economies can be substantial and need to be taken into account by domestic policy-makers to avoid further deterioration in global economic conditions (IMF, 2011b). Such analysis also shows that monetary policy is most likely to play a lesser role in supporting global economic activity at the current juncture, not only because of its already very accommodative stance in many advanced economies, but also because liquidity creation has triggered some unbalanced developments in emerging economies. Instead, it will be up to coordinated public finance measures to support the global economy going forward.

2. Repair and regulation of the financial system

Financial sector difficulties have reappeared in the private sector, after public bailouts provided only temporary relief. Banks – having used public support to buy up public sector debt – find themselves again under stress as sovereign debt has reached unsustainable levels

in many countries. The crisis has gone full circle, leaving banks increasingly unwilling and in no position to lend to the private sector. As a consequence, large firms are building up cash reserves to protect themselves against heightened uncertainty, whereas small and medium-sized enterprises (SMEs) face mounting difficulties in financing their businesses as credit lines dwindle and credit standards tighten. Some have claimed that the difficulties experienced by non-financial firms in accessing credit are related to recent changes in financial market regulation, but most of these changes – such as the higher capital adequacy ratios laid down by Basel III – are only gradually being implemented or are still awaiting an operational framework before being effective. Rather, the bailout process itself and the substantial amount of risk that sovereigns took over from the private sector have led to a serious deterioration of the outlook.

In this respect, this report has argued that more substantial repair and regulation of the financial system would restore credibility and confidence, allowing banks to overcome the credit risk that has dogged this crisis. All firms would gain from this, but especially SMEs, which not only need the credit more, but also end up creating more than 70 per cent of jobs. An encompassing reform of financial markets, including both larger safety margins in the domestic banking sector and stricter rules regarding international financial flows, would substantially help the labour market and could add up to half a percentage point in employment growth, depending on country circumstances.

3. Stimulus measures need to target employment, while increased private investment will be essential for new job creation

This report has also shown that targeting the real economy to support job growth is what is now needed most. Faltering employment creation and ensuing weak growth in labour incomes has been at the heart of the slowdown of global economic activity and the further worsening of public finances. The ILO's concern is in particular that despite large stimulus packages, these measures have not worked to roll back the increase of 27 million unemployed from the initial impact of the crisis. Clearly, the policy measures have not been well targeted and need some reassessment in terms of their effectiveness.

The analysis presented in this report has demonstrated that targeting spending measures on the labour market can actually be very effective. Indeed, estimates for advanced economies regarding different labour market instruments show that both active and passive labour market policies have proven very effective in stimulating job creation and supporting incomes. Country evidence across a range of labour market policies – including the extension of unemployment benefits and work sharing programmes, the re-evaluation of minimum wages and wage subsidies as well as enhancing public employment services, public works programmes and entrepreneurship incentives – show impacts on employment and incomes (ILO, 2009). Hence, countries should target such spending items, reducing – if needed – spending on other, less employment-rich instruments.

At the same time, additional public-support measures alone will not be sufficient to foster a sustainable jobs recovery. Policy-makers must act decisively and in a coordinated fashion to reduce the fear and uncertainty that is hindering private investment so that the private sector can restart the main engine of global job creation. Incentives to businesses to invest in plants and equipment and to expand their payrolls will be essential to jump-start a strong and sustainable recovery in employment.

In this respect, this report has reiterated that investment is essential for growth and for a sustainable recovery in jobs. As Chapter 1 has argued, to generate employment for the 27 million additional jobseekers created by the crisis, the investment share needs to increase by a further 1.8 percentage points over the next five years to fill that gap. Partly, this will require a more pronounced uptick in productivity – in particular in the tradable sector – such as by

strengthening incentives for businesses to invest. So far, however, the faltering recovery and the gloomy outlook have coincided with weak productivity trends. In addition, heightened uncertainties regarding the macroeconomic outlook, evidenced by high volatility in financial markets, have made investors reluctant to commit themselves to investment projects. As discussed in Chapter 3, in advanced economies a massive amount of money is being held in short-term facilities by large companies, limiting the near-term investment outlook, which, in turn, limits job creation.

4. Higher government spending does not need to increase public debt

In examining the policy options between austerity and stimulus, the efficacy of stimulus in generating growth and jobs has not been well tested in the advanced economies, where the lion's share of the sectoral stimulus budgets went to bail out the financial sector. While this may have been absolutely critical in preventing a financial meltdown, it left little budget for the real economy, where output and employment are generated. Conversely, the efficacy of the stimulus in generating growth and jobs is demonstrated for the emerging and developing economies, where the bulk of the stimulus went to the real sectors of the economy, and where growth and employment rebounded much more than in the advanced economies. Hence there is evidence for the efficacy of stimulus in generating growth and jobs.

Three caveats apply to the stimulus policy logic. First, stimulus-based recovery of growth and jobs in the emerging and developing economies might not be able to substitute for lack of demand in the advanced economies. On the demand side, the marginal propensity to consume out of lower incomes in the emerging and developing economies is not sufficient to substitute for the quantum of global demand generated by advanced economies. In addition, as global investment flows remain largely from advanced to developing regions, it is unlikely that developing economies could make up for the shortfall in investment in advanced economies within the near term. Hence, even though emerging economies have started to play a larger role in driving the global economy, as discussed in Chapter 1, this is still not sufficient to raise global growth and employment, given the large deceleration taking place in the advanced economies.

Second, austerity parameters will inevitably restrict the effect of any stimulus measures. If borrowing costs in the form of bond yields escalate, then the impact of stimulus on the demand side will not be met by adequate investment response on the supply side, leading to inflation rather than growth in output and employment. Setting up a sound, medium-term fiscal adjustment plan could go a long way in securing lower borrowing costs and reassuring markets. Part of the current uncertainty in sovereign bond markets also has to do with the fact that further strain on public finances lies ahead in many advanced economies, principally due to demographic ageing. A swift implementation of reforms that help restrict further spending pressures – without actually lowering spending today – will allow countries to continue to benefit from more benign financing conditions.

Third, public spending fully matched by revenue increases can still provide a stimulus to the real economy, thanks to the balanced-budget multiplier. In times of faltering demand, expanding the role of governments in aggregate demand helps stabilize the economy and sets forth a new stimulus, even if the spending increase is fully matched by simultaneous rises in tax revenues. Among others, Joseph Stiglitz has argued that such balanced-budget multipliers can be large, especially in the current environment of massively underutilized capacities and high unemployment rates (Stiglitz, 2011). At the same time, balancing spending with higher revenues ensures that budgetary risk is kept low to satisfy capital markets. Interest rates will therefore remain unaffected by such a policy choice, allowing the stimulus to develop its full effect on the economy.