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A shift in spending to save jobs

High unemployment figures point to a crucial question: when is the right moment to start reducing public stimulus programmes?

Henning Meyer
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Unemployment figures released yesterday show the highest rate of unemployment since the mid-1990s. This is a worrying situation but the UK is not the worst affected country in Europe. In Spain, for instance, unemployment is approaching 20%.

These figures point to a crucial question for public policy in the UK and other European countries: when is the right moment to start reducing public stimulus programmes? When the recession is technically over or when unemployment has peaked?

The problem is clear. It takes some time before a recession hits the labour market, and this time lag – together with worries about future economic security – is responsible for the situation we are currently in: the recession in some countries, and probably also in the UK, is technically over but unemployment figures will keep rising for the foreseeable future.

This trend together with the danger of premature removal of stimulus measures poses the real danger of choking off the fragile economic recovery through the loss of domestic demand. The OECD too is warning that economic activity will be weak well into the next year and that governments need to continue with stimulus packages to sustain the economic turnaround. Withdraw public spending too early and a double-dip recession could be the result.

So what should policymakers do in these circumstances? In my view, they should focus on two things: first, they should not withdraw public spending as yet but readjust it to focus on job retention. And second there needs to be more pan-European co-ordination to avoid national measures creating problems elsewhere.

Much of the spending under the existing stimulus packages has focused on creating work and general economic demand. But there are also other measures that can help the

private sector survive the downturn without losing too many staff – and with them crucial knowledge and expertise it will need again in the future.

One particular measure that deserves close attention is the reduced-hours compensation scheme (Kurzarbeitergeld), which has been very successful in Germany. Under this scheme companies can radically reduce the working hours of staff. The affected employees are, however, not laid off but compensated with up to 60% of their net salary (67% if childcare is involved) for up to 24 months by the federal government. Companies can implement the cuts they need to survive the recession and employees remain in employment. This scheme adds the aim of job retention in the private sector to the other aims of public spending. I see no reason why such a programme would not work in the UK as well.

Closer European co-operation of policies and government interventions is also necessary. The case of the GM Europe takeover, for instance, has caused anger in the UK.

Business secretary Lord Mandelson fears British jobs are more vulnerable than German ones. This is probably true because the German government has provided €4.5bn (£4bn) worth of guarantees to avoid job losses in Germany.

But the mechanism of negative impact also works the other way around. British banks are apparently withdrawing liquidity from abroad to provide the scarce credit they can make available in Britain. This is perfectly understandable given the role of the British government in preventing the collapse of many banks and the resulting expectation to help the national recovery in return. But because of Britain's dominant position in financial services, this aggravates the liquidity problems abroad, for instance in Germany. So both government interventions are perfectly sensible from a national point of view but create problems elsewhere. The only solution to this is to better co-ordinate interventions and policy responses on the European level.

The economic future is looking much brighter than even a few weeks ago. Public policy above all must not put this progress at risk.

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