



The social impact of the “Global Financial Crisis” and the prospects for recovery

The Hon Kevin Andrews MP*

A presentation to the European Ideas Network Summer University, Vienna, Austria, 15 October 2009

May I begin by thanking the EPP Group of the European Parliament and the European Ideas Network for the invitation to participate in this important conference? I regret that I cannot be physically with you, but rejoice that modern technology can bridge the tyranny of distance.

I hope that my remarks, from a different country, with different economic parameters, will provide a counterpoint to your important discussions.

In making my observations, I do so as an outsider, not imbued in the day to day policy-making of the continent. Nonetheless, I hope these perspectives help to shine a light on the challenges facing Europe, many of which we share elsewhere.

Secondly, my observations accept that the Global Financial Crisis has occurred and are not about attributing blame.

I also note that while most nations have introduced stimulus measures, the type of expenditure has varied considerably. I am not proposing to debate which was more effective – although I have my own views – but to accept the position that nation's find themselves in today.

The “global” financial crisis

Before turning to the response to the current economic situation, it is worth noting a number of matters.

First, although the expression “global financial crisis” is commonly used to describe the situation, the crisis is primarily one involving western nations. Many nations will experience GDP growth, especially those connected to China.

Secondly, the crisis is largely one of capital availability.

Thirdly, the failure was of prudence and governance, not of capitalism itself.

Unless the real causes are understood, we are unlikely to respond appropriately.

Finally, the crisis should not disguise pre-existing challenges facing many countries, especially in Europe, some of which I now turn.

Challenges and responses

As an observer, Europe faces three significant challenges. One is immediate, the others of medium and longer term duration. Each is related. Let me explain.

*Member of the Australian Parliament since 1991; Australian Minister for Ageing 2001-2003; Employment and Workplace Relations 2003-2007; and Immigration 2007. Deputy Chairman, House of Representatives Economics Committee.

The first challenge is the immediate social consequence of the Crisis, namely rising unemployment, especially amongst the young and the unskilled. It is estimated that 15.2 million people were unemployed in Europe in August¹, a figure that is certain to soar in the coming year. This follows a period of more than a decade during which Europe's unemployment levels have remained well above the OECD average. [See appendix].

This, in turn, will increase pressure on State expenditure, which is already dangerously high in many nations. Moreover, government expenditure in Europe was already higher than many comparable nations, including the OECD average.

There is an economic and moral case to ensure that as many young people can enter or return to the workforce as soon as possible.

While the rate of return will be governed in part by external factors, such as a recovery in trade, it is also dependent upon domestic policy decisions. Most important of these will be the readiness of young people for work, the incentives for them to do so (and disincentives to remain on welfare), and the ability of businesses to employ them.

This suggests a number of initiatives. First, nations need to reinvigorate their skills training for young people. Importantly, skills cannot be taught in isolation, but need to integrate education and on-the-job experience.

The German apprentice model, which has been successfully modified elsewhere, including in Australia, is one approach that has proven successful. It could be revived.

Secondly, there is a need to ensure that education is relevant to the current and future workforce requirements. IT skills, for example, are pre-requisites for many jobs. They need to be integrated into school curricula where this isn't done adequately.

Thirdly, businesses need incentives to take on young people as trainees. This is an investment in the future. In Australia, schemes include subsidies for apprentices and assistance in the provision of their tools. Incentives could also be extended to family enterprises in Europe.

Fourthly, disincentives to work and incentives to remain on welfare should be removed. If the welfare system implicitly taxes low-skilled workers, for example, it will discourage them from finding jobs. A work-first approach to welfare is required.

The second, ongoing challenge involves the rapid ageing of the population in Europe. As the continent recovers from the Crisis, it will face the need to counter relatively rapid depopulation. Unless nations are willing to accept very high levels of immigration, it will be necessary to ensure that the maximum number of residents is adequately trained and able to participate in the paid workforce.

The worst of all scenarios would be for Europe to find itself with a larger, older population, dependent upon a smaller, inadequately trained workforce and/or significant numbers of people of working age on welfare.

It will be necessary for European policy makers to look beyond popular notions of "the European model" or "the American model" to policies that deliver employment outcomes if social dissatisfaction, and the possible consequent radicalism, is to be avoided in coming decades.

This leads me to suggest that longer term structural issues ultimately must be addressed. In particular, Europe has tended to trail behind other regions in reaching GDP peaks, but then tends to fall to lower levels for a longer period of time. In other words, the cycle of GDP growth has tended to be shallower than in other economic regions (although there are significant variations from country to country in Europe). [See appendix]

The third challenge relates to government expenditure. Europe as a whole tends to spend more on government activity than other comparable nations and regions. [See appendix] This will present significant challenges to nations already facing increased unemployment and an ageing of their populations. However, it will be necessary to tackle this problem over the medium term. If not done, European nations will be in more weakened position when any future financial downturn occurs.

The long-term challenge for Europe

A leading economist at a major Australian think tank recently asked "Does Europe still matter?"²

While the question initially may seem impertinent to you, he was asking it in the context that Europe is still the destination for 10 per cent of Australia's merchandise exports, and that Europe accounts for 15.8 per cent of total Australian trade, which is still higher than China's 15.1 per cent. His concern, and that of other Australian commentators, is that Europe's weakness will have a detrimental impact on Australia, and may well offset any benefits of the Chinese recovery.³

A number of observations can be made. First, the nations that enter financial downturns in a healthy economic state are more likely to survive and emerge more quickly and in a better condition.

Secondly, the task of structural economic reform remains urgent. The lazy response is to blame all the ills of an economy on the recent crisis, whilst ignoring the pre-existing conditions. Reducing the amount of national wealth consumed by the state will be a major challenge for most nations. If this challenge is not tackled, the recovery will be delayed, and in some cases, will stall. Growth will be hampered, unemployment will remain stubbornly high with all the social consequences that ensue.

While part of the response is to impose appropriate regulation where it has been lacking, this should be matched by recognition that regulatory burdens in Europe are heavy. Similarly high marginal tax rates will be a disincentive to the rebuilding necessary in coming years.

In the meantime, however, a concentration on education and training for young people will be a necessary response to the immediate challenges facing most nations.

APPENDIX

The European situation

On a number of critical measures, the pattern in Europe can be compared with other nations.

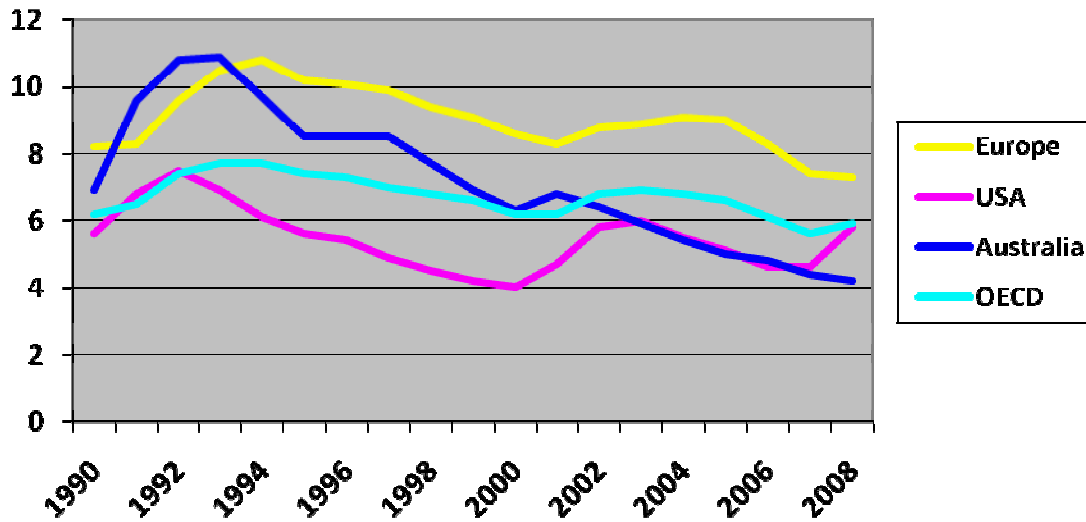
Unemployment

Taken as a whole, the current situation is concerning. In 2008, the European unemployment rate of 7.3 per cent was higher than the OECD average of 5.9 per cent, and higher than nations such as Australia (4.2 per cent), the UK (5.3 per cent) and the United States (5.8 per cent). Of course there were considerable variations from country to country, but the figures have since risen, leaving more than 15 million people jobless. In all likelihood, these numbers will grow in the immediate future.

This is the immediate social impact of the crisis. The impact is felt most among the young. Across Europe unemployment amongst 15 – 24 year olds was 15.6 per cent in 2008, rising to 18.8 per cent amongst 15 – 19 year olds.

While these trends can be seen elsewhere, the question facing policy makers today is about how to lower these numbers.

Current policies in many European countries protect individuals against market down turns and financial crises. Many are employed in the non-market sector, and most are covered by social protection legislation and generous unemployment benefits.⁴ While unemployment levels in some countries have reached as high levels as in Europe, they seem to recover more slowly in Europe, and return to levels of unemployment that remain higher than many other nations, as the following chart illustrates.

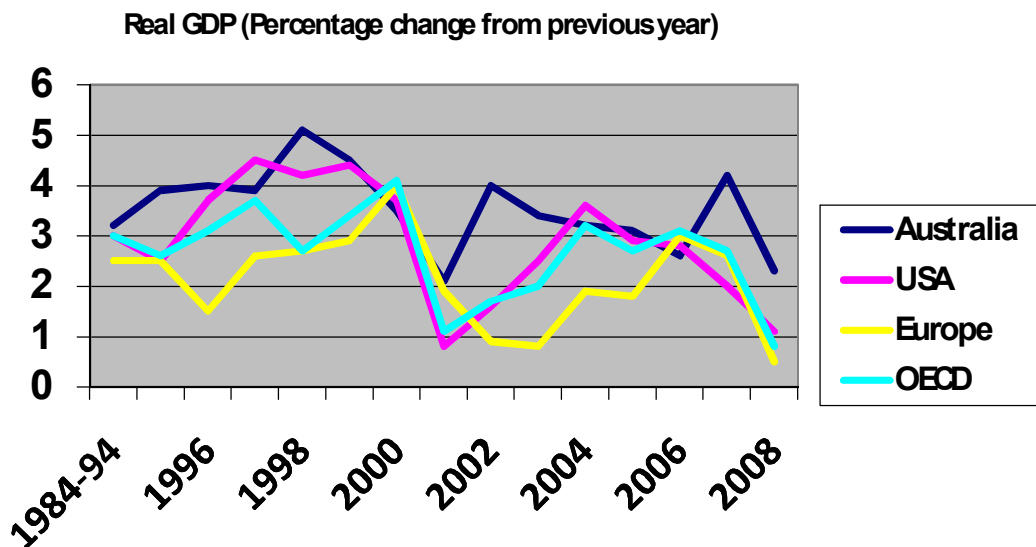


Source: OECD.stat (data extracted on September 9, 2009)

This points to structural weaknesses in the economies of some European nations⁵ which leave many more people unemployed than elsewhere. While the Global Financial Crisis has resulted in higher levels of unemployment in most nations, which will require greater public expenditure on income protection and associated payments, it would be foolish to blame it for the pre-existing structural deficiencies that are obvious.

Gross Domestic Product

Secondly, the pattern is repeated in an analysis of Gross Domestic Product, as the following chart illustrates.



Source: OECD Economic Outlook 85 Database

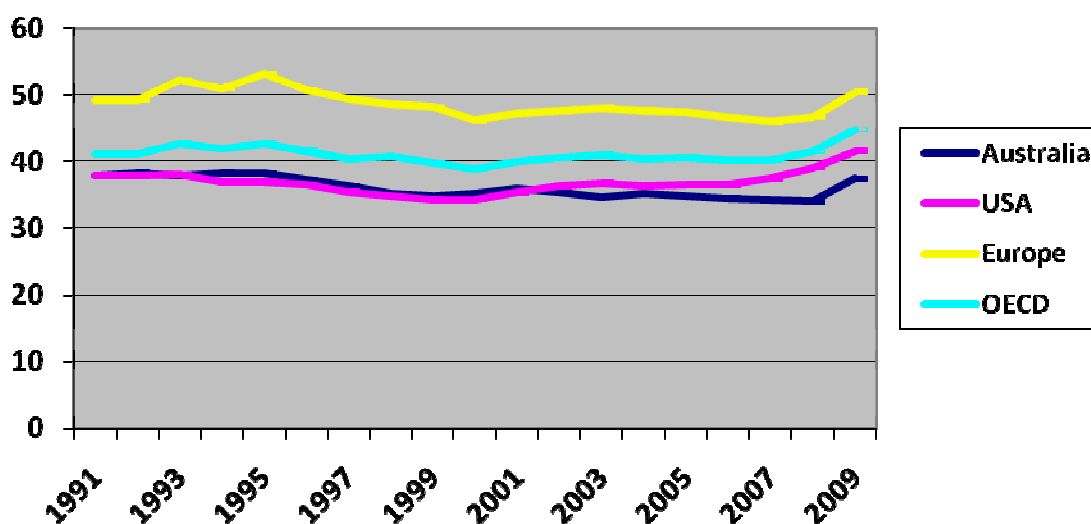
Once again, Europe has trailed behind other regions in reaching GDP peaks, for example in 2001, but then tends to fall to lower levels for a longer period of time. In other words, the cycle of GDP growth has tended to be shallower than other economic regions. Again there are significant variations from country to country in Europe.

Germany, Europe's largest economy, has had very low growth for a decade, long before the financial crisis. The country's export model 'has been blamed by some for the situation, but high taxes and duties and a complex taxation system limit domestic demand.

France's growth has been higher than Germany - at about the European average.

Government expenditure

Thirdly, Europe as a whole tends to spend more on government activity than other comparable nations and regions, as the following chart illustrates.



Source: OECD Economic Outlook 85 Database. Data refer to the general government sector, which is a consolidation of accounts for the central, state and local governments plus social security. Total outlays are defined as current outlays plus capital.

Again there are variations between the European nations.

Given the additional expenditure resulting from policy responses to the financial situation, government expenditure will increase in coming years. Britain's public finances, for example, have deteriorated, while the situation of Eastern Europe is grave. This will present significant challenges to nations already facing an ageing of their populations.

¹ Source: bbc.co.uk October 1, 2009

² Oliver Marc Hartwich (2009) "Does Europe still matter?" *Policy Winter* 2009

³ See also Alan Kohler "European vacation" *Business Spectator*, 18 May 2009

⁴ See, for example, "Vive la difference!" *The Economist* May 9, 2009, 24-26

⁵ For example, Belgium, Czech Republic, Finland, France, Germany, Greece, Italy, Poland, Slovak Republic, and Spain.

⁶ "The export model sputters" (2009) *The Economist*, May 9, 47 - 48