



KATHOLIEKE
UNIVERSITEIT
LEUVEN

Reinforcing our ambitions: how to overcome the present financial and economic crisis.

Prof. dr. Jozef Pacolet
Higher Institute for Labour Studies
Catholic University of Leuven
12 october 2009

Paper written with the support of the European Centre for Workers' Questions (EZA).
This measure is funded by the European Community



Hoger instituut
voor de arbeid

Content

Content	2
1. Motivation	4
2. Content of the position paper	6
3. From financial to fiscal crisis: some facts and figures	6
3.1 The financial crisis: from financial market and housing bubbles to a financial institution crisis	6
3.2 The economic crisis: declining economic growth figures	9
3.3 The employment crisis: double digit unemployment for the moment and truncated employment targets for the future	11
3.4 The fiscal crisis : fiscal deficits and public debt: from double digit to triple digit	13
4. Financial regulation: orthodoxy and prudence rediscovered:	15
4.1 Did it work?	15
4.2 Will it work?	16
4.3 Recommendations for further action	17
5. Industrial policy reinvented	19
6. Employment policies: new and old challenges	22
7. The automatic stabilisers and social protection: Keynesian expansionary policies rediscovered	26
7.1 Did it work?	26
7.2 Will it work? Yes it will have impact	27
7.3 How did it work?	27
7.4 Should it be directed to special policy strands or target groups?: the case of the ageing of the population	30
7.5 How to restore budgetary equilibrium: tax coordination	32
7.6 How robust is social security?	33
8. The pay-as-you go and funded pensions: the crisis hits both	35

8.1	The relative importance of first second and third pillar	36
8.2	The income of the pensioners after the crisis with funded pensions	39
8.3	The consequences for the pensions funds	39
8.4	The consequences for the state	40
8.5	Policy conclusions implications for the future	41
9.	Conclusion	42
10.	Bibliography	43

1. Motivation

For decades, concern about the creation of a social Europe built on a social market economy has inspired the European social movements to critically assess economic development and policy with a view to realising full employment and adequate social protection. Stimulating growth and employment, accommodating industrial change and preparing for new industrial development, promoting social inclusion and maintaining and completing sustainable and adequate social protection have all been points of concern for the EZA in numerous grass roots projects or more coordinated initiatives at the European level. This common wisdom was conceived in a context of relatively prosperous economic and social development, in recent years sometimes accompanied with the illusion that full employment had been realised again, and sometimes also with the illusion that the financial markets could overcome the upcoming challenge of the ageing population. The financial crisis and its fallout, with the deepening economic, employment and fiscal crisis, changed this world overnight and took away all our illusions.

The workers are not responsible for the direct and indirect causes of the present financial and economic crisis. However, they do risk being hardest hit by its consequences. For this reason, the workers' movement and civil society nevertheless want to take on responsibility for containing the consequences and finding ways out of this crisis

In this position paper we want, first of all, to take stock of the consequences and implications for the workers and benefit earners and secondly consider both old and new, temporary and structural measures to recover from this crisis. Within those measures, the aim of this position paper is to reveal how the workers' movement can and should change its strategies. The remedies proposed by the social movements in the past could perhaps turn out to be timeless answers to these new challenges as well. The current economic situation is perhaps in the end not that different from the structural situation in previous years. For instance, there will be a real decline of GDP this year, but it is a fall back on a level of economic development that had been cumulated for decades. Nevertheless, unemployment persisted all the time. However, the increased public debt caused by the financial and economic crisis throws us back perhaps more than ten years on the 'stability' path which we should have pursued in view of the upcoming challenge of a greying population. The urgent measures underway to cope with

challenges of sustainability and the greying of the population, need perhaps only be revitalised or accelerated. Perhaps the answer to the new situation involves more of the 'old' recipes. But how to assure that much needed structural changes (for instance increasing levels of labour market participation, reducing government debt), which were already difficult to accomplish in prosperous years, can be maintained or reinforced in years of recession? What are the consequences of this acute financial and economic crisis on the long-term choices already made?

This paper is intended as a dedicated but independent contribution of the author to this debate. It is nevertheless a partial view. The recommendations expressed in this paper are those of the author and should not be attributed to the cooperating organisations. It was completed after discussions with the EZA think tank and cooperating organisations, and was inspired by the Leuven conference of 7th September. It can be used to further the debate in the regional working conferences. Aside from this paper, EZA and its member organisations are preparing a policy paper of their own.

2. Content of the position paper

1. Taking stock of the direct and indirect consequences of the financial and economic crisis for workers and benefit earners.
2. Taking stock of the short term (contracyclical) measures underway and the way in which social movements could support those strategies or contribute to them. Is the social cohesion strong enough to overcome this 'economic and financial stress', and how can it be reinforced?
3. Taking stock of the impact of the ongoing restructuring of our economic and social system, its timing, its feasibility and the need for changes. How to put social and economic policy back on the path of budgetary orthodoxy while maintaining high levels of growth, employment and social protection?
4. the scope of the paper includes (1) the financial crisis and financial regulation, (2) fiscal policy, (3) social protection and especially pensions and health care, (4) unemployment and employment policies and (5) industrial mutation and its social consequences.

3. From financial to fiscal crisis: some facts and figures

3.1 The financial crisis: from financial market and housing bubbles to a financial institution crisis

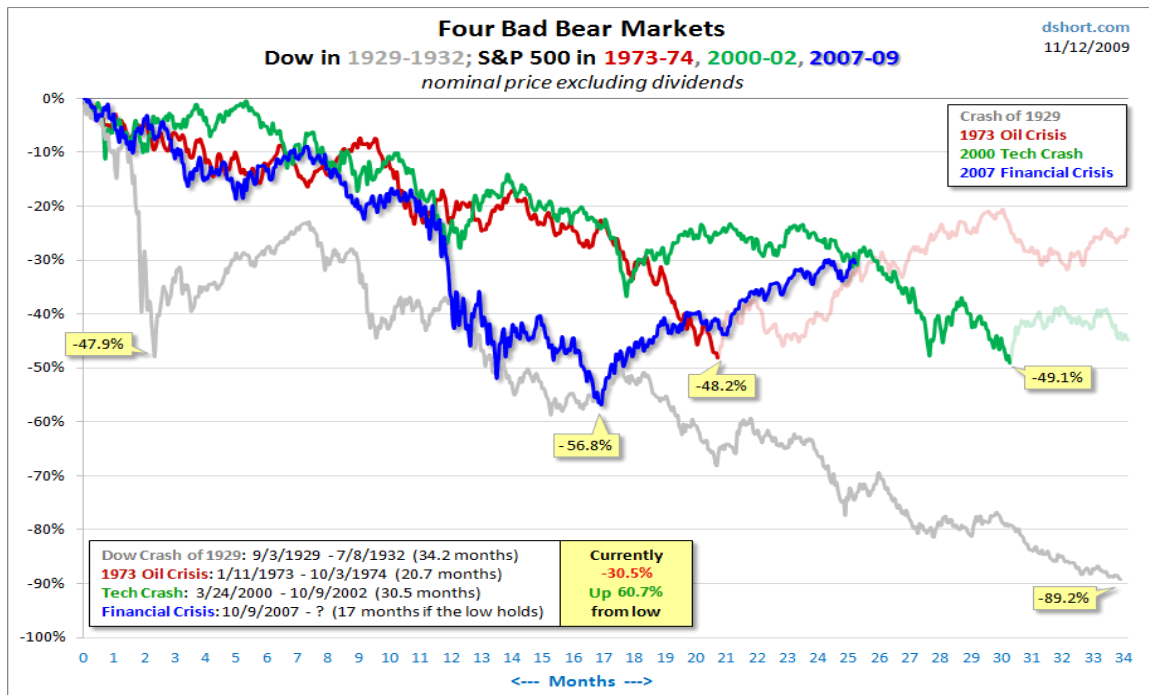
The comparison with the past helps us to put the present financial crisis in perspective. A nowadays popular picture compares the depth and the length of the present stock market crash or bear market with other major stock market crises. As can be seen from this graph the bear market already started in 2007 but collapsed in September 2008 and further downgraded until March 2009. From then on until now 12th of November 2009 it recovered with some 60%, evoking the comment on the Dshort website that . 'Bear turns to bull?'. Financial crises come and go. Fiscal crisis and employment crises stay?

The difference with these other stock market crises, which made the present crisis so similar to the thirties, is that a crisis of the financial institutions ensued. Starting from a housing price bubble, combined with deregulation and innovation in the

financial sector, irresponsible and seemingly uncontrolled risk taking of the financial institutions created a wave of bankruptcies of financial institutions and bank runs during the downturn of the housing bubble. Governments had to choose between bailing out or letting banks fail with contagious effects.

Bankruptcies of financial institutions occurred on a smaller scale on many other occasions and in many other countries in the recent economic history, with similar consequences and similar measures to solve those crises. What was new about the latest financial crisis was that it was in fact truly a *global* crisis.

The financial crisis illustrated the irrational exuberance of the (financial) market system, but government also failed since they went down the road of deregulation and had to admit afterwards that they did not have a clear view on the systemic risk and did not have it under control. Nevertheless, the government interventions in the aftermath of the crisis were a success, by containing the solvency problems and avoiding a liquidity crisis by a quick and even more or less coordinated (although that could have been better) monetary and prudential regulation. Banks were bailed out or taken over and even nationalised, interest rates were reduced and the liquidity of the banking system was effectively increased.



Source: : dshort.com

Figure .1 The stock market crisis

3.2 The economic crisis: declining economic growth figures

The financial crisis (causing wealth loss) and the credit crunch resulted in a worldwide economic recession. With still on average positive growth figures in 2008, the forecast for 2009 became ever more negative quarter after quarter. For Europe it seems to settle at a decline of 4%, with the Baltic countries hit the most. The latest forecast for 2010 lies around -0.1%. Despite the stabilising effect of a large public sector, and huge social protection schemes, the decline is deeper and the recovery slower than in the USA. Some, however, doubt that economic growth measured by GDP is a relevant measure (see among others ETUI). Some believe that zero growth is the best growth target. We do not want to enter the debate on the limits to growth, but one should certainly realise that behind those growth figures the level of GDP per capita between similar countries might differ enormously. And after decades of permanent growth, the present negative growth figures are a fall back, but GDP nevertheless remains at a high level. The somewhat larger time perspective in table 1 also illustrates that some of those growth miracles were of recent date, as could be observed in some new EU Member States and also in Ireland and Spain, and partly in the UK which during the last decade embarked on a growth path fuelled by household indebtedness and a housing boom, similar to what preceded the crisis in the USA (J. Sapir, 2009). However, this economic growth did not bring us full employment.

Table 1: The economic crisis: Gross domestic product, volume (percentage change on preceding year, 1992-2011)

	5-year averages			2007	2008	2009	2010	2011
	1992-96	1997-01	2002-06					
Belgium	1.5	2.7	2.0	2.9	1.0	-2.9	0.6	1.5
Germany	1.4	2.1	1.0	2.5	1.3	-5.0	1.2	1.7
Ireland	5.9	9.1	5.4	6.0	-3.0	-7.5	-1.4	2.6
Greece	1.1	3.8	4.1	4.5	2.0	-1.1	-0.3	0.7
Spain	1.5	4.4	3.3	3.6	0.9	-3.7	-0.8	1.0
France	1.2	3.0	1.7	2.3	0.4	-2.2	1.2	1.5
Italy	1.2	2.0	0.9	1.6	-1.0	-4.7	0.7	1.4
Cyprus	5.5	4.2	3.3	4.4	3.7	-0.7	0.1	1.3
Luxembourg	2.6	6.3	4.2	6.5	0.0	-3.6	1.1	1.8
Malta	5.0	3.4	2.1	3.7	2.1	-2.2	0.7	1.6
Netherlands	2.5	3.7	1.6	3.6	2.0	-4.5	0.3	1.6
Austria	1.8	2.6	2.2	3.5	2.0	-3.7	1.1	1.5
Portugal	2.0	3.8	0.7	1.9	0.0	-2.9	0.3	1.0
Slovenia	2.0	4.2	4.3	6.8	3.5	-7.4	1.3	2.0
Slovakia	:	2.7	5.9	10.4	6.4	-5.8	1.9	2.6
Finland	1.3	4.6	2.9	4.2	1.0	-6.9	0.9	1.6
Euro area	1.5	2.8	1.7	2.8	0.6	-4.0	0.7	1.5
Bulgaria	-2.8	2.0	6.0	6.2	6.0	-5.9	-1.1	3.1
Czech Republic	2.3	1.2	4.6	6.1	2.5	-4.8	0.8	2.3
Denmark	2.6	2.4	1.8	1.6	-1.2	-4.5	1.5	1.8
Estonia	:	6.5	8.4	7.2	-3.6	-13.7	-0.1	4.2
Latvia	-8.8	6.3	9.0	10.0	-4.6	-18.0	-4.0	2.0
Lithuania	-8.3	4.7	8.0	9.8	2.8	-18.1	-3.9	2.5
Hungary	0.6	4.6	4.2	1.0	0.6	-6.5	-0.5	3.1
Poland	4.9	4.4	4.1	6.8	5.0	1.2	1.8	3.2
Romania	1.4	-0.9	6.2	6.3	6.2	-8.0	0.5	2.6
Sweden	1.2	3.3	3.2	2.6	-0.2	-4.6	1.4	2.1
United Kingdom	2.5	3.4	2.6	2.6	0.6	-4.6	0.9	1.9
EU	1.4	2.9	2.0	2.9	0.8	-4.1	0.7	1.6
USA	3.3	3.8	2.7	2.1	0.4	-2.5	2.2	2.0
Japan	1.3	0.5	1.7	2.3	-0.7	-5.9	1.1	0.4

Source: European commission, European economic forecast, Autumn 2009

3.3 The employment crisis: double digit unemployment for the moment and truncated employment targets for the future

The economic crisis, which was characterized by a huge fall in demand, resulted already in 2008 in a slowing down of employment growth over the year, but in 2009 total employment declined with some 2.6%. This job loss was even larger in the US, where it started earlier and continues in 2010. The forecast for job decline in 2010 is somewhat lower: -1.4%. This decline of jobs during these two years puts us back on the level of employment that had been reached in 2003. This job decline includes temporary layoffs but is also the result of structural layoffs which will be accelerated. Lack of demand, lack of investment, bankruptcy of firms and relative cheap targets for new takeovers, overcapacity, and possible protectionist reactions, all will be accompanied with industrial changes. Because of this the unemployment figures again reached double digit range. It should remind us however that full employment has never been reached the last decades, and that we are again confronted with massive unemployment. This is further illustrated by the fact that the employment level of 70 % put forward by the Lisbon-target, which had to be attained in 2010, is again further away. Furthermore we need to realise that this is perhaps not even an ambitious target, 'truncated' (curtailed) as it is by the reality of still massive unemployment of the early 2000 years. In view of the greying population, this target should be higher. Observing the scenario's projected by the European Commission, in which this curtailed figure is maintained far in the future (until 2020), illustrates that there is a need, also here, to reinforce our ambitions.

Table 2: The employment crisis: Total employment (percentage change on preceding year, 1992-2011)

	5-year averages			2007	2008	2009	2010	2011
	1992-96	1997-01	2002-06					
Belgium	0.1	1.4	0.7	1.6	1.9	-0.8	-1.4	0.1
Germany	-1.4	0.0	-0.7	1.5	1.4	-0.5	-1.9	-0.3
Ireland	2.5	5.6	3.2	3.6	-0.8	-7.8	-3.9	0.7
Greece	0.9	0.7	1.7	1.4	0.1	-0.9	-0.8	-0.2
Spain	-0.3	4.1	2.8	2.8	-0.6	-6.6	-2.3	-0.4
France	-0.5	1.7	0.5	1.5	0.6	-1.8	-0.9	0.4
Italy	-0.9	1.1	0.8	1.0	-0.1	-2.6	-0.4	0.4
Cyprus	:	1.6	3.0	3.2	2.6	-0.4	-0.1	0.6
Luxembourg	2.5	4.7	2.8	4.4	4.7	1.1	-1.3	0.0
Malta	1.5	0.8	0.7	3.2	2.4	-0.6	0.3	0.6
Netherlands	1.0	2.4	-0.2	2.3	1.2	-0.1	-2.1	-0.9
Austria	0.0	0.8	0.5	1.6	1.8	-1.5	-0.7	0.3
Portugal	-0.8	2.1	0.0	0.0	0.4	-2.3	-0.4	0.1
Slovenia	:	0.2	0.6	3.0	2.9	-2.6	-2.0	-0.3
Slovakia	:	-1.1	0.9	2.1	2.9	-2.0	0.0	0.6
Finland	-2.3	2.3	0.9	2.2	1.6	-2.9	-2.5	0.1
Euro area	-0.6	1.4	0.6	1.7	0.6	-2.3	-1.3	0.0
Bulgaria	-1.6	-0.4	2.4	2.8	3.3	-2.0	-1.3	0.8
Czech Republic	:	-0.8	0.5	2.7	1.5	-2.0	-1.4	0.3
Denmark	0.1	1.0	0.3	2.7	0.8	-2.6	-2.1	-0.1
Estonia	-5.2	-1.8	1.9	0.8	0.2	-9.0	-2.5	1.6
Latvia	-7.4	0.3	2.2	3.6	0.7	-11.9	-5.6	-0.2
Lithuania	-2.7	-2.1	2.0	2.8	-0.5	-8.3	-2.4	-0.2
Hungary	:	1.3	0.3	-0.1	-1.2	-3.0	-0.8	0.9
Poland	:	-1.1	0.5	4.4	3.8	-0.7	-1.1	0.1
Romania	-2.8	-1.8	-1.1	0.4	0.3	-3.3	0.8	0.9
Sweden	-1.9	1.4	0.1	2.2	0.9	-2.2	-1.8	0.0
United Kingdom	0.0	1.2	0.9	0.7	0.7	-2.0	-0.9	1.3
EU	:	0.9	0.6	1.7	0.9	-2.3	-1.2	0.3
USA	1.8	1.7	0.6	1.1	-0.5	-3.5	-0.5	0.3
Japan	0.4	-0.6	-0.2	0.4	-0.4	-3.0	-1.2	-0.2

Source: European commission, European economic forecast, Autumn 2009

3.4 The fiscal crisis : fiscal deficits and public debt: from double digit to triple digit

The financial crisis required some direct intervention of the governments. For the moment fiscal deficits are estimated at 3 to 6% but these could in more adverse scenario's mount up to 16.5% of GDP. This seems to end up in line with the average observed cost of national financial crises in the past (some 15%). Its final cost depends on the speed of action, the unwinding of the risks and the recovery possibilities. The economic consequence has been in the past V-shaped, but there is a danger that it will be different this time because of the global character of the crisis, the complicated nature and high leverage. An output loss has been observed in many national systemic bank crises in the past (Public Finance EMU, 2009). The indirect fiscal burden because of global economic consequences in the past was estimated at 4%, bringing the increased debt because of the financial crisis to 20%.

The total fiscal deficit for 2009 is at present 6% EU-wide. In the USA it is 12%. The forecasts for 2010 are respectively 7 and 14%. But the budgetary deterioration emerges already earlier in 2008. It is the consequence of reduced fiscal revenues, increased social benefit expenditures, additional expansionary measures and the cost of resolving the financial sector. The European economic stimulus plans, besides the rescue plans for the financial sector and the automatic stabilisers, are estimated at 1% of GDP (weighted average for 18 EU Member States) and 0.5% for the next year (Watt,2008). The efforts were lower the better automatic stabilisers were at work, and higher when the demand shock was greater. The stimulus plans seem to be properly designed, but too little compared to the efforts in the US. Some figures from the EC confirm this level of effort: 85% seems to be related with further income support, and only 15 % with (active) labour market policies. But this again is acceptable if those measures are directed to compensate a 'demand shock'.

Table 3: The fiscal crisis: net lending (+) or net borrowing (-) general government (as a percentage of GDP, 1992-2010)

	5-year averages			2007	2008	2009	2010	2011
	1992-96	1997-01	2002-06					
Belgium	-5.4	-0.7	-0.6	-0.2	-1.2	-5.9	-5.8	-5.8
Germany	-3.0	-1.6	-3.3	0.2	0.0	-3.4	-5.0	-4.6
Ireland	-1.7	2.4	1.2	0.3	-7.2	-12.5	-14.7	-14.7
Greece	-9.6	-4.2	-5.2	-3.7	-7.7	-12.7	-12.2	-12.8
Spain	-5.6	-1.9	0.4	1.9	-4.1	-11.2	-10.1	-9.3
France	-4.9	-2.1	-3.2	-2.7	-3.4	-8.3	-8.2	-7.7
Italy	-8.3	-2.2	-3.5	-1.5	-2.7	-5.3	-5.3	-5.1
Cyprus	:	-3.6	-3.7	3.4	0.9	-3.5	-5.7	-5.9
Luxembourg	1.6	4.5	0.6	3.7	2.5	-2.2	-4.2	-4.2
Malta	:	-7.6	-5.1	-2.2	-4.7	-4.5	-4.4	-4.3
Netherlands	-3.3	0.0	-1.3	0.2	0.7	-4.7	-6.1	-5.6
Austria	-4.1	-1.6	-1.9	-0.6	-0.4	-4.3	-5.5	-5.3
Portugal	-4.7	-3.4	-3.8	-2.6	-2.7	-8.0	-8.0	-8.7
Slovenia	:	-2.9	-2.0	0.0	-1.8	-6.3	-7.0	-6.9
Slovakia	:	-7.6	-3.9	-1.9	-2.3	-6.3	-6.0	-5.5
Finland	-5.8	2.8	3.2	5.2	4.5	-2.8	-4.5	-4.3
Euro area	-5.0	-1.6	-2.5	-0.6	-2.0	-6.4	-6.9	-6.5
Bulgaria	:	1.4	1.1	0.1	1.8	-0.8	-1.2	-0.4
Czech Republic	:	-4.4	-4.5	-0.7	-2.1	-6.6	-5.5	-5.7
Denmark	-2.5	1.0	2.6	4.5	3.4	-2.0	-4.8	-3.4
Estonia	:	-0.5	1.5	2.6	-2.7	-3.0	-3.2	-3.0
Latvia	:	-1.5	-1.2	-0.3	-4.1	-9.0	-12.3	-12.2
Lithuania	:	-4.9	-1.1	-1.0	-3.2	-9.8	-9.2	-9.7
Hungary	:	-5.3	-8.0	-5.0	-3.8	-4.1	-4.2	-3.9
Poland	:	-3.9	-4.9	-1.9	-3.6	-6.4	-7.5	-7.6
Romania	:	-4.0	-1.6	-2.5	-5.5	-7.8	-6.8	-5.9
Sweden	-7.7	1.2	0.7	3.8	2.5	-2.1	-3.3	-2.7
United Kingdom	-6.1	0.6	-2.9	-2.7	-5.0	-12.1	-12.9	-11.1
EU	:	-1.4	-2.5	-0.8	-2.3	-6.9	-7.5	-6.9
USA	-4.2	0.3	-3.7	-2.7	-6.4	-11.3	-13.0	-13.1
Japan	-2.5	-7.3	-6.1	-2.5	-3.8	-8.0	-8.9	-9.1

Source: European commission, European economic forecast, Autumn 2009

Table 4: Gross debt, general government (as a percentage of GDP, 2002-2011)

	2002	2004	2006	2007	2008	2009	2010	2011
Belgium	103.2	93.9	88.1	84.2	89.8	97.2	101.2	104.0
Germany	60.3	65.6	67.6	65.0	65.9	73.1	76.7	79.7
Ireland	32.2	29.4	25.0	25.1	44.1	65.8	82.9	96.2
Greece	101.5	98.6	97.1	95.6	99.2	112.6	124.9	135.4
Spain	52.5	46.2	39.6	36.1	39.7	54.3	66.3	74.0
France	58.8	64.9	63.7	63.8	67.4	76.1	82.5	87.6
Italy	105.7	103.8	106.5	103.5	105.8	114.6	116.7	117.8
Cyprus	64.6	70.2	64.6	58.3	48.4	53.2	58.6	63.4
Luxembourg	6.5	6.3	6.6	6.6	13.5	15.0	16.4	17.7
Malta	60.1	72.5	63.6	62.0	63.8	68.5	70.9	72.5
Netherlands	50.5	52.4	47.4	45.5	58.2	59.8	65.6	69.7
Austria	66.4	64.8	62.2	59.5	62.6	69.1	73.9	77.0
Portugal	55.5	58.3	64.7	63.6	66.3	77.4	84.6	91.1
Slovenia	28.1	27.2	26.7	23.3	22.5	35.1	42.8	48.2
Slovakia	43.4	41.4	30.5	29.3	27.7	34.6	39.2	42.7
Finland	41.3	44.2	39.3	35.2	34.1	41.3	47.4	52.7
Euro area	68.0	69.5	68.3	66.0	69.3	78.2	84.0	88.2
Bulgaria	53.6	37.9	22.7	18.2	14.1	15.1	16.2	15.7
Czech Rep.	28.5	30.4	29.4	29.0	30.0	36.5	40.6	44.0
Denmark	46.8	44.5	31.3	26.8	33.5	33.7	35.3	35.2
Estonia	5.6	5.0	4.5	3.8	4.6	7.4	10.9	13.2
Latvia	13.5	14.9	10.7	9.0	19.5	33.2	48.6	60.4
Lithuania	22.3	19.4	18.0	16.9	15.6	29.9	40.7	49.3
Hungary	55.6	59.1	65.6	65.9	72.9	79.1	79.8	79.1
Poland	42.2	45.7	47.7	45.0	47.2	51.7	57.0	61.3
Romania	24.9	18.7	12.4	12.6	13.6	21.8	27.4	31.3
Sweden	52.6	51.2	45.9	40.5	38.0	42.1	43.6	44.1
U.K.	37.5	40.6	43.2	44.2	52.0	68.6	80.3	88.2
EU	60.3	62.1	61.3	58.7	61.5	73.0	79.3	83.7

Source: European commission, European economic forecast, Autumn 2009

4. Financial regulation: orthodoxy and prudence rediscovered:

4.1 Did it work?

The past financial surveillance at national and international level did not prevent the crash of the financial sector, it did not even warn us for its potential problems. There was indeed an increased attention for systemic risk, but deregulation (abolishment of Glass Steagall act allowing again commercial banking and investment banking in the USA), prudential regulation (solvability measures) and widespread financial innovation left too much to the self-control of the financial sector (e.g. the market of credit agencies). On top of that it went together with irrational exuberance from stockholders and investors which resulted in an

irrational system of bonuses for traders and bank officials and huge golden parachutes.

Some scholars warned against this irrational exuberance (for example Shiller, Steinherr). Now the cost of these risk positions (even though the picture of risk exposure is still not clear), the cost of bailing out, the cost for bank shareholders and deposit holders, the fiscal cost, the economic cost, the lack of transparency for investors, but seemingly also for bankers themselves, for auditors and rating agencies became obvious. Now it also becomes clear how an extraordinary intermediation margin had been created in the economy by the financial sector, using real resources.

The financial crisis was the result of a housing boom and exorbitant mortgage lending, not only to finance housing but also to finance further consumption, reaching a level of 100% of GDP in 2007. This indebtedness of households was according to Sapir J. a response to the shift of income, making them more vulnerable for insolvency when they become unemployed and asset prices turn down. Declining income for households forced them to increase indebtedness, which artificially fuelled the further spending in the economy. The AARP (American Association of Retired Persons) mentions that many of the foreclosures in recent years was caused by diseases, invalidity and problems to lack of social protection and not only because of inappropriate lending or misselling of mortgages. Some European countries went down a similar road: UK, Ireland and Spain. At the bottom of this vicious circle a housing bubble and bust results in a rapid decline of the economy, and an even more rapid deterioration of public finances.

We can distinguish countries with higher private debt, and lower public debt. Spain, UK, Ireland developed a lending and consumption profile similar to the USA, also based on a housing price boom. Those countries were hit harder than the countries with higher public debt.

4.2 Will it work?

'The current financial crisis seems to repeat and amplify the shock waves the latest crisis between 2000 and 2003 sent to pension funds throughout the world. Whereas last time the term 'perfect pension storm' was coined to visualise the disastrous impact the simultaneous fall of equities and yields exerted on pension

funds, this time the term 'tsunami' is spreading when referring to the current turmoil on worldwide financial markets.' (quote for the announcement of o Allianz - Oxford Pensions Conference 2009, Meeting the Challenges of the 21st Century, 17-18 September 2009, University of Oxford).

Within this perfect storm, the measures taken after the crisis however succeeded at containing the spreading of the crisis. The true cost is not yet clear, the credit crunch is not over, and new negative consequences are feared (for instance the inflation risk following the monetary policy). New risks become obvious, and the amount of national and international re-regulation is large.

4.3 Recommendations for further action

There is a return to banking orthodoxy, distinguishing more clearly between commercial banking (intermediation between savings and credit) and investment banking. This should not imply, however, that we should return to simple banking.

There has been a realisation that the internationalisation meant an additional risk: some banks were so important internationally (including both balance sheet assets and off balance sheet assets) that they became not only too big to fail, but also too big for the national state. Falling back on national markets, however, might endanger the potential of diversification, scale economies and more competition.

More collaboration between national controlling authorities should be stimulated, combining systemic risk control, macroeconomic surveillance and prudential control. More functions in the financial system require more state intervention or are even better 're-nationalised'. The Dutch - Anglo economist W. Buiters concludes in a 2008 'Den Uyl Lezing' that self-regulation of the financial markets was a mistake, and that market elements such as ratings, should be taken out of public control schemes on solvency. But the contrary is the case: 'there is also no common language for measuring, analyzing and comparing insurer financial strength- other than ratings' (Impavido, Tower, 2009).

There should also be a new outreach of public control on the settlement and clearing platforms (for bank transfers, but also for clearing all kinds of financial products). Now they seemed to be traded in 'opaque over-the-counter' markets.

Thus, the role of the state is massive:

- macroeconomic and monetary stability
- systemic risk control
- solvency regulation
- control of innovation
- state owned banks
- stock market control and market information
- transparency of commercial banking and consumer protection
- deposit insurance, reaching to all kinds of financial assets (mutual funds, insurance companies, pension savings and pension funds).

The crisis revealed that not all these systems were in place and up to their responsibilities. It was also discovered that the national authorities reached the limits of their capacities. Not only where banks too big too fail, forcing governments to intervene to avoid bank runs and systemic risk, bailing out those that before had shown a too risky behaviour, but some banks were so big and internationally engaged that their rescue was beyond the means of national authorities and required international coordination.

The collapse of the banking sector could have the consequence of avoiding competition , resulting in too low remuneration for savings, too high tariffs for credits, credit rationing, and too high marginsfor the financial sector. In this case, the economy would pay twice for the actual crisis of financial institutions.

There is a huge deficit in improving financial regulation, not only for the banking sector but also the insurance and pension fund sector and all other types of regulation. The lack of international standards is also clear, and even when they are in place the question remains whether those standards are defined by the profession or by public interest.

One of the characteristics of recent financial crises is how bear markets rapidly turned into bull markets again, illustrating the increased volatility of financial markets. On a longer term, and compared with economic growth, it can imply that the relative wealth (as a share of GDP) did not increase much over the last two decades (this is certainly the case in Belgium, for example). This fact can be easily

forgotten due to money illusion. But there is another danger of going 'the sooner the better' back to business as usual. After the substantial bailing out efforts which put government deficits and debt a decade back in time, and after putting the entire economy at risk (as a matter of fact the risk *materialised*) the financial industry is already recovering: they are realising profits again and shocked the international community by paying out bonuses again to their traders (a bonus system which, according to many, contributed the financial crisis). P. De Grauwe, calles this 'back to business as usual'-mentality unacceptable. The governmet, which indebted itself by intervening will have to pay interest and reimburse this debt at a moment when it was supposed to continue on its path of debt reduction to prepare their public finances for the ageing problem. The financial sector was rescued from a virtual bankruptcy and was helped, among other measures, by guarantees for which they now have to pay a levy. They want to get rid of this levy as soon as possible in order to improve their profitability again. P. De Grauwe compares this situation with a fire insurance where for which you could contribute when your house is at fire, and withdraw for the rest of the time.

There is also the danger that regulators will allow the banking sector to increase its margin and profitability at the expense of savers and debtors. The extraordinary expansion of financial intermediation in the last half of this decade illustrates how the financial sector became a substantial part of GDP, but perhaps also a substantial burden. Allowing effective competition, and adequately taxing profits are ways to curtail that. Expecting a continued contribution to the repayment of the intervention costs of the government during the crisis should also be part of that.

The financial sector, which is promising to solve the ageing problem, aggravated the public finances by putting them a decade back in time as a result of the forced interventions of the states to rescue the system.

5. Industrial policy reinvented

In the previous sections we outlined the impact of the financial crisis on the real economy through both a decline in GDP of 4% and a fall in total employment of 2,6% in 2009, the latter of which is forecasted to fall further in 2010 at a rate of 1,5% (European Commission, Economic forecast, spring forecast 2009; see also tables 1 and 2). Strategies to combat this employment crisis roughly fall into two approaches. One approach focuses on labour *supply* via active labour market

policies such as subsidies for reduction in working time, hiring subsidies and job search assistance and matching. We discuss these strategies in a separate section regarding employment policies. A second approach deals with maintaining labour *demand* through industrial policies aimed at attracting and supporting firms or industries which are deemed crucial to domestic employment and economic growth. In the present section we outline some general principles relating to industrial policy and apply these principles to actual and preferred policy in the wake of the current economic crisis.

Let us first consider the framework used by economists to assess issues of industrial change and the location of economic activity. This framework consists of two theoretical concepts: the concept of comparative advantage on the one hand, and the concept of agglomeration effects on the other. The first concept derives from traditional theory of international trade, the latter concept is an essential part of the 'New Economic Geography' for which Paul Krugman received the 2008 Sveriges Riksbank Prize of Economic Sciences in Memory of Alfred Nobel (the semi-official nobelprize in economics).

Comparative advantage encourages sectoral specialization nation-by-nation for sectors whose production is intensive in the use of those factors with which the nation is relatively well endowed. In the absence of barriers to trade this mechanism allows nations to specialize in the sectors in which they have a comparative advantage. This leads to important efficiency gains and is potentially welfare improving.

The so-called 'New Economic Geography' theory introduces agglomeration and dispersion forces (cfr. Jozef Konings¹). Agglomeration effects are based on the economies of scale which result from being located near large markets (demand linkages) and/or near suppliers of intermediate inputs (cost linkages). The concentration of economic activity may also generate important knowledge or technological spill-overs. However, so-called dispersion forces also come into play. Dispersion forces result from the rise of land prices, office prices and wages within agglomerations of economic activity. Furthermore, the concentration of economic activity raises local competition. Since firms naturally seek to avoid competition, this effect tends to motivate firms to seek lesser concentrated areas.

¹ Lecture at the conference 'Reinforcing our ambitions: how to overcome the present financial and economic crisis', September, 2009, Leuven.

These two opposing forces, i.e. agglomeration and dispersion forces, create a unique 'locational equilibrium'.

Now, in what way do these insights (both comparative advantage and New Economic Geography) contribute to our understanding of industrial change and the location of economic activity at present? In this respect, one cannot overemphasize the role of the 'globalisation' process and European integration in considerably reducing barriers to trade, via lower import tariffs and lower costs of both transportation and communication. On the one hand, this has resulted in an increased importance of comparative advantages as a driving force behind international trade. On the other hand, this systematic reduction in barriers to trade has reduced the importance of dispersion forces, since a lowering of trade costs implies more competition between agglomerations and distant markets. Yet, the reduction in barriers to trade also results in a decrease in agglomeration forces, which leads to outsourcing, off-shoring and an internationalisation of the supply chain.

This increased international interdependence is one of the reasons why the present financial and economic crisis had such global consequences. As a result, the current crisis has induced some policy makers to seriously consider new protectionist measures in order to counteract the negative effects of a deteriorated international environment. One example is the saga surrounding GM/Opel, in which Germany resorted to an explicit form of state aid with respect to the automobile industry located in Germany.

Is this kind of industrial policy appropriate in the current conditions or is there a need for a new perspective with regard to industrial policy adapted to the realities of increased specialization (comparative advantages) and increased agglomeration and internationalisation of the supply chain (new economic geography)? Firstly, one should be reticent in applying policy measures which dispute agglomeration forces and comparative advantages. One should certainly not try to support industries in which one's country does not display comparative advantages. Secondly, one should try to direct its support towards projects which support agglomeration forces, such as investments in infrastructure, mobility and education. Thirdly, a gradual approach seems preferable to a 'laissez-faire' approach in which extinguishing industries/firms do not receive transitory support. However, one should always keep long-term objectives in mind.

Did actual policy measures reflect these concerns? The EERP (European Economic Recovery Plan) allows for support to be given to sectors that are most affected by the crisis, provided these measures are temporary, targeted and timely (the three T's). However, the European Commission also warns for the risk of an increase in protectionist tendencies, which still remain "under the threshold of being actionable but with the potential of triggering an avalanche of 'tit for tat' responses" (European Commission, *European Economy* 7, 2009, p. 75). They advise to maintain openness within the internal market and to target interventions towards long-term policy goals such as building a low carbon economy (*idem*, p. 74).

This leads us to the following conclusions with respect to industrial policy: the 'old' recipes of industrial policy, which consisted of protectionist measures aimed at directly (sometimes permanently) subsidising certain firms or industries, should be reinvented and adapted to the present international economic reality, in which economies are increasingly interdependent. The focus should therefore be on structural measures, aimed at adapting the industrial structure of a country's economy to the economic forces described above. This means governments should devise strategies to protect the economy and employment *as a whole*, in stead of strategies aimed at protecting *specific* industries or jobs. This implies that governments should keep a certain reserve regarding traditional industrial policies and should most definitely not try to 'swim against the tide' created by comparative advantages and increased agglomeration forces. In the short term, governments should aim to smooth the consequences of Schumpeterian 'creative destruction', not resist it. Structural measures aimed at the longer term are preferable, such as increased investments in infrastructure, mobility, low carbon alternatives and education.

6. Employment policies: new and old challenges

The European Economic Recovery Plan should according to a recent study of ECFIN (Carone, Koopman, Pichelman, 2009, p. 2) combine social cohesion, employment policies and economic recovery.

The labour policies should keep people in employment, should reinforce activating, provide adequate income support for the unemployed, provide

retraining schemes and upgrading of skills, should lower the wage cost of low-skilled workers (restoring more progressive tax structure) and tackle youth unemployment. It should keep people in employment, for instance with temporary working-time arrangements and temporary adjustments of working times, but avoid locking up people in declining industries.

Some of those measures are also a contribution to increase labour supply in view of the upcoming labour shortages due to demographic changes. A problem arises, however, if those transitory policies are not permanent. The financial crisis brought back the realisation that we are far away from full employment. Full employment is far away since the financial crisis, but it was neither reached before the onset of the crisis. Measures should thus stimulate short- and long-term employment at the same time. A moment of crisis could provide the momentum for changes that were already needed for years.

Labour policies should, however, not maintain tax-funded support of jobs in declining industries, since this will reduce economic efficiency (p.4). On the contrary, they should speed up the transition from old to new industries and jobs. Neither should the governments create jobs in the public sector 'outside of planned and needed staffing improvements in education, health and the social services' (and with the exception of specific vulnerable groups, p. 4). What they also should not do is avoid the early retirement question: 'Enabling older workers to remain active is important to support the economic recovery and to preserve the long-term sustainability of public pensions' (ibidem, p. 4). In the future projections of the sustainability of public pensions, with projections up until 2060 in Europe, we read also the hypothesis of an increase of the activity degree (active population/population at working age) ...to be 70 in the year 2060. But this was already the ambition of the Lisbon target for 2010! It probably can be higher by 2060, or the denominator should be larger.

Table 5. Discretionary changes in labour market policy in response to the economic downturn

	labour demand			measures to help unemployed find work					income support for job losers and low-income earners				other training measures	
	job subsidies, recruitment incentives & public sector	reductions in non-wage labour cost	short-time work schemes	activation requirements	job search assistance and matching	job-finding and business start-up incentives	work experience programmes	training programmes	generosity or coverage of unemployment benefits	social assistance	other payments or in-kind support	fiscal measures for low earners	training for existing workers	apprenticeship schemes
Austria			x		x			x				x	x	
Belgium		x	x		x				x	x		x		
Czech Rep.		x	x	x					x					
Denmark			x	x				x					x	
Finland		x	x	x	x	x		x			x	x	x	
France	x	x	x		x		x	x	x	x	x	x	x	
Germany		x	x		x			x			x	x		
Greece	x				x			x			x	x	x	
Hungary	x	x	x								x	x		
Ireland			x	x	x		x	x					x	
Italy			x	x	x			x						
Japan	x	x	x		x	x	x	x	x	x	x			
Luxembourg	x		x											
Netherlands			x		x			x				x	x	
Norway			x		x		x	x						
Poland	x	x	x	x	x			x	x	x		x		
Portugal	x	x		x		x	x	x	x					
Slovakia	x	x	x			x					x	x		
Spain	x	x			x	x		x	x		x	x	x	
Sweden	x	x			x		x	x	x		x	x		
Switzerland			x											
Turkey		x	x	x				x						
U.K.	x			x	x	x	x	x			x	x	x	
U.S.	x				x		x	x	x		x	x	x	

Source: OECD, Addressing the labour market challenges of the economic downturn: a summary of country responses to the OECD-EC questionnaire, 2009

Confronting those do's and don'ts with the real amount of stimulus in labour markets and related social protection, the study concludes that almost 0.87% of GDP behind the taken measures are aimed at raising household purchasing power, (which is at it should be as a stabilising policy) and only 0.14% of GDP is aimed at labour market policies.

Exactly a year ago the main problem was inflation, caused among others by oil price increases and commodity prices. A month later the global banking crisis and the fear for a consecutive depression, did not erase the menace of rising energy prices. The growing interest of the ETUC for redefining GDP and focusing on green economy is one urgently needed approach. We refer to their recent initiatives. This concern is of course not new, it goes back to the Report of the Club of Rome in the seventies.

Another challenge which becomes ever more urgent is the demographic challenge. since from 2010 on the baby boomers will be retiring and a decade or two later they will become dependent on health and long term care. Institutions and systems of social protection needed to be adapted and reinforced.

The economic crisis sets our economies several years back, or even a decade or more depending on which criteria are used. It was a time lost. At the same time the remedies ,at least in the short term, need massive new efforts.

Some measures have spill-over effect on other countries, and should be better coordinated. Especially the reduction of social security contributions, not only puts an additional stress on social security systems, but it also has distortive effects on other countries. Previous E.U. Commissioner of the Internal Market Mario Monti pleads not only for more coordination in tax policy to avoid fiscal dumping, but also for more coordination with respect to social security contributions. But this social security remains a national competence, as are many fiscal political measures. This plea is also not new: our major conclusion of 'welfare state watching' in the EZA-project 'The state of the welfare state' in 2005 was exactly this major threat posed by fiscal and social dumping

What about the debate on early retirement? The creation of the early retirement schemes has been a result of the need for industrial change in socially acceptable ways. They were used massively for absorbing the economic crisis of the early

seventies. Sometimes the argument was also directed towards solving youth unemployment. Is this crisis strategy feasible today? We are afraid that this recipe of the past is not suitable for the future. And perhaps it was not even the most adequate measure in the past, since it deprived us from economic growth and it created deficits and debt.

7. The automatic stabilisers and social protection: Keynesian expansionary policies rediscovered

7.1 Did it work?

Automatic stabilizers work automatically. Incompressible public expenditures, increasing benefits for unemployment, and declining fiscal revenues automatically create deficit spending. It depends on the level and structure of taxes and expenditures. On top of this automatic mechanism fiscal stimulus programs were decided.

What has been the 'marge de manoeuvre'?

Not all member states started from the same 'room for manoeuvre' in their public finances. They were constrained by a high budget deficit or a high public debt or both. Some of them could not fully engage in an expansionary policy.

Table .5 Fiscal policies reflecting differences in room for manoeuvre

Sound public finances, Significant expansionary policy Finland, Denmark, Luxembourg, Sweden, the Netherlands, Germany, Austria.
Less comfortable public finances, reasonable counter-cyclical policy Cyprus, Belgium, Czech Republic, Slovenia.
High government deficit and sizeable fiscal stimulus United Kingdom, Poland, Spain and France.
Low expansion: Greece, Hungary

Source: European Commission, Economic Forecast 2009

Another problem will be the timing of those measures, when to reduce support measures and how to restore the balance of public finances.

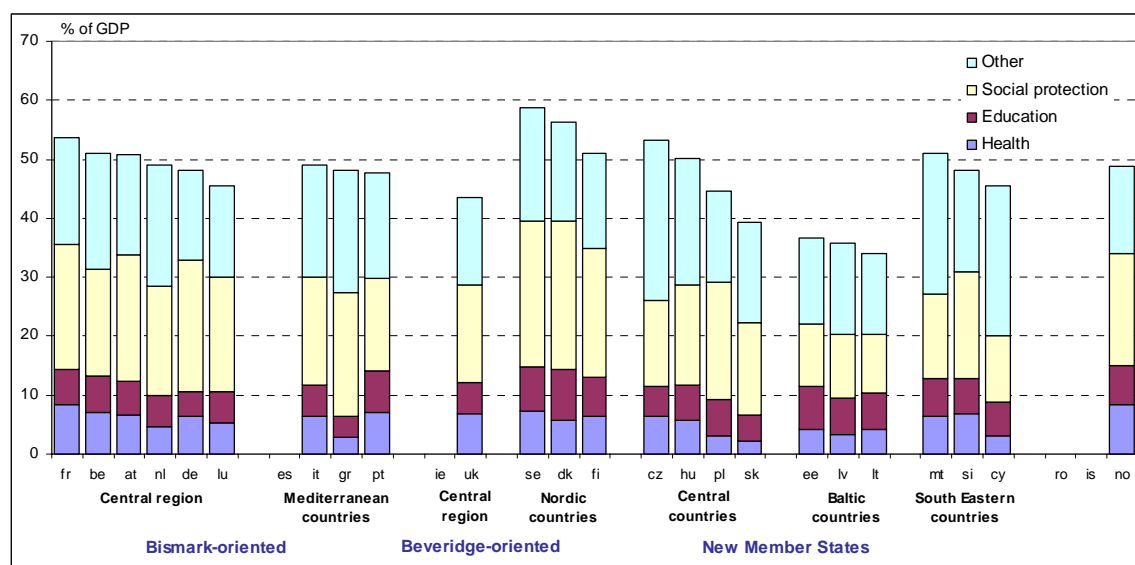
7.2 Will it work? Yes it will have impact

Today, there is a growing belief in deficit spending. Recent European studies revealed that, when confronted with more and more households subject to credit constraints (as a result of credit rationing by the financial sector), short run budgetary policies show real effects on private consumption under the hypothesis that they are limited in time.

There has been theoretical doubt about the workability of short-term financial stabilisers or expansionary policies. This problem was documented by previous crises that where more 'supply' crises: the two oil shocks, the technology bubble. The present crisis was more characterised by a fall in demand.

7.3 How did it work?

We want to make a distinction between the stabilising effect of the social protection expenditures and public employment. In the following figures we give the situation in middle of 2000. With between 30 and almost 50 % of GDP spent by the government, of which a large part is public consumption, services provided by the state, and benefit payments, there is a huge stabilising factor present in the economy that did not exist in the time of the great depression. It makes the GDP less volatile. It acts as an automatic stabiliser. The issue remains however how to restore balance after a downturn.

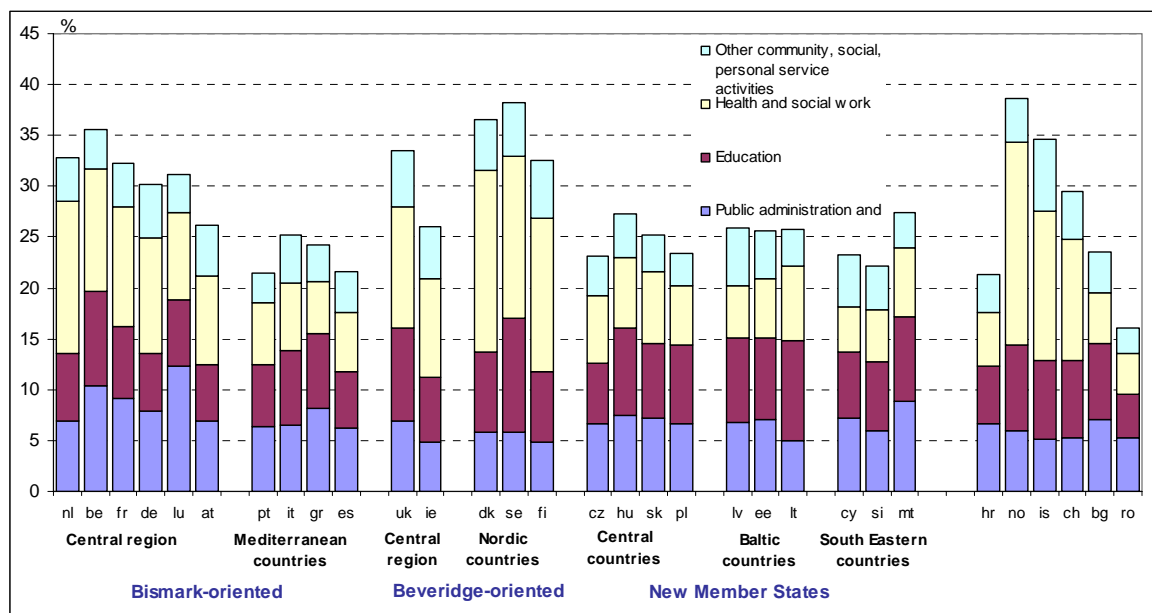


Source: Own calculations based on Eurostat

Figure .1 General government expenditure by COFOG function, as % of GDP, 2003

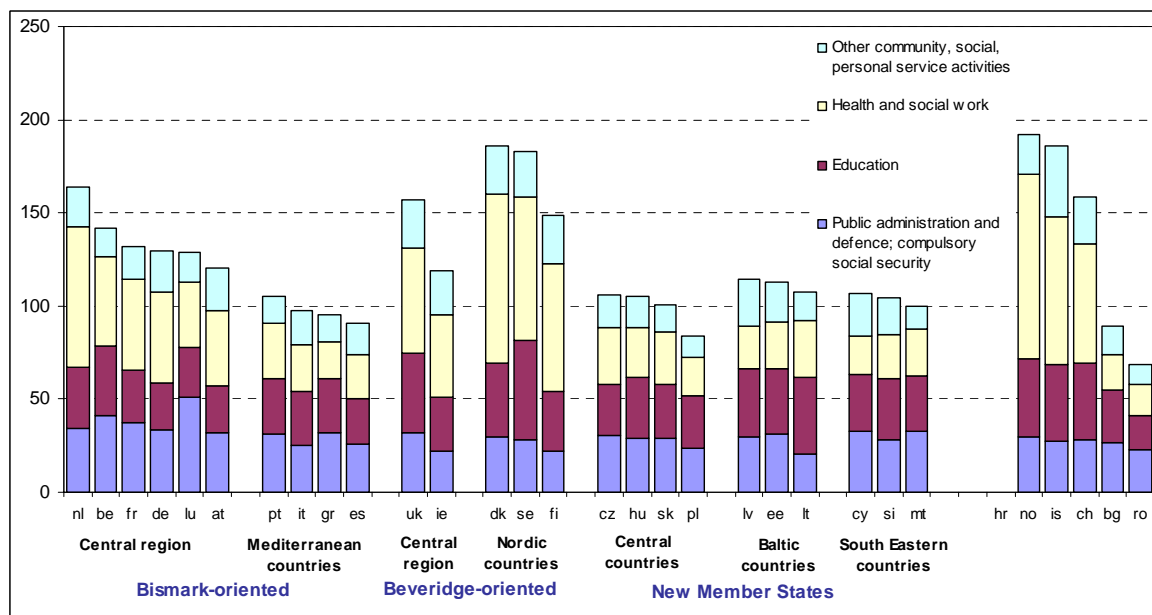
In the US the absence of a well developed welfare system implied huge problems for the unsecured, the ill and the unemployed (who lost access to health insurance). Their income based on public pensions, but also occupational pensions and private pension savings and reversed mortgages, was confronted by the October crisis with a decline of pension assets and income security. (A. Munnell)

With respect to the share of public subsidized employment in total employment we see huge differences between European countries: this share is lowest in the southern and new member states and is highest in the Scandinavian countries. High levels of public employment go together with high levels of total employment (they indeed support total employment, as they also support formal GDP) so that this difference becomes even more clear expressed in number of jobs per 1000 inhabitants (see figure 4). There is a great chance that jobs created also imply rendered service, for instance in education, care etc. So observed job gaps are also care gaps. Confronted with huge unemployment problems for the coming years it should be the momentum for those countries lagging behind to expand the employment in those industries. This is, again, in line with the recommendation of the European researcher only to 'engage in further expansion for really needed staffing'. Those needs are obvious in health care and long term care for instance and also in education and lifelong learning. It is also an opportunity to fill in the education and training efforts for jobs needed in those industries, to avoid the danger of shortages of workforce in those sectors. Confronted with the threat of unemployment , discovering industries with future work force shortages should be a relief.



Source: Eurostat

Figure 3 Total employment in the private and public non-profit sector, as % of total employment, 2004 (2e quarter)



Source: Eurostat

Figure 4 Total employment in the private and public non-profit sector, per 1000 inhabitants, 2004 (2e quarter)

7.4 Should it be directed to special policy strands or target groups?: the case of the ageing of the population

The huge amount of budgets for expansionary policies in the USA were confronted with a demand for adequate spending: no white elephant projects.

There is a growing concern to orient the expansionary fiscal programmes to long term needs and lasting effects in the future. Such a policy should include a shift of the economy to challenges of global warming, environment, energy saving investments etc.. One of those challenges will also be the greying of the population.

The social security absorbed the crisis by maintaining the income of inactive persons and by the well developed unemployment benefits system.

The major, although manageable, challenge will be the further financing of the cost of ageing. Upgrading the infrastructure of health and social care is urgently needed, not the least since in many countries investments are lagging. It also means modernising infrastructure up to the standards of 2010. One example is the number of one-person bedrooms in hospitals and old age homes. People who can afford expensive hospital insurances, can afford an individual room in hospitals. Those that can afford can even apply for old age service flats as they become old and dependent. In many countries the rooms with two beds or even wards with more than two beds still exist. Starting now a programme of upgrading the health and long term care infrastructure is needed in many countries . It is a programme that implies investments for the future, perhaps not as spectacular as roofs with photovoltaic solar cell systems, but of direct influence on the quality of care and life, today and tomorrow.

For many years the cost consequences of a greying population have been a core element in monitoring the sustainability of European public finances. The European commission calculated the impact of the present crisis on the future costs. The results are given in the following table. The basic scenario was the continuation of economic growth and social expenditures for older persons on the level before the crisis. The cost of ageing was estimated to rise with 'only' 0.5 % for the EU between now and 2020, but would increase to an additional spending of 4.5% between now and 2060. It confirms that the cost is affordable, in the short term, because people are not yet retired or dependent, and in long term since we must be capable in the next 50 years to adapt our society and economy to an

additional cost of 4.7%. Compared to this baseline scenario other scenario's are calculated, which take account of the impact of the crisis on the cost of ageing: a quick rebound to the past growth path (no impact in 2020 and 2060), a lost decade scenario (with another 1% expenditures) and a permanent shock scenario which places us on a lasting lower growth path. But even in this more dramatic scenario, the impact on the cost of greying is reasonable. We should again use these figures carefully.

Table 6 The impact of the economic crisis on the sustainability of social protection

	Change 2007-2020 Difference from baseline				Change 2007-2060 Difference from baseline			
	Baseline (% of GDP)	Rebound - baseline	Lost decade - baseline	Permanent shock - baseline	Baseline (% of GDP)	Rebound - baseline	Lost decade - baseline	Permanent shock - baseline
BE	1,7	0,0	1,5	2,1	6,9	0,1	2,0	3,6
BG	-0,1	0,0	-0,6	-0,5	3,7	0,0	-1,2	-0,8
CZ	-0,7	0,0	0,4	0,5	5,5	0,0	0,6	0,9
DK	2,6	0,0	0,3	0,7	2,6	0,0	0,2	0,6
DE	0,0	0,0	0,1	0,3	4,8	0,0	0,2	0,3
EE	0,2	0,0	0,3	0,3	0,4	0,0	0,2	0,3
IE	1,4	0,0	1,4	1,5	8,9	0,0	2,2	2,2
EL	1,9	0,0	1,5	1,9	15,9	-0,1	1,3	3,9
ES	1,4	0,0	1,3	1,6	9,0	0,0	1,8	3,2
FR	0,9	0,0	1,4	1,9	2,7	0,0	1,2	2,4
IT	0,3	0,0	1,1	1,4	1,6	0,0	0,5	1,1
CY	1,3	0,0	1,9	2,3	10,8	0,0	1,1	2,0
LV	-0,7	0,0	1,0	1,1	0,4	0,0	0,7	1,0
LT	-0,7	0,0	0,4	0,4	5,4	0,0	0,5	0,6
LU	1,2	0,0	1,2	1,4	18,0	0,0	0,5	0,6
HU	-0,3	0,0	1,6	1,9	4,1	0,0	0,7	1,2
MT	2,3	0,0	1,0	1,2	10,2	0,0	0,8	1,8
NL	2,1	0,0	0,4	0,9	9,4	0,0	0,5	1,1
AT	0,3	0,0	0,8	1,3	3,1	0,0	0,8	2,4
PL	-2,7	0,0	1,0	1,1	-2,4	0,0	0,6	1,1
PT	0,8	0,0	1,0	1,4	3,4	0,0	1,2	2,3
RO	2,0	0,0	-0,2	-0,1	10,1	0,0	-0,3	-0,2
SI	1,9	0,0	-0,2	-0,2	12,8	0,0	-0,2	-0,3
SK	-0,7	0,0	0,5	0,6	5,2	0,0	0,6	0,7
FI	3,0	0,0	1,0	1,4	6,3	0,0	0,7	1,5
SE	-0,3	0,0	1,4	1,7	2,6	0,0	1,6	2,0
UK	0,8	0,0	0,5	0,6	5,1	0,0	0,8	0,9
NO	3,0	0,0	0,1	0,3	9,0	0,0	0,2	0,5
EU27	0,5	0,0	0,9	1,1	4,7	0,0	0,9	1,6
EA	0,7	0,0	0,9	1,2	5,2	0,0	0,9	1,8
EA12	0,7	0,0	0,9	1,3	5,2	0,0	0,9	1,8
EU15	0,7	0,0	0,9	1,2	4,8	0,0	0,9	1,6
EU10	-1,4	0,0	0,8	0,9	2,1	0,0	0,7	1,1
EU25	0,5	0,0	0,9	1,2	4,7	0,0	0,9	1,6

Source: European Commission, 2009, Ageing Report

7.5 How to restore budgetary equilibrium: tax coordination

Monti pleads for a minimum level of tax coordination to avoid the continued danger of a race to the bottom because of tax competition. There might be a desire

to maintain tax sovereignty, but what is the value of it if 'de facto evaporation' is occurring because of unrestrained tax competition? (Monti, 2009,p.10). 'Tax receipts curtailed by tax competition often do not allow the funding of social programmes'. (p. 9) and 'certain factors of production get a declining effective tax rate while those factors , like labour and lower skilled labour in particular, which economic policies would like to encourage, are penalised by a growing relative tax burden' (p. 11). He argues for increased tax coordination, and refers to the ECOFIN Council tax package of 1997 including the Savings Directive and a code of conduct on business taxation as evidence that it is possible to design such strategies within the EU. (p. 11).

The fight against undeclared work could also play a role in restoring public finances. As a matter of fact the G20 raised the issue of tax havens and brought upfront the issue of tax evasion. the April 2009 decision of the G20 to fight tax havens was indeed a step forward. Naming and shaming tax havens, could help to expose some of them. But this policy addresses tax evasion according to Monti, not 'legal tax avoidance which goes on massively, as most states engage in unlimited tax competition...So the Member States of the European Union themselves have to realise that from the angle of the other state,each of them is a paradise relative to the citizens of the others' (p. 11). Two years ago we organized a conference for EZA on the growing awareness for the need to fight tax evasion and tax avoidance. The momentum to close the gap between expenditures and receipts is now more urgent than ever before.

In his proposal to raise more government revenue during the coming decade, President Obama not only proposes new taxes, he also suggests, among other measures, to limit the tax reduction in the highest tax brackets to 28% for all kinds of deductions, and he also explicitly targets persistent tax avoidance and tax evasion strategies which had been set up in the past to alleviate tax payment of large and international active companies. The elimination of tax havens is also on his agenda. An example is the recent decision of the Swiss bank UBS to divulge details of 4,450 accounts to the US Internal Revenue Service as a first crack in the Swiss bank secrecy system.

7.6 How robust is social security?

In the eighties there was a fear that the welfare state could not be maintained following the economic crisis at that time. The question was whether institutions

which were designed and developed during the roaring fifties and the golden sixties would be able to survive the economic problems of the seventies and eighties. This fear is in the end surprising, but understandable. These questions were formulated at that time with the short-sightedness of that time: in a period of economic stagnation, and hoping at the same time that a crisis of the thirties would never come back. Now we know that the prosperity of the golden sixties was going to last for the 'trente glorieuse' and that we still are at a very high level of national income and wealth.

The systems of social security were designed for social risks of unemployment, sickness and old age. We also should know that the social protection is designed for coping with systemic crises such as cyclical downturns and we add to it the systemic risk of a greying population of a baby boom generation followed by a stabilising population or even decline². They are at least intended to insure us against those risks. We are convinced by their intelligent design.

The benefits of the social welfare state in absorbing the economic crisis and the need to reconfirm it, emerged as a major conclusion of a recent EU economic summit. (M.Monti, A. Atkinson). Prof. Atkinson additionally invites the European Commission to apply a stress test on social security systems. In a project for EZA, initialised more than a decade ago, we've been systematically monitoring the evolution and development of the welfare state within the context of the completion of the European internal market and the growing globalisation of the economy. This project seemed to reveal a great deal of robustness of these social security systems. The growing interest of the European Commission to assess adequacy and sustainability of social protection schemes is also in line with this need for stress testing.

Furthermore coordination is needed with respect to the financing of social security. When everyone agrees that fiscal dumping should be avoided with respect to the taxation of profits and capital income (among others), this should also be applied to an even more important factor, labour, since in this case tax competition is as undermining for social protection. There are limits to plea for the reduction of taxes or social contributions on labour since in the end it will erode

² Although we should know that this is not always the reality. In the beginning of the nineties, the demographic forecast for Belgium shows a demographic decline by 2040 of 8.5 million; at the beginning of 2000 the new forecasts showed a stagnation population around 10 million, at the end of 2000 (2007), the new demographic forecast shows an increasing population of 12 million by 2040.

receipts, and in the end it is a premium for own insurance. Otherwise, it will re-emerge as a premium for private health insurance and private pensions.

8. The pay-as-you go and funded pensions: the crisis hits both

In many countries a three pillar system is in place in a variety of mixes: the statutory pensions, mostly on a pay-as-you-go basis (PAYG), is the first pillar; the second pillar consists of occupational pensions, i.e. pension funds or group insurances, and finally there is the third pillar consisting of individual retirement saving, varying from individual retirement accounts and individual life insurance, to all other long-term or life-cycle savings. Even reversed mortgages can be included in the third pillar. Housing wealth may be considered as a fourth pillar and finally also income provided by continued working after retirement can be viewed as an additional pillar.

Financing	Total wealth		Public support
Savings	Housing Personal saving IRA Pension savings Life insurance	Third pillar	Public expenditures Fiscal expenditures
Premiums	Occupational wealth Pension funds Group insurance	Second pillar	Fiscal expenditures
Social contributions and taxes	Social Security Wealth public pension Health insurance	First Pillar	Government expenditures
Private expenditures Taxes	Human capital education health		Government expenditures

Source: See also J. Pacolet, R. Bouten

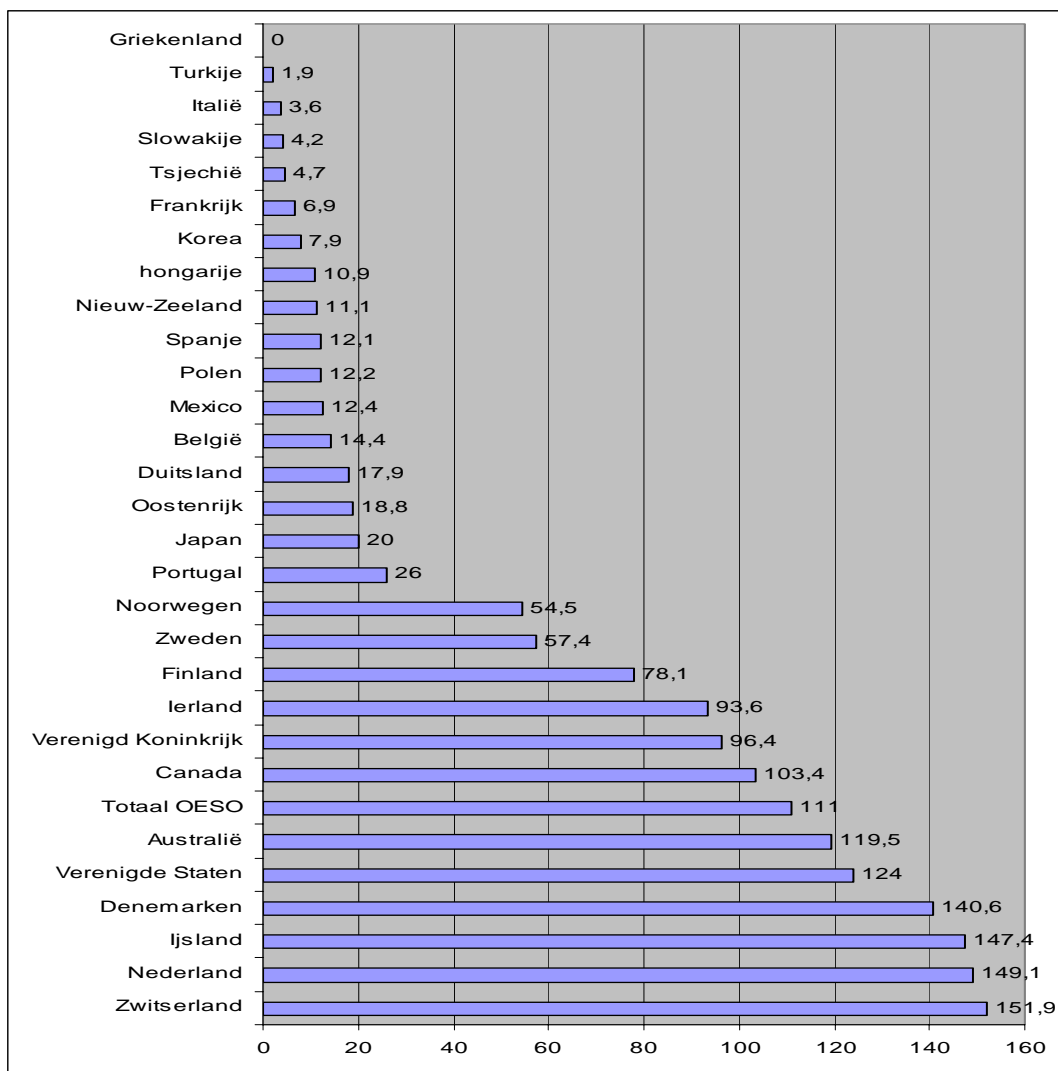
Figure .5 A three-pillar system of social protection and saving for old age

8.1 The relative importance of first second and third pillar

Tabel .7 Public and private pension spending in the OECD-countires, 2006, in % GDP

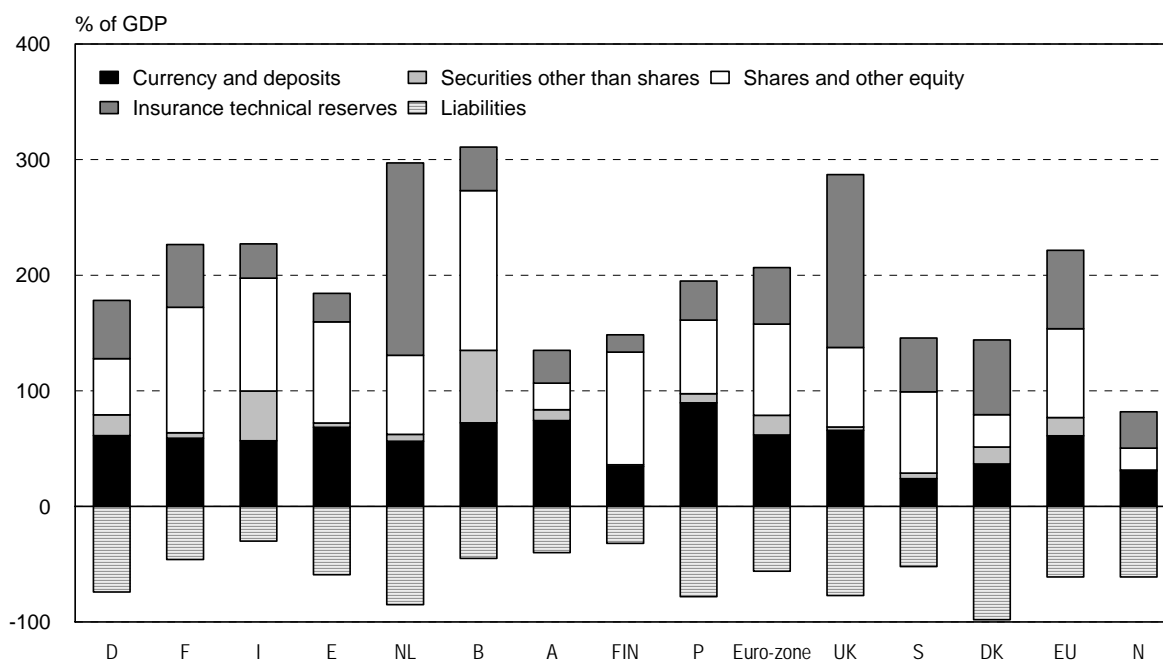
	Public	Private	Privaat/Totaal
Italië	12	0,3	2%
Oostenrijk	12,1	0,2	2%
Zwitserland	6,7	5,5	45%
Duitsland	11,7	0,1	1%
Verenigd Koninkrijk	7,5	3,1	29%
Polen	10,4	0	0%
Finland	1,1	9,2	89%
België	8,1	1,3	14%
Nederland	5,4	3,6	40%
Denemarken	4,8	4,2	47%
Zweden	7,7	1,1	13%
Portugal	7,5	1	12%
Spanje	7,8	0,6	7%
Hongarije	8,1	0,1	1%
Tsjechië	7,2	0,3	4%
Australië	3,6	3,7	51%
Noorwegen	4,4	1,4	24%
Canada	3,6	2,1	37%
Nieuw-Zeeland	3,7	1,5	29%
Luxemburg	4	0,1	2%
IJsland	0,4	3,6	90%
Zuid-Korea	1,3	0,9	41%
Mexico	0,7	0,2	22%

Bron: OECD Private Pensions Outlook, 2009



Bron: OECD Private Pensions Outlook, 2009

Figuur .6 Size of private pension funds in the OECD countries, 2007, in % BBP



Source: Massaro R. & Lääkäri E., 2002

Figure .2 Household financial assets and liabilities in 2000

Table .1 Share of financial and housing wealth, debt and net wealth, as share of GDP and GDI

Wealth	Financial		Housing		Debt		Net wealth	
	1995	2000	1995	2000	1995	2000	1995	2000
%GDP								
Belgium	270	317	192	176	39	43	480	450
% gross disposable income								
Belgium	422	494	299	275	60	67	749	702
Netherlands	442	583		207	114	117		679
UK	389	456	218	292	107	116	500,2	631,3
USA	334	405	137,6	155,1	80,2	89,8	391,8	470,5

Source: A. Babeau, T. Sbrano, 2003

8.2 The income of the pensioners after the crisis with funded pensions

Table .2 Influence of the financial crisis of the pension wealth (private and public) of the population, according to age

	Young,, active	Persons reaching pension age	Retired persons
Strongly hit		Persons mature DC pension systems has to convert their pension capital in annuities	DC for pensioners where capital was not converted in annuities
Moderately hit		Persons in mature DB systems, public PAYG systems with deficits	Pensioners with adaptable pensions
Hit to a lesser degree	Most	Persons in just started DC	Pensioners with DC converted in annuities just before the crisis, DB and PAYG

Source: Pensions at a Glance, 2009, p. 26.

8.3 The consequences for the pensions funds

The stock market crash had an immediate effect on the value of pension assets. In a recent IMF study the decline during the first ten months of 2008 was found to be some 25 to 30% in real terms. Fortunately those reserves need not be used immediately, since most pension obligations lie in the future. But it was not only the decline in the value of assets which hit funded pensions. Also, the decline in interest rates that occurred increased the present value of future liabilities, which needed to be rebalanced. Declining returns need to be rebalanced in defined benefit (DB) private pensions by additional payments of the promoter. They put a further stress on the rest of the economy. For defined contribution (DC) and all other pension savings the financial crisis implied a wealth loss for the active population, and a decline in annuities for pensioners. Pension schemes which are not of the defined benefit, and less and less pension funds are of this type, put more risk on the shoulders of the worker himself.

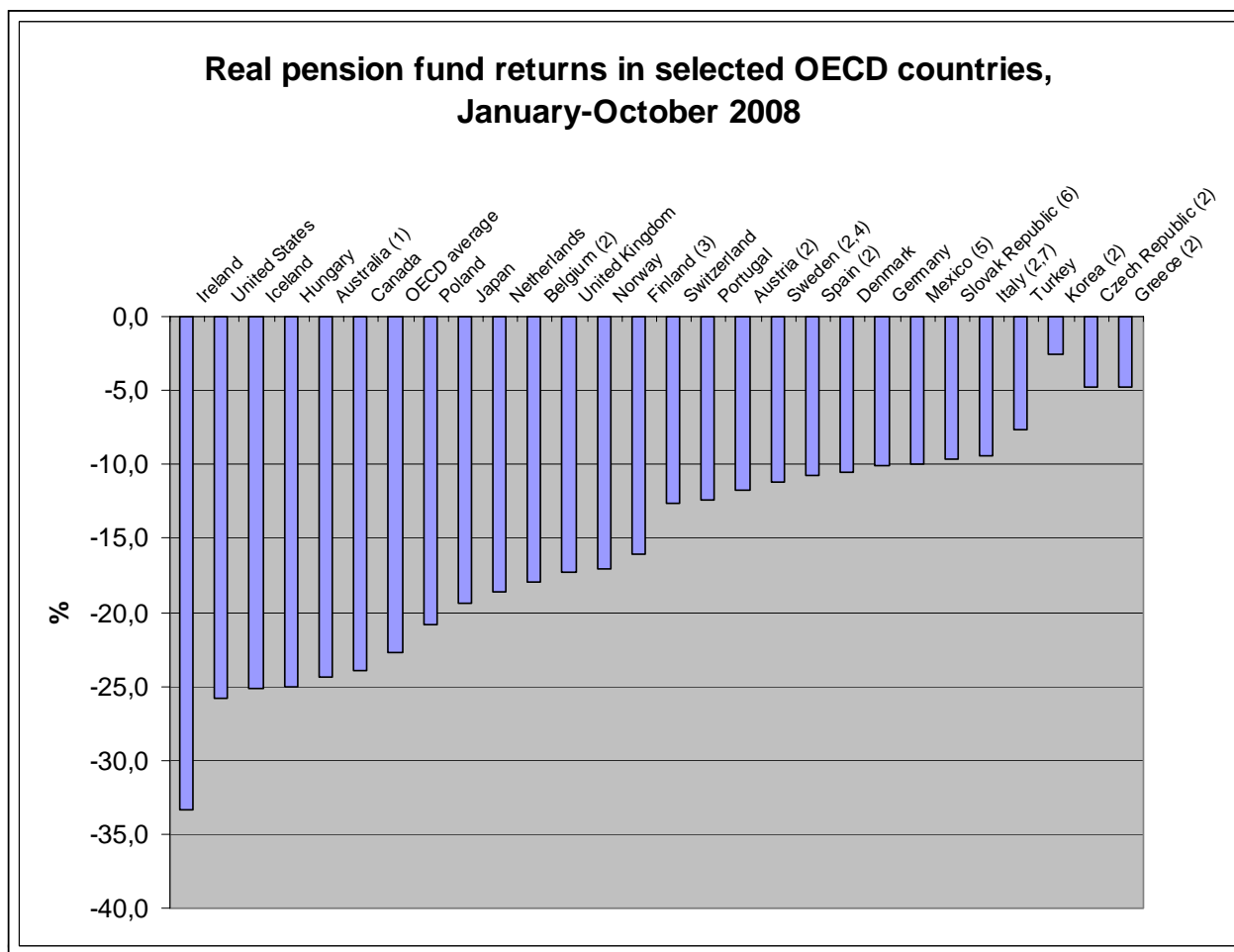


Figure .5 Pension Fund returns in selected OECD countries January – October 2008

8.4 The consequences for the state

The state is responsible for the regulation and control of the pension system. In the past and up until now there were some negative experiences (for instance the miss selling of pension funds in the UK, the pension fund problem of Maxwell also in the UK), but most of the time they are improving there financial oversight and control of the sector. A major aspect of their control is maintaining the balance between liabilities and assets. In periods of crisis, or under influence of the controlledsector itself, authorities can relief or postpone some of those requirements since otherwise they could become even countercyclical. But they cannot compensate the hardship of the financial crises. Some pensions funds were hit again by the present crisis at the moment they were not even completely recovered from the crisis of 2000-2003. Parts of the industries are not yet adequately regulated, especially taking into consideration the distress of the

financial system following the present crisis. Pension funds can go bankrupt. In some countries pension fund guarantee schemes have been created (USA, UK), and for instance in the USA this pension fund guarantee scheme had to intervene during the latest episode for 0.4% of GDP. But our major concern is whether funded pensions are able to guarantee better pensions in the future than PAYG systems, and at what price?

Today the state is confronted with a substantial cost of bailing out the financial sector while it should have been on the road to reduce the deficit and to prepare for the greying of the population. It is an unpleasant track record for the financial sector which pretends to solve the ageing crisis.

There is a growing uncertainty that the funded pension sector is capable for guaranteeing an adequate pension. The market returns that are used to demonstrate this are proven to be overestimated, but even then those market returns are not equivalent to the pay-out for the pensioner, and go together with a substantial risk for the pensioner. This risk increases when pension systems become more and more DC instead of DB. The potential 'melt down' of the financial sector at the moment the present babyboom generation is retiring, can still happens to us. The financial sector is demanding a safety net for funded pensions, like the one which exists in many cases for savings deposits. This makes sense if they are willing to pay the premium for it, but presumably the premium will be below the cost (which is the case for the moment in the USA) so the state will still remain the one that will have to bail out the funded pensions if they would come at distress. In the end, the financial sector is already asking the state today to provide the debt instrument which will guarantee the repayment of pensions in a far future. There should indeed be a market for annuities that are invested in a bond market with real returns. However, only the state can provide such a guarantee. But does this not put us back in a system of PAYG pensions?

8.5 Policy conclusions implications for the future

PAYG pensions are an implicit contract between the active and inactive generations, whereby the benefits of an economy (but also the decline) are spread over multiple generations.

The introduction of the PAYG system implied in many cases a gift to the first generation who did not contribute over their active years. This generation lived

during the first world war, the interbellum period and the second world war and endured the consequences of the great depression. 'Virtually all observers agree that the decision to provide full benefits to early cohorts was a wise one' (A. Munnell, 2009,p.3). It comes, however, at a cost for the following generations. Munnell adds an interesting additional point that is of relevance also today: 'the recession of 1937 followed rapidly after the introduction of the Social Security system, making the accumulation of a substantial surplus undesirable on fiscal grounds' (ibidem, p. 3). This also applies today. Many countries considering the shift to funded pensions (the OECD reports in its latest 'Pension at A Glance' that this is however not the case), today and in the coming years, will have to counterbalance this with expansionary policies to stimulate consumption instead of saving. They will have to choose between reducing the public debt (rebalancing it after present efforts) and creating pension funds. Doing both will be twice as difficult. In many countries the funded pensions can be described as too little. Some argue (Börsch Supan for instance) that this should be balanced the sooner the better: we had a window of opportunity for doing this before the baby boomers reach pensionable age. In view of the present financial crisis (that, by the way, puts the already existing system under pressure), there is perhaps no room of manoeuvre to create a funded pension. It is too little but perhaps also too late. However, we doubt that funding is needed.

You can organise a pension system in a PAYG way or a funded way. Some argue for a balanced system. Others say that if funded pensions would provide better returns, you should completely shift to a funded pension. But this will lead to a substantial cost of transition, and in neither system provides a free lunch. Funded pensions come at a cost of contributions and at a risk cost: the risk of inflation, of investment, of longevity. It can be covered by the pensioner, the employer, the financial intermediary or the state. The cost in both systems is directly related to the effective and legal retirement age. The balance can be maintained by reducing benefits (various parameters can be used), shifting pension age and/or increasing contributions.

9. Conclusion

The ambition of this paper is of course not exhaustiveness. Some important policy strands and policy options are completely left out of the picture. For example, the global dimension of the crisis and the danger of worldwide protectionism that could lead to a new round of economic downturn is omitted. The growing interest

in sustainable growth in terms of energy and environment saving is omitted. Policies on poverty, and on migration are also not discussed. But even those policy strands included are partial and the selection is biased. But what comes out from even this partial picture, are the links with some of those other parts, and possible also the contradictions.

The social market economy is rediscovered. Some years ago we prepared a position paper on the sound principle that lay behind the social market economy, namely the mix of stimulating the market economy on the one hand (among other by stimulating private initiative and prevailing competition) and mechanisms of social corrections and redistribution on the other hand.

10. Bibliography

- Aiginger, K. (2009). *“Finanzkrise: Anlass, Ursachen, Strategien, inklusive Blick nach vornen”*, Wien, Österreich: Österreichisches Institut für Wirtschaftsforschung (WIFO), 23°p.
- Auerbach, A. J. & Gale, W. G. (2009). *“The Economic crisis and the Fiscal Crisis: 2009 and Beyond. An Update”*, 26°p.
- Babeau, A. & Sbrana, T. (2003). *“Household Wealth in National Accounts of Europe, the United States and Japan”*, OECD Statistics Working Papers, OECD Publishing, 39°p.
- Baily, M. N. & Elliot, D. J. (2009). *“The US Financial and Economic Crisis: where does it stand and where do we go from here?”*, United States, 26°p.
- Buiter, W. *“Useless finance, harmful finance and useful finance”*
- Buiter, W. H. (2009). *“Lessons from the global credit crisis for social democrats”*, European Institute, London School of Economics and Political Science”, CEPR and NBER, 35°p.
- Carone, G., Koopman, G. J., & Pichelmann, K. (2009). *“Labour market prospects and policies to soften the impact of the financial crisis”*, ECFIN Economic Brief, Brussels: European Commission - Directorate-General for Economic and Financial Affairs, 7°p.

- Commission of the European Communities (8 A.D.). *"Communication from the commission to the European Council. A European Economic Recovery plan"*, Brussels: Commission of the European Communities, 19°p.
- Commission of the European Communities (2009). *"Communication for the spring European Council, Driving European recovery"*, Brussels: Commission of the European Council, 19°p.
- Commission of the European Communities (2009). *"Communication from the Commission. European financial supervision"*, Brussels: Commission of the European Communities, 17°p.
- Committee of European Insurance and occupational Pensions Supervisors (2009). *"Guidelines on preparation for and management of a financial crisis"*, Frankfurt, Germany: CEIOPS, 27°p.
- De Grauwe, P. (2009). *"The politics of the Maastricht convergence criteria"*
- Eichengreen, B. & O'Rourke, K. H. (2009). *"A Tale of Two Depressions"*
- European Commission, D. g. e. a. f. a. (2009). *"Public Finances in EMU 2009"*, Brussels: European Commission.
- European Commission, D. g. e. a. f. a. (2009). *"Economic forecast"*, Brussels: European Commission, 121°p.
- European Commission, D. g. e. a. f. a. (2009). *"European Economy Research Letter", Time is essence*, European Commission, 16°p.
- European Commission : Directorate-General for Economic and Financial Affairs (2009). *"Beyond the crisis: a changing economic landscape"*, Keynote speeches at the Brussels Economic Forum 2009, Brussel: European Commission, 24°p.
- European Trade Union Confederation (ETUC) (2009). *"The Paris Declaration of the ETUC"*, ETUC, 3°p.
- Europees Parlement, D.-G. S. (2029). *"Europeanen en de economische crisis. Analytische samenvatting"*, Directoraat-generaal communicatie. Afdeling analyse van de publieke opinie, 25°p.

- Gadrey, J. (2009). *"Que penser et que faire des travaux de la "commission Stiglitz" lorsqu'on appartient à la "société civile organisée" ? Comment les syndicats peuvent-ils s'en emparer?"*, Bruxelles: ETUI.
- Holthuis, E. (2009). *"European Responses to the Crisis and Alternatives to GDP as an Element of a Paradigm Shift"*, TURI Seminar European Commission, DG Employment, Social Affairs and Equal Opportunities.
- Koopman, G. J. & Székely, I. P. (2009). *"The financial crisis and potential growth: policy challenges for Europe"*, ECFIN Economic Brief, European Commission - Directorate-General for Economic and Financial Affairs, 10°p.
- Kropp, M. (2009). *"Background paper for the second session of the TURI seminar. "European responses to the crisis and alternatives to GDP as an element of a paradigm shift"*, Overview of Alternative Indicators measuring societal progress. Brussels: ITUH, 11°p.
- Méda, D. *"What measures the GDP? Why is it necessary to implement new indicators of wealth and progress?"*
- Philippon, T. (2008). *"The evolution of the US Financial Industry from 1860 to 2007: Theory and Evidence"*, New York, USA: Stern School of Business.
- Prasad, E. & Sorkin, I. (2009). *"Assessing the G-20 Economic Stimulus Plans: A Deeper Look"*, Washington: Brookings, 20°p.
- Roeger, W. & in't Veld, J. (2009). *"Fiscal policy with credit constrained households"*, Economic Papers 2009, 22°p.
- Saha, D. & Von Weizsäcker, J. (2009). *"Estimating the size of the European stimulus packages for 2009: an update"*, Bruegel.
- Sinn, H. W. (2007). *"The Welfare State and the Forces of Globalization"*, Working Paper 12946 Cambridge: National Bureau of Economic Research.
- Snower, D. J., Brown, J. G., & Merkel, C. (2009). *"Globalization and the Welfare State: a review of Hans-Werner Sinn's. Can Germany be saved?"*, pp. 136-158.
- Tangian, A. *"The strategy of trade unions after the crisis"*, Düsseldorf: Hans Böckler Foundation.

Watt, A. (2008). *"The economic and financial crisis in Europe: addressing the causes and the repercussions"*, ETUI-REHS, 23°p.

Watt, A. (2009). *"A quantum of solace? An assessment of fiscal stimulus packages by EU Member States in response to the economic crisis"*, Working paper 2009.05. Brussel: ETUI, 40°p.

Watt, A. (2009). *"Fiscal stimulus packages in Europe in response to the crisis - a quantum of solace?"*, 'Presentation to TURI Seminar 'European Responses to the Crisis and Alternatives to GDP as an Element of a Paradigm Shift' Brussels: European Trade Union Institute.