Eurofound

FOUNDATION FORUM 2009

Global recession – Europe's way out

4th Foundation Forum, Dublin Castle, Ireland, 5-6 November 2009

Background paper

Introduction

The 2009 Foundation Forum, *Global recession: Europe's Way Out,* will discuss and attempt to develop policy perspectives on how to emerge from the current recession while maintaining living and working conditions in Europe. This background paper provides some explanation of how the economy entered recession, as well as giving a relatively up-to-date account of its impact on the labour market. There are distinct signs of economic recovery; however, the strength and sustainability of this are questionable and most observers believe that the labour market will continue to deteriorate for some time to come. While the recession has affected all Member States, it is quite striking that some labour markets have been exceptionally hard hit whereas others remain so far relatively unscathed. The data provided here on the different impact on labour markets in Member States may be the point of departure for further discussion in Dublin. The paper outlines the main features of some policy responses at both Member State and EU level. It should be emphasised that there may be less of a conflict of interest between long- and short-term policy goals than is often thought to be the case.[1]

1 Much of this background paper is based on the ERM Annual Report 2009, 'Restructuring in Recession', published in November 2009. The ERM Report provides much more detail on several of the topics taken up here and includes a full set of references.

Background to the recession

The first signs that the extraordinary long period of global growth that started in the mid-1990s was coming to an end appeared in mid-2007. It was not, however, until the summer of 2008 that it became clear that the downturn would not be slow and temporary. Indeed, the subsequent collapse of many large financial institutions and potential collapse of many others, together with the swift fall in GDP and exceedingly rapid decline in world trade, indicated that something quite exceptional was happening.

There is no lack of explanations for the current recession, but rather a multitude of competing or complementary factors still not fully understood, and analysis of these remarkable times will surely engage economists for decades. The truly distinguishing characteristic of this recession is a globally synchronised banking crisis, which sparked off a remarkably severe global recession. It is highly likely that the preceding, equally remarkable boom, together with significant shifts in the balance of global trade and capital flows that gained speed in these years, constitutes the macroeconomic background to the subsequent bust. That period was characterised by a prolonged period of strong non-inflationary growth, which began in the early 1990s. Global imbalances, expressed as massive current account deficits in some countries (especially the US) and correspondingly high surpluses in others (particularly China, but also the oil-exporting countries), became an increasingly distinguishing feature of the extended global boom. It is also fair to assume that the path to global stability lies in resolving the contradictions of the emerging new global economic and financial order.

The truly distinguishing characteristic of this recession is a globally synchronised banking crisis, which sparked off a remarkably severe global recession.

Simply expressed, the big exporting counties lent the credit to finance the purchase of their exports by other countries. The influx of credit into the borrowing countries drove down interest rates there. Monetary policy, not least in the US, pushed real interest rates further down into negative territory and fuelled both a remarkable increase in asset prices (most notably property) and unprecedented levels of private and corporate debt, in both the US and some European countries. The availability of cheap money led to a host of financial institutions borrowing at low short-term interest rates to lend over a longer period at higher rates. This risky strategy of borrowing short to lend long became astoundingly profitable: for example, in 2006, profits in the financial sector constituted 23% percent of all profits in the UK. While this risky behaviour can be attributed to irrational

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exuberance or moral frailty, it is more useful to see it in the light of faulty financial instruments, bad incentive structures and regulatory failure.

Role of financial products

In recent decades, commercial banks increasingly adopted the strategy of pooling mortgages into financial products, which were then sold on to other financial actors (often investment banks). With the sale of the mortgage obligations for cash, the commercial banks could then continue to issue more mortgages. Not only were investment banks involved in this trade but also hedge and pension funds. Moreover, not only property mortgages but other forms of debt – such as equipment loans, commercial mortgages, and credit card debt – became securitised in a similar fashion. On top of this, other financial markets developed that were thought to function as insurance. The complexity of these instruments and the involvement of actors not subject to the relatively strict regulation of retail banks made the overall understanding of the real risks practically impossible. One obvious problem was that the loan originators (the retail banks) retained no risk on the loans they had made and there was no direct link between the original borrowers (for example, homeowners in the UK) and the final holder of the mortgage (for example, a hedge fund in Germany). Another problem was the feasibility of insurance in highly integrated global financial markets. A basic principle of insurance is independent risks, but if all insurance takers claim at the same time (i.e. their risks turn out to be correlated) any insurance system will collapse.

The complexity of new financial instruments and the involvement of actors not subject to regulation made the overall understanding of the real risks practically impossible.

The most obvious weakness in the incentive structure was the premium paid to individuals based on the short-term performance of the financial company as approved by the boards of the companies without interference by the regulatory authorities. Moreover, the market 'self regulator', i.e. the credit rating agencies, was often paid by the very financial companies they assessed. As the financial bubble inflated, these rewards were enormous and contributed to the individual's disregard of any potential penalty, such as dismissal, when the bubble would finally burst. The level of leverage grew to historically unprecedented levels, with some commercial banks even lending up to 30 to 40 times their capital. Often, though, their structural investment vehicles were formally placed in unregulated offshore locations. All of these issues are related to failures of corporate governance.

As the level of leverage grew to historically unprecedented levels, some commercial banks were lending up to 30 to 40 times their capital.

Property market crash

The immediate reason behind the financial crash was the collapse of the housing boom in the US, where house prices had on average increased by 50% between 2000 and 2005, the largest boom in US history. It began to falter by mid-2006, when financial turmoil was then triggered by the rise in defaults by subprime mortgage borrowers, followed by the implosion of the market for securitised assets backed by such loans. The highly leveraged and interrelated house of financial cards then came falling down. In the autumn of 2008, several US banks, and some European banks failed or would have failed had they not been supported by the monetary authorities. The dramatic collapse of the big US investment bank Lehman Brothers sparked panic in the world's financial system. The effect of this financial turmoil on the already wavering real economy was severe and GDP declined rapidly throughout the world.

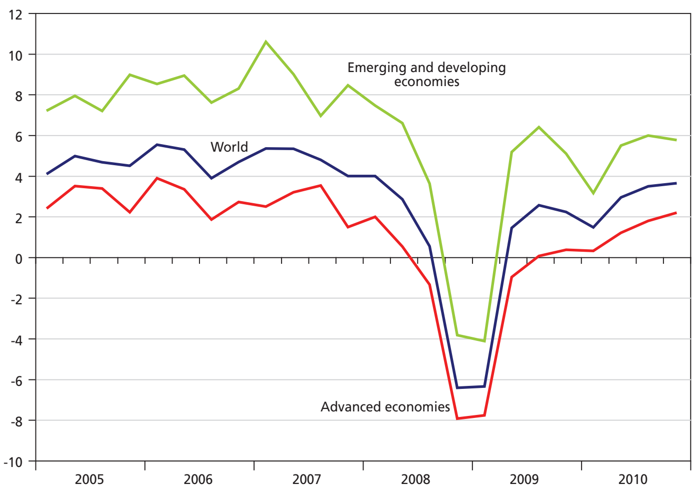
Between 2000 and 2005, house prices in the US had on average increased by 50%.

Economic prospects

Whatever developments in the world economy can realistically be expected up to the end of 2009, there is no doubt that the world economy has already experienced one of the most serious recessions in modern times. The global scope of the recession is totally unprecedented. With the entry of India, China and the countries from the former Soviet Union (since the early 1990s) into the global trading and production system, the first truly global recession is now being witnessed. Up to 2008, the world had experienced a remarkably long and strong period of economic growth, at which point it began to dip downwards and finally, towards the end of 2008, plummeted at an alarming rate (see Figure 1). The development of the recession in the European Union does not differ much from other advanced economies. In the 10 years up to 2008, real annual GDP growth in the EU averaged a very respectable 2.5%. In 2008, it fell sharply to -0.9% and the forecast of the European Commission (at the time of writing) for 2009 is an unprecedented -4.0%.

We are witnessing the first truly global recession. Its development in the European Union does not differ much from other advanced economies.

Figure 1: Global GDP growth (%)



During the summer of 2009, there were some signs that the freefall of most economic indicators had ceased and that some, such as business confidence, had turned upward. Similarly, real output data from some countries pointed to recovery. Growth in China, India and other Asian economies has been most positive, but even in France and Germany it appeared that the worst could be

The view that recovery will be slow is shared by the European Commission, the ILO, the European Central Bank and the OECD.

over. Of great symbolic importance was the statement by Jean-Claude Trichet, President of the European Central Bank (ECB), on 3 September 2009 that 'the latest information supports our view that there are increasing signs of stabilisation in economic activity in the euro area and elsewhere. This is consistent with the expectation that the significant contraction in economic activity has come to an end and is now followed by a period of stabilisation and very gradual recovery'. Similarly, the September Interim Economic Assessment from the Organisation for Economic Co-operation and Development (OECD) also revised its growth estimates for the G7 economies for 2009 upwards. However, both the ECB and the OECD expressed much caution concerning the strength of the recovery, with the OECD stating that 'the pace of the recovery is likely to be modest for some time to come'. The view that recovery will be slow is also shared by the European Commission and the International Monetary Fund (IMF).

The crash in financial markets wiped out much of the value of assets often bought on borrowed money, which must be repaid.

There are many reasons why a sluggish recovery could be expected and the possibility that the economy may dip downwards again should not be ruled out. Previous experiences indicate that recovery from a recession caused by acute financial crisis is slower than otherwise, since it takes time for financial markets and business confidence to recover. This is particularly likely to be the case in those countries where the full extent of credit default has yet to be revealed and the value of the banks' financial assets is still very uncertain. For example, the IMF estimated in its October 2009 *Global Financial Stability Report* that euro-zone banks are set to incur a total of US$814 billion in write-downs by the end of 2010. Moreover, the costs of rescuing the banks and the financing of the fiscal stimulus have greatly increased the public debt in many countries and money for new private investment is scarce. Perhaps the most worrying aspect of this recession is the massive amount of debt still outstanding. It is obvious that the crash in the financial markets wiped out much of the value of the assets held not only by banks, but also by consumers and companies. Moreover, much of this asset value was bought on borrowed money. At least a significant proportion of this debt must be repaid – which may lead to lower investment by firms and spending by consumers. Such a 'balance-sheet recession' plagued Japan for much of the 1990s.

The one indicator that has yet to turn upwards is the level of consumer confidence.

In terms of the speed of the current recovery and its sustainability, it is highly significant that the one indicator that has yet to turn upwards is the level of consumer confidence, which remains very low. The steep decline in household wealth, including not only housing but also financial assets, such as shares and expected pension incomes, together with high levels of debt, has severely dented consumer confidence. This, together with the decline in earnings as jobs were lost or working time reduced, has significantly reduced the propensity to spend. Recovery in European labour markets is not only a matter of policy concern for the welfare of those directly affected: it is vital for the generation of profits for businesses and for the economy as a whole.

Consequences for the labour market

With an increase in unemployment of over five million people, the effect of the recession on the labour market is already considerable. However, it is highly likely that the full force of the recession has yet to impact fully on the labour market. Experience from previous recessions on the lag between decline in GDP and employment suggest that bad news is to be expected in European labour markets for some time to come. Even if a lot depends on policies implemented and the sustainability of current tendencies towards recovery, many observers believe that the labour market may continue to deteriorate until the middle of 2010.

Since May 2009 the unemployment rate in the European Union is higher for men than for women.

To some extent, the experiences of this recession so far show that the cyclical pattern of restructuring is, in qualitative terms, not much different from the structural trends: it only speeds up and accentuates these longer-term trends. For example, job loss is concentrated most among young, male, manual workers in manufacturing. Indeed, the labour market consequences of the rapid recent contraction of European manufacturing were notable for two very symbolic statistical firsts. In the first six months of 2009, China (not the US or Germany) became the world's largest exporter of goods and, since May 2009, the unemployment rate in the European Union is higher for men than for women.

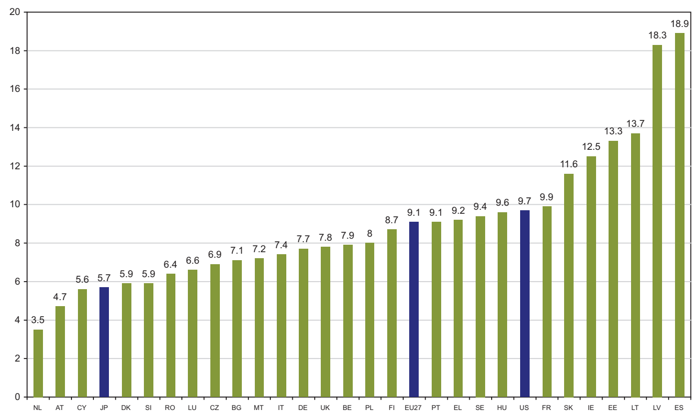
The rest of this section presents the most recent European-wide data available on the consequences of the recession on the labour market. It may provide a basis for further discussion at the Forum. Due to the on-going revision in sector codes (NACE), there is only limited information available on the distribution of employment by economic sector.

Unemployment

In August 2009, unemployment in Europe stood at 9.1% (European Labour Force Survey – ELFS), corresponding to 22 million men and women – five million more than a year earlier. There is much variation among Member States: the lowest unemployment rates were recorded in the Netherlands (3.5%) and Austria (4.7%), and the highest rates in Spain (18.9%) and Latvia (18.3%).

Unemployment has hit young people, and particularly men, disproportionately hard.

Figure 2: Unemployment rates in EU 27 Member States, Norway, United States and Japan, August 2009



Source: Eurostat. Data for JP from July 2009. Data for EE, EL, IT, LT, RO, UK from June 2009.

There is quite a clear pattern in terms of age and sex in most Member States. In most countries, unemployment has hit young people, and particularly men, disproportionately hard. Figure 3 depicts the unemployment rates for women and men in various age groups and shows which groups are most affected in each Member State.

Figure 3: Change in unemployment rates by age and sex in 25 Member States between first quarter 2008 and first quarter 2009

Source: ELFS

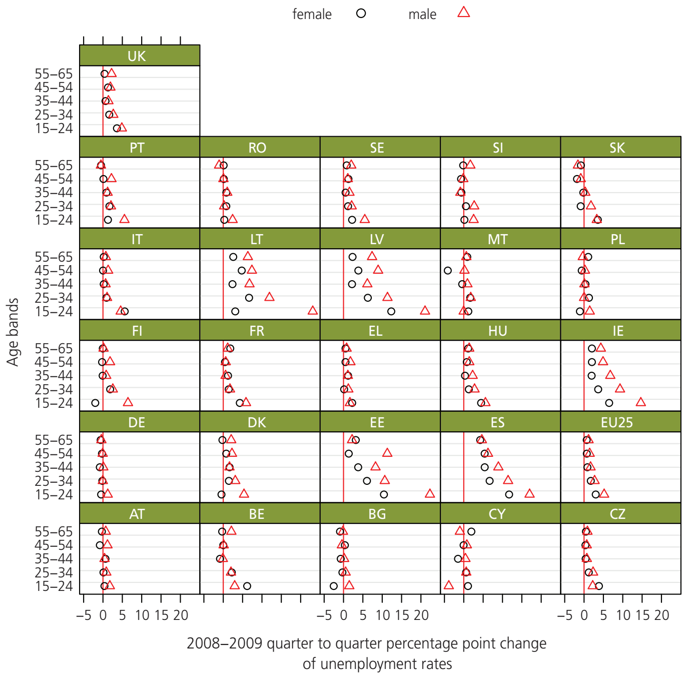
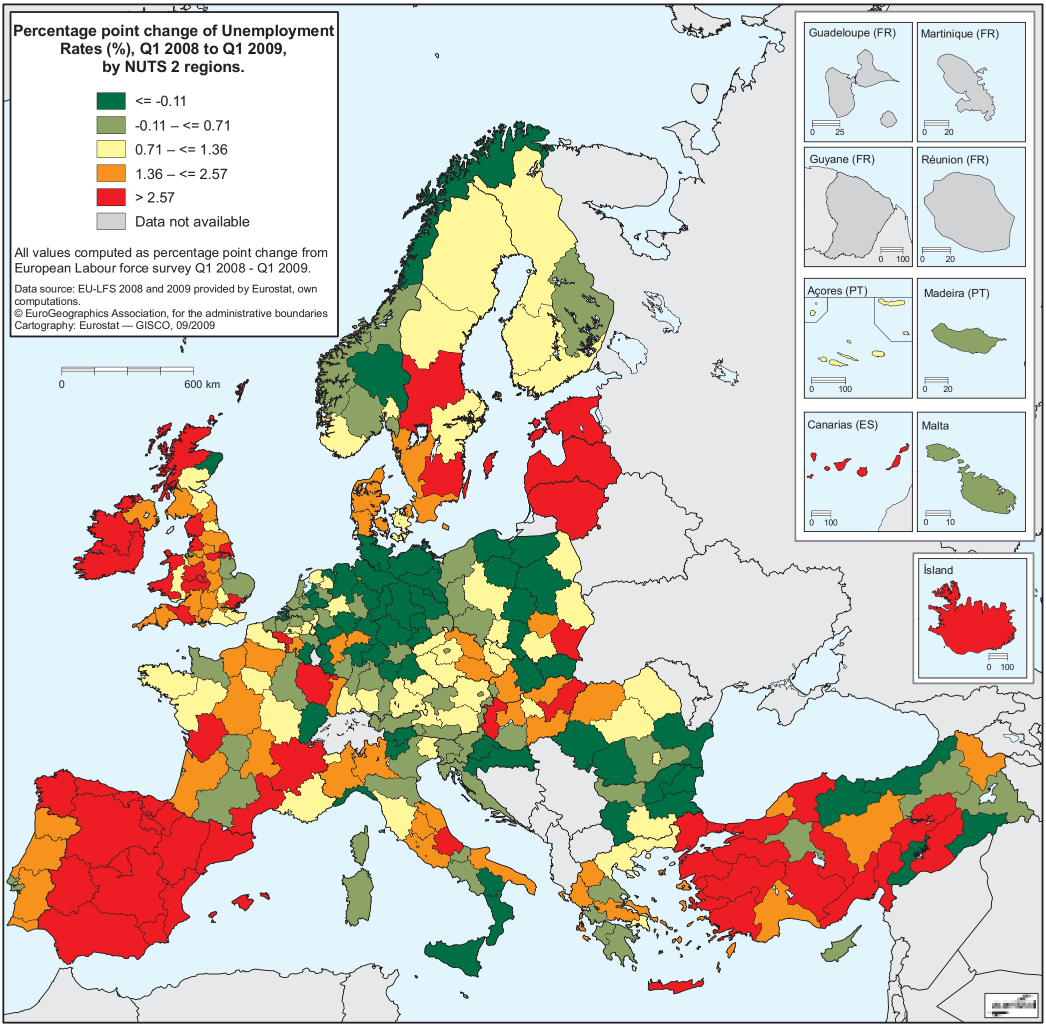


Figure 4: Change in unemployment rate between first quarter 2008 and first quarter 2009 by (NUTS2) region



Source: ELFS

Compared with a year ago, all Member States recorded an increase in their unemployment rate. The smallest increases were observed in Belgium (7.5% to 7.9%) and Germany (7.2% to 7.7%). The highest increases were registered in Latvia (7.4% to 18.3%) and Estonia (4.1% to 13.3%) between the second quarters of 2008 and 2009. The map above shows the EU-wide spread of the increase in unemployment by region.

Employment

In the second quarter of 2009, employment fell by 1.9% in the EU27 compared to the same quarter 2008. Compared to the previous quarter, employment fell by 0.6% (see Table 1).

Table 1: Employment growth rates in the European Union

Percentage change	2008Q3	2008Q4	2009Q1	2009Q2
Compared to previous quarter	-0.2	-0.3	-0.8	-0.6
Compared to same quarter previous year	0.7	0.2	-1.2	-1.9

Source: Eurostat, national account estimates

All broad sectors of the economy recorded a decrease in employment, except for other services (which mainly includes public administration, health and education), which grew by 0.4% in the EU27 between quarters one and two in 2009. The decreases were recorded in manufacturing (-1.7%), construction (-1.7%), financial services and business activities (-0.9%), agriculture (-0.4%) and trade, transport and communication services (-0.7%).

Somewhat more detailed information at sector level is available from the ELFS, but only up to the first quarter of 2009, and this is presented in Table 2. Net employment levels in the EU27 declined by 2.5 million between the first quarter of 2008 and the first quarter of 2009, a decrease of just over 1%. Most of the net decline in employment – in both absolute and relative terms – was in manufacturing and construction. However, employment has even fallen in some service sectors such as accommodation and food services and wholesale and retail. Employment is still growing in professional, scientific and technical activities, and sectors that are predominantly public, such as health and education.

Most of the net decline in EU employment of 2.5 million between the first quarter of 2008 and the first quarter of 2009 was in manufacturing and construction.

Table 2: Absolute and relative employment change in 24 Member States between first quarter 2008 and second quarter 2009 by sector (NACE 2.0 classification), preliminary figures

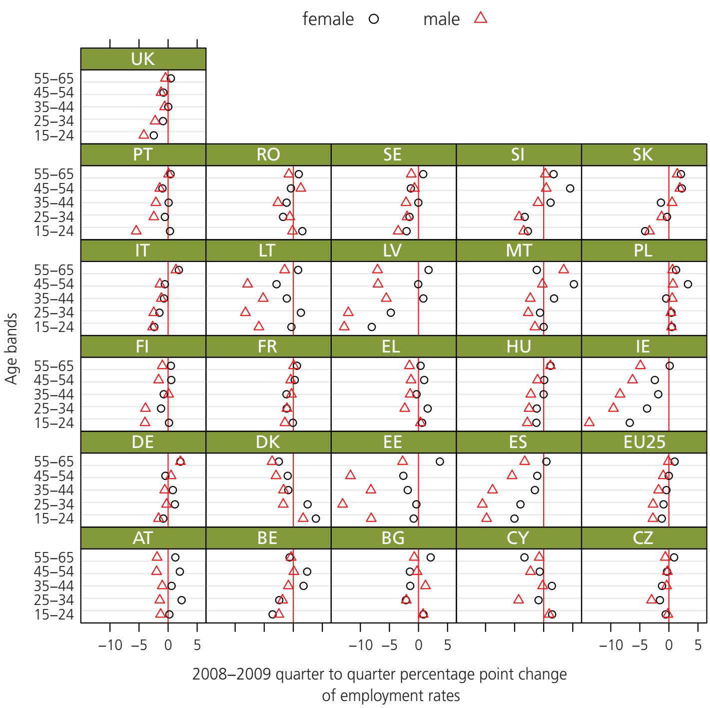
Economic Sector	Absolute change (thousands)	Relative change (%)
Agriculture, forestry and fishing	-314	-3.0
Mining and quarrying	-30	-3.6
Manufacturing	-1,794	-5.3
Electricity, gas, steam and air-conditioning supply	110	8.3
Water supply; sewerage, waste management and remediation activities	10	0.7
Construction	-839	-5.2
Wholesale and retail trade; repair of motor vehicles and motorcycles	-395	-1.4
Transportation and storage	-95	-1.0
Accommodation and food service activities	-127	-1.6
Information and communication	-97	-1.8
Financial and insurance activities	39	0.7
Real estate activities	54	4.2
Professional, scientific and technical activities	227	2.5
Administrative and support service activities	297	4.3
Public administration and defence; compulsory social security	54	0.4
Education	245	1.8
Human health and social work activities	585	3.3
Arts, entertainment and recreation	13	0.4
Other service activities	-93	-2.0
Total	-1,937	-1.0

Source: ELFS

Note: The figures are preliminary; some very small sectors have been excluded and the data does not include France, Ireland and Luxembourg. Data cover all persons in employment aged 15 years and over.

Figure 5 charts the percentage point change in employment rates up to the first quarter 2009 by age and sex. It shows a very significant decline in rates for young people and, in particular, for men. It is also striking to note how employment rates for older women have generally held firm and have even increased in some countries.

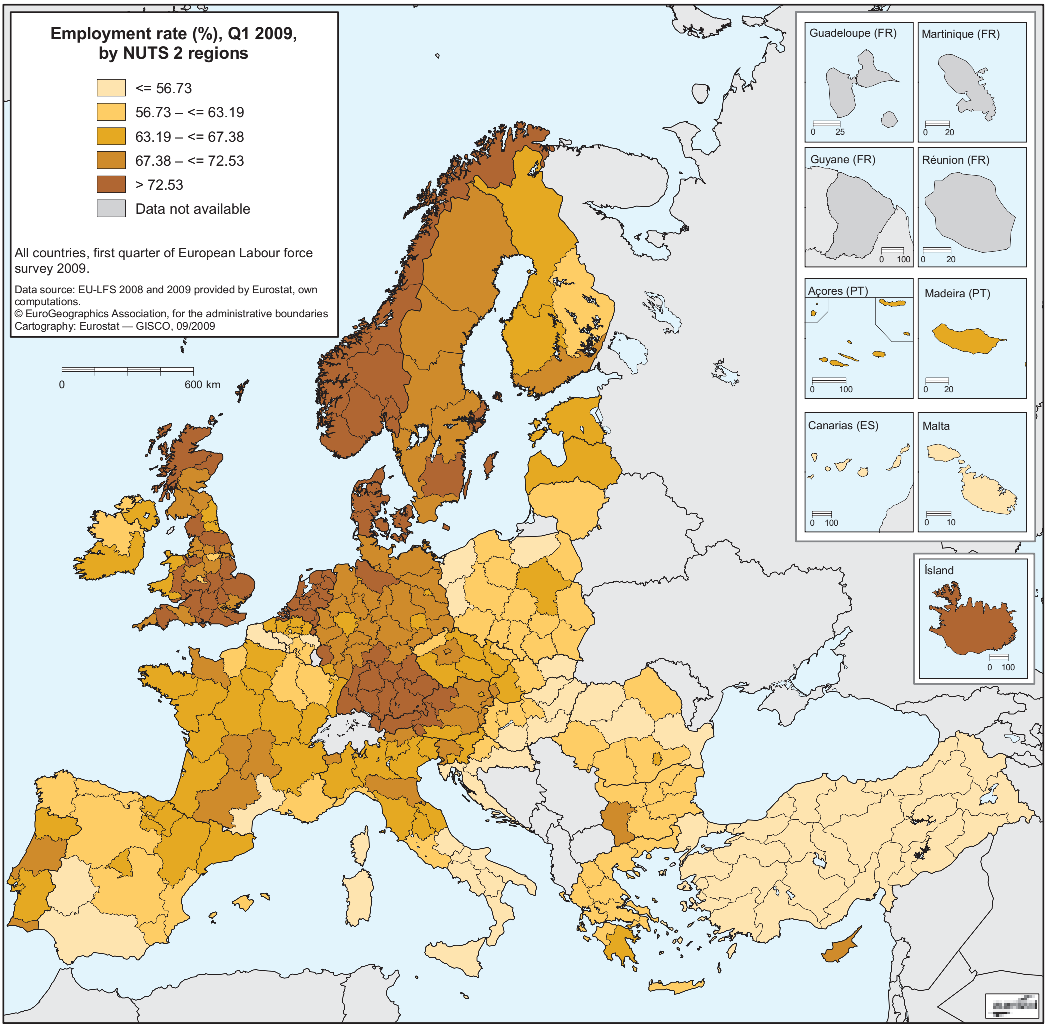
Figure 5: Change in employment rates by age and sex in 25 Member States between first quarter 2008 and first quarter 2009



Source: ELFS

The pattern of change of employment rate in the regions of Europe is roughly reflected in the unemployment map in Figure 4. Figure 6 maps the level of employment rates throughout Europe.

Figure 6: Employment rates in Europe first quarter 2009 by (NUTS2) region



Source: ELFS

Probably the most striking impact on the labour market is the massive increase in the unemployment of the younger members of the labour force in most Member States. It is clear that if this is not tackled quickly, there will be very serious implications for the lives of many of these young people and for society in general. One could possibly argue that this is the most acute labour and social policy issue facing policymakers in Europe.

Finally, it must be underlined that the recession will very likely not only lead to further distress in the labour market but also negatively affect living and working conditions more broadly. As profit margins are squeezed and workers experience less job security, working conditions may suffer. The public debt has increased significantly in many countries, which will surely have some negative effects on social and other welfare-promoting policies. However, with the exception of the Member States in dire financial straits, social spending cuts have largely yet to occur.

Responses to the recession

The main policy response to the recession throughout the world has been a return to fiscal demand stimulus policy on a grand scale. There is almost universal agreement that supply-side measures alone could never have tackled the problems that have arisen.

EU policy response

There are several obvious and economically logical roles for the EU in this recession. Experiences from the early 1980s demonstrated very clearly the limitations of expansive macroeconomic policy at the level of individual Member States. To be effective, EU-wide coordination is required. While the EU policy competency is relatively limited in this respect, the European Economic Recovery Plan (EERP) may be successful in encouraging a more coordinated macroeconomic response. In the EERP, the European Union and Member States have agreed on a significant increase in discretionary public spending, and automatic stabilisers, such as unemployment insurance, provide further fiscal expansion. It was almost universally welcomed, although there is some discussion as to whether the expansion is sufficient or sufficiently well coordinated.

Given its strong competition policy mandate, the EU will have a vital role to play in ensuring that protectionist responses from Member States are avoided. The Great Depression in the US was significantly deepened and prolonged by global protectionism through a massive increase in tariffs. While this is unlikely in the well-established customs union, there have already been tendencies among some Member States to protect national industries through state aid and, in particular, the coupling of this aid to 'buy national' clauses. While the economic argument against state aid is not exactly the same as against tariffs, state aid does distort competition and trade and exacerbates public sector finances. The issue of state aid is likely to figure prominently in the forthcoming policy debate. If the recession is as prolonged as some fear, there may even be some argument for temporary public support for crisis industries. It is crucial, however, that this does not disturb the functioning of the Single Market. This can only be avoided with EU-level industrial policy or coordination. It may be that the current recession will trigger a significant development of EU industrial policy.

Disturbance of the functioning of the Single Market through temporary public support for crisis industries can only be avoided with EU-level industrial policy or coordination.

National responses

In many countries throughout Europe, short-term working schemes have so far buttressed the worst employment effects of the recession. The 2009 ERM Report, *Restructuring in Recession*, has numerous very recent examples of such company schemes. State support for these schemes has already been prolonged but it is hardly likely that the state can subsidise short-time working indefinitely. Indeed, for all three parties, workers, employers and governments, there are financial limits to short-term working schemes and they are specifically designed to be short-lived.

There are financial and temporal limits to short-term working schemes.

In the current situation, it is essential that the capacities freed during short-time work are put to good use. Training is the obvious option and the 2009 ERM Report has examples of this. Nevertheless, it is highly likely that the current financial difficulties experienced by many companies seriously curtail the opportunity for enterprises to provide such training. Consequently, there is a strong argument for public support. However, there is some scepticism regarding such training initiatives. As the employer cannot accurately forecast the duration of short-time working, it is assumed that mainly short training measures will be applied, giving rise to criticism regarding their effectiveness; hence, modular qualification instruments are recommended.

The source of finance for these schemes is crucially important for the nature of the training likely to be provided. On the one hand, the more the employer pays, the more likely it is that training in skills useful at the existing workplace will be provided; on the other hand, the more the costs fall upon the worker or the public funds, the more likely it is that general or generic skills – which are useful in the wider labour market – will be provided.

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Some evidence indicates that short-time working does not prevent dismissals in the long run and only postpones redundancies in times of severe economic difficulties. Furthermore, the application of short-time working, particularly if used over a longer period of time, negatively affects structural change by artificially maintaining employment in declining industries instead of redirecting the workforce into more future-oriented jobs. The longer the economic crisis lasts, the less effective is the instrument of short-time working. Indeed, unless there is a rapid and strong recovery (which seems unlikely), one can very soon expect a return to the shorter working week debate that was so predominant in the 1980s and 1990s.

Labour market measures

The EU held a special employment summit in Prague in May 2009 dedicated to tackling the impact of the economic crisis on jobs in Europe. The summit identified ten actions to fight unemployment and create new jobs:

1. Keep as many people as possible in jobs, with temporary adjustment of working hours combined with retraining and supported by public funding (including from the European Social Fund).
2. Encourage entrepreneurship and job creation, e.g. by lowering non-wage labour costs and flexicurity;
3. Improve the efficiency of national employment services by providing intensive counselling, training and job search in the first weeks of unemployment, especially for the young unemployed.
4. Increase significantly the number of high quality apprenticeships and traineeships by the end of 2009.
5. Promote more inclusive labour markets by ensuring work incentives, effective active labour market policies and modernisation of social protection systems that also lead to a better integration of disadvantaged groups, including the disabled, the low-skilled and migrants.
6. Upgrade skills at all levels with lifelong learning, in particular giving all school leavers the necessary skills to find a job.
7. Use labour mobility to match supply and demand of labour to best effect.
8. Identify job opportunities and skills requirements, and improve skills forecasting to get the training offer right.
9. Assist the unemployed and young people in starting their own business, e.g. by providing business support training and starting capital, or by lowering or eliminating taxation on start-ups.
10. Anticipate and manage restructuring through mutual learning and exchange of good practice.

However, while global financial markets are hardly a field for research to be undertaken by Eurofound, it must be underlined that the key to a sustainable recovery is about global financial regulation and macroeconomic coordination. As outlined in the first section, the fundamental reason for the crisis was the unsustainability of macro imbalances, together with flaws in regulatory structures, and risk-management practices that allowed these imbalances to take the world to the brink of financial and economic disaster.

Social partnership

There is potentially a crucial role for social partnership in times of economic crisis. While hard times could conceivably intensify conflict between the social partners, it may instead focus attention and mobilise action on common interests and induce compromise where fundamental conflicts of interest have previously impeded progress. Such a positive perspective is neither unrealistic nor naïve. It was the crisis in the Irish economy at the end of the 1980s that galvanised the social partners into deep and successful cooperation. Similarly, it was the difficult times in the 1980s that encouraged a wide range of interests in the Netherlands to come together around the consensus-based 'Polder Model' upon which subsequent success was built. Currently, Sweden and Finland are held up as models of how to deal with a deep recession. Again, social partnership was instrumental in agreeing and implementing the measures necessary for the recovery in the latter half of the 1990s. This current crisis is widespread across Europe and all parties call for more coordinated policy making. Crisis does provide an opportunity for, not least, the European social partners. For example, it might be that the return of Keynesian demand stimulus could call for a closer coordination of monetary and fiscal policy together with wage determination. This would strengthen the European macroeconomic dialogue where social partners have an important role to play.

In Finland and Sweden, social partnership was instrumental in agreeing and implementing the measures necessary for the recovery in the latter half of the 1990s.

Labour policy perspectives in the short and long term

Short-time working schemes exemplify how there may be conflicts between policies in the short and long run. However, while short and long-term compatibility may often be an issue, at least from a political perspective, from some economic and social perspectives the distinction may be less than is sometimes imagined. The long-term drivers of change framing the context of Eurofound's current four-year programme are: climate change, demographic developments, globalisation and technological innovation. In many respects, the recession only puts into even sharper focus their importance and accentuates the urgency of dealing with the issues they raise.

The expected increase in the dependency ratio reinforces the need to maintain the participation of the millions of unemployed in Europe in the labour force.

The most problematic demographic issue, the projected increase in the dependency ratio within the coming decades, clearly illustrates this point. As recession typically results in the permanent exclusion of some members of the labour force, this will immediately and significantly worsen the imbalance between the active and non-active population and only reinforce the urgency of the ageing problem. Furthermore, the recession also makes the primary financial problem of recent demographic developments, namely the adequacy of future pension incomes, acute. The trend towards marketisation (privatisation and funded pensions) in recent decades and the subsequent decline – or in some cases the collapse – in their market value leads to problems not just for future cohorts but for many of those currently becoming pensioners. Thus the expected increase in the dependency ratio only reinforces the need to maintain the participation of the millions of unemployed in Europe in the labour force and society in general. While early exit from the labour force may have been an attractive option for some workers in previous recessions, it is not only unsustainable in the long term but with strapped public budgets, it is not even a viable short-term option for many.

The participatory role of ALMP may be useful in terms of mitigating the effects of long-term unemployment on individuals and society.

In this context, the maintenance of the active line in the European Employment Strategy is essential. However, the quite probable bad-case scenario for the labour market in coming years should prompt some thought towards a possible reorientation of the activation measures in the Employment Strategy. Active labour market policy (ALMP) does not really create jobs; this is primarily the role of macro and industrial policy. The primary role of ALMP is to ensure workers can fill the available job vacancies created in companies. In a recession, the participatory role of ALMP may be useful in terms of mitigating the effects of long-term unemployment on individuals and society. These active individuals may then be able to return to work when times improve. Experiences from the 1980s show that when unemployment increases, it is exceptionally difficult to reduce it again. An important reason for this is the demoralising and alienating effect that unemployment has for individuals, families and communities.

Endless training for a job that may never appear can be just as demoralising as long-term unemployment.

With mass unemployment and few jobs in sight, participants may experience specific job training as meaningless or even punitive and endless rounds of training for a job that may never appear can be just as demoralising as long-term unemployment. Some Swedish experiences may be instructive here. In the early to mid-1990s, Sweden experienced mass unemployment for the first time since the 1930s, and it became obvious that training the unemployed to fill non-existent jobs did not make sense. The single biggest individually-oriented policy response was the Adult Education Initiative, which, at one point, had as many adult participants as there were schoolchildren in upper secondary school. This provided formal school education for poorly educated adults – without even the implicit promise of a subsequent job. It was presumably interesting and meaningful for participants, or at least more so than training that would not lead to a job. Evaluations of this massive programme in terms of employment and earnings have shown, on balance, quite positive results.

The strategic goal of the Lisbon Agenda is 'to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion'. A massive education programme targeted at unemployed youth and adults would at least coherently address not only the major immediate problem of the recession but also this strategic Lisbon goal.

The sustainability of the massive stimulus from a public finance perspective and its orientation towards so-called 'green' jobs are hotly debated.

The reorientation of demand-side policy on a grand scale also raises some long and short-term perspectives. Perhaps the most debated current policy issue is the sustainability of the massive stimulus from a public finance perspective. The Commission strongly advocates that public spending should be oriented towards environmental improvement, so-called 'green' jobs. This is clearly illustrated by the environmentally-motivated loans that constituted a significant element of the European Economic Recovery Plan. Here there is an obvious coherence in short- and long-term goals. However, there are some doubts as to the green content of the current stimulus packages in many Member States. It also raises questions on how other policy areas, not least ALMP and education systems, should be aligned with this green orientation.

While it may be somewhat out of the current policy focus, globalisation, in terms of a shifting global division of labour, has not gone away. It is highly likely that the competitive situation of Europe vis-à-vis, for example, China will continue to deteriorate in many activities, not least manufacturing. It certainly is the case that China and India are emerging from the recession much faster and stronger than either the EU or the US.

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Thus the challenges identified before the recession remain highly relevant. Indeed, possibly one of the few positive views of the recession is that it may provide a sharpening of the understanding of what needs to be done and harness the political will to address challenges today that until now it had been accepted could be addressed tomorrow.

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