Responding to Financial Crisis: Are austerity and suffering inevitable?

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All too often people in countries experiencing financial crisis are told that the road to recovery necessarily involves pain, that fiscal austerity and cuts in spending that adversely affect the lives of ordinary citizens are necessary costs of correction of macroeconomic imbalances and the consequent adjustment that is considered essential for recovery. This is repeated so often that it is now taken as received wisdom by policy makers and civil society alike – yet in fact it is not true at all. It can actually be plausibly argued that in several situations the reverse is correct, that attempts to reverse economic downswings through cuts in public spending are counterproductive and makes matters much worse. This is clearly evident for all to see in the case of crisis-ridden countries in the Eurozone, for example.

And there are also positive counter-examples that show how taking into account the concerns and requirements of ordinary citizens (and paid and unpaid workers in particular) can work as a positive macroeconomic strategy that actually provides a route out of crisis. Sweden provides an example of a country that responded to the financial crisis by explicitly recognizing and attempting to reduce the pressures on workers, and particularly women workers whose needs are often the last to be considered in such periods of crisis. Sweden incorporated measures to maintain or ensure favourable conditions of women's work and life into its broader economic recovery strategy.

In the early 1990s, Sweden experienced a dual financial and real economic crisis that bears many similarities to the sub-prime crisis in the United States and to the current difficulties faced by some Eurozone countries. Financial deregulation in the 1980s generated significant capital inflows and sparked a lending boom, which was then associated with rapidly increasing consumption, investment and asset price bubbles and heightened activity in the domestic non-tradable sector (particularly in real estate and construction). The Swedish krona was pegged to the US dollar, and so the real exchange appreciated— but this was not the only problem (because even if there were flexible exchange rates, the capital inflows may have nonetheless continued to drive up the nominal exchange). Around 1990, the bubble burst and the boom turned into slump, with capital outflows, widespread bankruptcies, falling employment, declining investment, negative GDP growth, systemic banking crises driven by deterioration in banks' balance sheets and currency crises (Jonung 2010).

As a result, Sweden experienced a severe depression in the early years of the 1990s. GDP fell by 5 percent, employment rates fell by nearly 10 percent and there was a massive increase in unemployment, almost 500 percent in absolute numbers of people (Freeman et al, 2010). However, the policy response was swift and positive, addressing not just the financial imbalances but also the real economic downswing and the impact on the labour market, including particular attention on the conditions facing women workers.

In terms of financial policies, consolidation of struggling financial institutions was accompanied by an unlimited government guarantee against loss for all depositors and counterparties. This enabled credit lines to be re-established with foreign banks while maintaining the confidence of private retail depositors. The bailouts provided to banks were limited by the requirement that recipient banks had to fully disclose all their financial positions and open up their books to official scrutiny, so that only those banks that were deemed worth rescuing received government funds. Banks' shareholders were not protected by any guarantees. Some banks were taken over and nationalized, with zero compensation to shareholders because they were deemed to be worthless. These measures not only prevented a credit crunch from creating a more severe downturn, they also limited moral hazard and reduced the cost of the financial rescue, increasing its political acceptability.

In terms of macroeconomic strategy, an immediate measure was the devaluation of the exchange rate, which dramatically improved the export competitiveness of the economy and led to a long period of rapidly growing exports. However, the crucial point is that export-led growth was not seen as the only means of economic expansion, and measures were taken almost immediately to provide countercyclical fiscal policies that would generate internal demand to bring the economy out of the recession. This included labour markets and social welfare measures that affected women, which provided important countercyclical buffers.

Thus, instead of forcing reductions in fiscal deficits through austerity and contraction of public spending, the Swedish government let fiscal deficits increase during the crisis. This took the form of maintaining some earlier expenditures and expanding other spending to respond to the crisis and its employment effects. Sweden's famous welfare system, an essential element of the Swedish model, simultaneously provided direct public employment for women and helped to reduced unpaid work in the care economy and household reproduction. Rather than allowing it to deteriorate, Sweden expanded the system with a renewed emphasis on employment programmes and active labour market policies. This protected women from the worst effects of the financial crisis and economic downswing and provided a demand cushion that assisted faster recovery of the real economy.

An important element of this strategy with direct contemporary relevance was the creation of a personalized youth employment guarantee programme (ILO 2012). This is a scheme in which all young people (18 to 24 years) in Sweden are offered employment in youth specific activities, following a period (90 days) of unsuccessful job search. The idea is to provide special measures and activities for the participant to enable him/her to get a job or return to education as soon as possible. In the initial period, the programme includes assessment, educational and vocational guidance and job search activities with coaching. Thereafter, these activities are combined with work experience, education and training, grants to business start-ups and employability rehabilitation efforts. The emphasis is on rapid integration with the labour market. A young person can participate in the job guarantee for up to 15 months. The programme is estimated to have been quite successful (with nearly half of the young jobseeker participants getting successful outcomes as a result of the scheme) at relatively low cost. Female participation in such programmes has been high, at around half. Given the high rates of youth unemployment that prevail currently not just in Europe but in many other parts of the world, such a programme can have positive effects in other contexts as well.

The Swedish recovery programme also focused on avoiding labour market exclusion, particularly for women. Two cornerstones of Swedish family policy—paid parental leave and subsidies to day care for children—that were both maintained during the crisis and even expanded to some extent, have been recognized as being particularly beneficial to women workers, even by researchers who have otherwise queried the fiscal costs of such programmes, such as Freeman et al. The welfare state provisions continued to provide strong social protection and safety nets to those at the bottom of the income and wage pyramid. Government benefits supplemented the incomes of the lower- paid and non-working population. These measures prevented the emergence of poverty, reduced tendencies to enhance inequality in the wake of the crisis, and also operated as countercyclical buffers that cushioned domestic demand from further declines.

Another important element in the Swedish success was the continued maintenance of social dialogue, particularly in wage bargaining. This was made possible by the developed institutional structure in which trade unions and employer associations were active participants in tripartite dialogues with government in the Nordic model well before the crisis. The financial crisis did not lead to the abandonment of such dialogue, and its continuation allowed wage increases that protected workers to some extent but also secured the benefits of exchange rate devaluation in the form of greater competitiveness of the domestic manufacturing industry.

The result of this combination of measures was a relatively quick recovery from the financial crisis in terms of both output and employment. Further, it was achieved at relatively small cost to the public exchequer, with recent estimates putting the cost of the financial rescue package at only 3 percent of GDP. In addition, it was achieved with relatively little increase in inequality or social disruption.

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