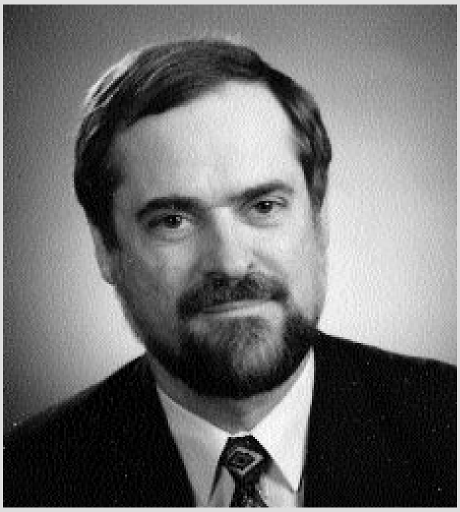
OPINION

Macroeconomics and the Labor Market



With their ambitious proposal to reduce the fiscal 2000 federal budget by DM 30 billion, the German government has sent a remarkably strong signal. If you consider that federal debt has accumulated to over DM 1.6 trillion and that one fourth of the budget is now spent on servicing that debt, the budget proposal seems like a measure that restores the government's room to maneuver. Achieving a balanced budget in the medium run is becoming more likely. The budget cuts are already praised as a political about-face that will put a definite end to the discussion on the revival of an anticyclical, Keynesian approach to economic policy - a discussion that started when the new government assumed office last fall.

This conclusion is too hastily drawn. The Keynesian policy of the past was not flawed in a factual, scientific sense, but proved difficult to implement. This was mainly due to long, uncontrollable delays in the effect of measures undertaken by the government, combined with the inability of political institutions to reduce the national debt during periods of economic upturn. The temptation to increase debt led to the euphoric belief that a stimulating fiscal policy would keep all economic problems under control.

For more than a decade, macroeconomic policy has therefore primarily been anti-inflationary. It cannot be disputed that the monetary policy of the German Bundesbank, with its money-supply oriented ideology, did produce positive results. However, these results must be attributed more to the moral power of the well publicized announcements of monetary goals rather than to either the achievement of these goals or the hard facts of demonstrable policy effects. The correlation between changes in money supply and inflation ceased to exist long before the introduction of the Euro.

With the Maastricht Treaty, we left a large part of our macroeconomic instruments in the cloakroom of economic history. We handed over monetary policy to a group of European experts whose sole obligation is to fight inflation. In addition, the European Stability Pact, keeping national fiscal policies on a tight rein, is almost a testimony to the victory of conservative economic policy and an instrument for its reinforcement. That this was possible despite high and persistent unemployment is absolutely astonishing.

The difficult labor market situation, which has come to be the central economic policy issue of our time, is a problem that mainly affects unskilled workers. They are becoming increasingly redundant in the course of technological progress because they are not adaptable enough and their wages are too high. Trained and otherwise qualified workers enjoy almost full employment in Germany and across Europe. A macro-oriented labor market policy has to be shaped from this starting point.

Concessions to the development of employment and other economic factors in Europe were made at the end of last year, when the European central banks loosened the interest rate screws, and this spring, when the newly established European Central Bank cut interest rates. This demonstrates that an anticyclical monetary policy, carefully executed, is possible. Interest rate cuts are certainly not the wrong policy to alleviate the negative effects of the business cycle. The same is true for German budget policy, which has become less stability-oriented in 1999. This leads to a welcome demand stabilization, from which employment could gain new momentum, although this effect will certainly take time.

The labor market is, as the last recessions in Europe have proved, very sensitive to changes in demand. Nothing points to a separation of economic growth and changes in employment - in fact, the opposite is the case. Unskilled workers are more heavily hit in recessions. Creating more stable demand therefore makes sense in terms of labor market policy. It also creates opportunities for a structurally oriented approach.

The planned 2000 fiscal budget cuts will come in a period of economic upturn. They are therefore being made at the right time. In the medium run, this policy may unload some of the burden from the economy and German society. This in turn would spur economic growth and lead to a more favorable development of the business cycle. A cautious, business-cycle oriented macro policy remains necessary and possible, if it keeps a long-run balanced budget in sight.

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