Europe's phony war between Austerians and Deficitarians

2013/11
25 | 03 | 2013

PEOPLE
PROSPERITY
PROTECTION

Marc De Vos

Director
Itinera Institute

President Harry Truman famously begged for a one-handed economist, tired of having advisors keep the middle ground between "one the one hand" and "on the other hand". These days there is no shortage of one handed economists in Europe. Indeed, a small war of the economists is raging over the choice between austerity and deficits in Europe. Both sides – the Austerians and the Deficitarians – promote their recipes as the way out of the crisis and back to growth. The intellectual impasse is easily politically exploited. All over Europe, the political left and the unions have united under the Deficitarians' banner, while parties on the right have fallen for the Austerians.

"The political logic is the opposite of the Keynesian economic logic: only when the economy fails and puts budgets under pressure will governments slash."

But the dogmatic debate over debt or discipline is truly academic. The Deficitarians are evidently right in arguing that belt tightening pushes a recessionary economy deeper still. One does not have to read the collected works of Keynes to understand that fiscal policy should ideally row against the business flow, loosening when the economy falters and tightening when the economy hums. Economic theory thus suggests governments to spend in the bad times, and cut in the good times.

But what about political practice? What democratic government enforces budget cuts upon its citizens when it doesn't need to? More revenue through more growth is a political recipe for more expenditure, not less. The political logic is the opposite of the Keynesian economic logic: only when the economy fails and puts budgets under pressure will governments slash. Pressure is needed to touch expenditures, entitlements and expectations. Deficits are politically easy because they send the bill to the future. Austerity is politically difficult because it hurts the present. Public debt thus has a natural tendency to increase over time. That is until a major overhaul – mostly devaluation and inflation – or until markets scare and start doubting whether the debt will actually be repaid.

That brings us to the beginning of the euro-crisis, which is a solvability crisis. Have we forgotten that capital markets have lost faith in the ability of Greece & co to repay their debt? Those who plead for more debt to solve a debt crisis, must also explain where the debt is supposed to come from, since it clearly cannot come from the same countries. It can only come through bigger transfers from Northern Europe to Southern Europe, or from the rest of the world to Europe. The first option is anathema for Germany and a few others. The second is pure utopia, except for piecemeal support with plenty of strings attached. Once again, political reality trumpets economic theory.

“Europe’s Deficitarians are essentially a US import. But the economic and demographic reality of Europe differs profoundly from that of the US.”

Europe’s Deficitarians are essentially a US import. Theirs is the campaign that Paul Krugman and other progressives across the Atlantic wage against the Republicans’ budget plans. But the economic and demographic reality of Europe – in particular Southern Europe – differs profoundly from that of the US. America is an entrepreneurial country with a diverse economic base and healthy demographic growth. Compare that to Europe. France hasn’t balanced its books since the 1970s and carries the heaviest of public sectors. Italy is Europe’s Japan: stuck into economic stagnation and demographic decline. Spain’s pre-crisis economy was one big bubble of banking and real estate.

The US today can afford more debt because it will be able to pay off more tomorrow, and because its global currency and mature currency union simply can shoulder more debt than Europe’s crippled Eurozone. Those who want Europe to go for more debt today, must therefore also explain how Europe will pay off that debt tomorrow. Short-term fiscal doping carries a long term cost. What a country spends on debt servicing, it cannot spend on investment, innovation, education, and the like. That erodes economic potential. Yesterday’s debt is a recurrent drain on tomorrow’s prosperity. There comes a time when these long term costs outweigh the short-term benefits. Many of Europe's debt-ridden countries are past that turning point. Piling up more debt for the future will benefit those who are able to finance it: regressive redistribution of future prosperity to today's rich.

In the final analysis, economic growth stems from innovation and productivity. Countries that score well on prosperity and job creation in the long run are not the countries with the highest public debt, but those where prudent policy facilitates innovation and its transition into economic activity. Europe's stark reality is that of more than thirty years of declining growth capacity masked by increasing debt. The total Greek debt – governments, families, and companies – stood at 92% of the then Greek GDP in 1980. By 2010, at the advent of the euro-crisis, it was 262% of the much bigger 2010 GDP. In the same period total debt to GDP went from 190% to 310% in Italy, from 160% to 321% in France, from 136% to 241% in Germany, and so on. Such debt addiction is not sustainable and has reached its last hour with the euro's confidence crisis. More debt will not shorten the path towards new and real economic potential, but lengthen it instead. The crisis is the lever to redress Europe's derailed budgetary culture and to ensure a healthy economic legacy for the young generations.

“Countries that score well on prosperity and job creation in the long run are not the countries with the highest public debt, but those where prudent policy facilitates innovation and its transition into economic activity.”

In the crisis countries of Southern Europe, austerity is essentially the symptom of a failed system in emergency repair. What is needed there is a parallel strategy for investment, which will require European solidarity. What goes by the name of 'austerity' elsewhere is simply maintaining deficits within the boundaries of reason. One can of course debate the economic validity of particular budget targets for any given country, but they too are essentially the expression of the politics of the euro crisis. Without common budget standards across the Eurozone there can be no common rescue strategy. The budget targets, no matter how arbitrary their percentage points may be, are the necessary means to a higher end.

Instead of fighting battles that have been long lost, we should direct our energies towards the where and how of budget savings. The path of least resistance is the well-trodden road of one-off measures and linear cuts. We need reforms that generate budget margins through effectiveness and efficiency. Savings should flow from structural reforms

We should direct our energies towards the where and how of budget savings.

that enable economic growth, streamline the public sector, and stabilize the welfare state. That's what at stake. The phony war between Austerians and Deficitarians is one big waste of time.

Marc De Vos is the general director of the Brussels-based Itinera Institute and teaches at Ghent University

Twitter @devosmarc

For sustained economic growth and social protection.

ITINERA INSTITUTE
INDEPENDENT THINK TANK
IDEAS READY FOR ACTION

Itinera Institute ASBL
Boulevard Leopold II 184d B-1080 Bruxelles
T +32 2 412 02 62 - F +32 2 412 02 69
info@itinerainstitute.org
www.itinerainstitute.org

Editeur responsable: Marc De Vos, Directeur