Extract from:
Yves Bertoncini, "European Steering Committee 2011 of Notre Europe - Key elements", Notre Europe, December 2011.

3. "The dilemma between austerity and stagnation"

Moderated by Jean-Christophe Ploquin, the session on the dilemma sparked by the effort for austerity being made in the EU included speeches by Laurence Boone, Pervenche Berès and Daniela Schwarzer, and comments and questions from other participants. The session as a whole led to the identification of the following main points for present analysis and future direction[3].

3.1. The financial markets' vision

3.1.1. An alarm-bell role

- the financial markets have evinced their alarm (sometimes even excessively so) regarding countries' ability to control

3. The views expressed here are not necessarily those of *Notre Europe*.

their finances, although they themselves are not the source of sovereign debt crises;

- the markets are not (or are no longer) attacking the euro, and indeed the currency's rate of exchange shows that, at this stage, it enjoys a good level of confidence: those hedge funds that tried to speculate on the euro losing value have lost too much money and they are now feeling somewhat disheartened;
- over the past few weeks, banks and insurance companies have had to sell French bonds to compensate for their Italian and Spanish losses: we should not necessarily interpret this as an attack on one or the other country;
- on the whole, the markets would be happier with a functional euro and a stabilised situation – the default of a large European country would cause the stock markets to panic.

3.1.2. The markets question the European response

- it is true that the euro zone is in a better overall situation than the United Kingdom or the United States, but given that there is no genuine unified management of the situation, the markets tend to make national comparisons (Greece with the United Kingdom; Italy with the United States, etc.);
- the credibility of Europe's political "word" has been badly undermined by the way the crisis has been handled, and thus that credibility needs to be rebuilt *(see 3.3.)*;
- the markets know that excessive austerity would weaken growth and increase the danger of a recession, and so they are very concerned to ensure that Europe's responses are going to be sustainable in the longer term *(see 3.4.)*.

3.2. The EU member states' economic strategies: a contrasting assessment

3.2.1. Germany

- broad support for austerity, a synonym of confidence, even though Germany adopted a Keynesian approach in the 1990s;
- awareness of having to make an effort to address some very substantial challenges (funding reunification, demographic decline, the move away from nuclear energy);
- good competitiveness strategy based, in particular, on structural reforms (labour market), on involving the trade unions (moderation in wage demands) and on partial relocation to central Europe;
- strong attachment to its own growth model.

3.2.2. Spain

- a diligent disciple of the stability pact until only recently, and in terms of regulation of the banking industry;
- real estate bubble caused by a very low interest rate linked to the changeover to the euro, to a housing stock in need of modernisation and to an extremely dynamic demographic trend;
- a rude awakening in these three fields with a build-up in competitiveness problems, with respect to which European monitoring has not been effective.

3.2.3. France

- lack of assessment of the successive economic policies;
- public spending rates hitting the 56% mark, with political stances being adopted on taxation and the feeling that spending is untouchable;
- also competitiveness problems, although there is excellent potential to make a comeback.

3.2.4. Italy

- is paying the price for its record debts in the 1990s;
- major ability to make an effort to remain in the heart of the EU (see the special tax levied in 1996 to enable the country to join the euro zone);
- excellent ability to make an economic comeback.

3.3. Rebuilding the credibility of European politicians' "word"

3.3.1. The need for a firm national political commitment to reform

- the strategy adopted by the most effective member states consists in not seeking to deny the problems and in clearly stating how they intend to proceed (United Kingdom and Ireland);
- austerity plans that fail to embody a genuine adjustment strategy may be perceived by the markets as being mere marketing tools (France);
- recourse to technocrats to adopt structural reforms may be useful in the short term, but it may also confirm doubts regarding the political class's ability to implement such reforms in the longer term (Greece and Italy).

3.3.2. The way the Greek situation has been handled is emblematic of Europe's dithering

- denial that default is a possibility, followed by implicit recognition of the fact;
- debt erasure threshold set at 20%, and then at 50%;
- preventing Greece from leaving the euro zone was presented as a last-ditch goal, yet the scenario was then countenanced by Europe's own leaders for several days (after the announcement that a referendum might be held).

3.3.3. The way the "EFSF" has been handled also points up the dithering involved in Europe's efforts to promote solidarity

- major financial commitments on the part of member states, but with so many strings attached that doubt has been cast on the authenticity of their solidarity efforts;
- the procedures adopted to boost the size of the EFSF have been too complex;
- the request that emerging countries, which are presumed to be poorer, take part in the EFSF is a rather worrying sign.

3.4. The need for balanced austerity

While public deficits are not unhealthy things in themselves, they have to be widely reduced in the short and medium terms on the basis of balanced stringency efforts.

3.4.1. Striking a balance between revenue and expenditure

- the strategy adopted by the most effective member states consists in splitting their adjustment between 2/3 spending cuts and 1/3 tax hikes (e.g. Ireland);
- spending cuts tend to impact one of the European model's most important distinguishing features, namely the welfare state, which needs to be better tailored to the new social, family, and demographic reality;
- new resources must also be found, including taxation of higher income brackets, a tax on financial transactions, and the taxation of capital and income covered by banking secrecy or tax havens.

3.4.2. Striking a balance between austerity and fairness

- structural reforms will be sustainable, and thus effective, if they are fair – the financial markets are also aware of that fact;

- fairness is all the more crucial if we consider that the adjustment efforts which need to be made are going to have an impact in the medium term (e.g. in Greece);
- the aim must not be to whittle away at the system in dribs and drabs but to rebuild it in such a way that it becomes both sustainable and fair (counterexample of France, which now has the lowest pension turnover rate);
- reforms undertaken in the field of financial regulation (including in connection with tax havens) play an important role in determining whether current adjustments are fair or not.

3.4.3. Striking a balance between austerity and growth *(see 3.5.)*

3.5. A key objective: boosting potential for growth

The trend in the debt-to-GDP ratio also depends, of course, on the trend of the… GDP itself, so GDP also needs to be stimulated at both the national and European levels.

3.5.1. Measures that need to be adopted at the national level

- deregulation measures need to be adopted in certain countries in order to free up the growth potential in certain state-protected sectors (e.g. in Italy);
- at the same time, fewer regulations are required in order to allow small businesses to grow more easily, but also to simplify bankruptcy procedures;
- at this juncture, investing in manufacturing is not necessarily the priority any longer: "human capital" appears to be a stronger source of growth (hence the need to invest massively in education).

3.5.2. A strategy for growth at the European level

- deepening the single market is one of the main sources of growth in Europe – the Polish presidency's initiatives are welcome;
- European funding for projects of common interest must be developed further, including in the framework of public-private partnerships;
- the renegotiation of the European budget must make it possible to shine the spotlight more clearly on the added value inherent in European spending.

3.6. For converging economic policies

3.6.1. Converging budget policies

- a properly functioning euro zone will be sustainable if it is possible to organise improved convergence in the area of debts and deficits (the recent stability pact reform being a useful step in that direction);
- it is better to debate national budgets upstream rather than to resort to penalties after the event, which are more difficult to apply: this common upstream debate presupposes some form of transfer of budgetary sovereignty to the European level – which would help to resolve the moral hazard problems that have dogged the EMU since it was first set up;
- the kind of budgetary convergence to be aimed for cannot be confined simply to the enforcement of further discipline and further austerity: it also needs to facilitate the coordination of the budget choices made by countries with a surplus and countries with a deficit, to lead to the adoption of better harmonised investment policies, and to include a minor cyclical role for the Community budget.

3.6.2. Converging competitiveness policies

- implementing economic strategies primarily based on exports (Germany) weakens European internal demand: the adoption of such strategies by all of the EU countries would inevitably have a globally depressive impact;
- conversely, excessive recourse to fiscal and social competitive advantages may start to resemble dumping, thus dragging down both the internal market and public policies;
- the interdependence of Europe's economies, as highlighted by the current crisis, demands stronger coordination of national supply-side policies: the adoption of the "Euro-Plus Pact" points to a commendable monitoring effort, but its scope and importance now need to be defined;
- policies that can be subject to effective European convergence must be carefully chosen: it is by no means certain that taxing businesses is the most promising area for such an initiative if we remember the complexity of procedures in the EU's various member states.

3.6.3. Convergence requires a helping hand in both political and democratic terms

(see the session on "Institutions and People")

3.7. ECB intervention, a key issue

The ECB has been playing a major role since the crisis began, and that role is set to grow in the short and medium term.

3.7.1. Three kinds of complementary intervention, which could resemble a surreptitious form of solidarity

- the ECB has launched debt-purchasing programmes worth over 200 billion euro, 60 of which involve secured bank debts;
- the ECB provides banks with liquidity at various intervals (weekly, six-monthly, yearly and even biennially), accepting "collateral" which can be part of the Greek debt;
- the ECB is the framework through which interbank loans transit, which has prompted certain central banks to advance funds to central banks with no liquidity (examples in Greece);
- if the liquidity thus advanced is not recovered, these operations will effectively be akin to transfers of wealth (an IMF study has, for example, recently quantified the impact of such operations for a country like Germany).

3.7.2. The ECB sends out messages which could be more effective

- the ECB tends to intervene in the context of the limits that it sets itself (approximately 20 billion euro in debt purchases per week), whereas it would be preferable in the markets' eyes if it did not set itself any limits at all;
- the ECB resorts alternately to arguments based on monetary policy and on financial market stabilisation, which can blur the direction of its policy;
- it would be useful for the ECB to say that it is prepared to intervene even if it then fails to do so, rather than the other way around: this, because in the past it has occasionally given the impression that it is hesitant to intervene, only to then do so in the end.

3.7.3. Interventions which need to develop further

- criticism in Germany of the ECB's intervention has more often than not been levelled by economists (not by the government)

- and has not been primarily concerned with the purchase of debts on the secondary market;
- the debate on the potential inflation risk deserves to be taken further, as does the debate on the ECB's sterilising the inflationary impact of its intervention;
- if it were to be confirmed that the EFSF cannot have the impact expected, it would be necessary to turn once again to the ECB.