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America's Bad Advice for Europe

Economic growth doesn't come from deficit spending, but competitiveness.

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Brussels

In the run-up to this weekend's G-20 meeting, there is growing U.S. pressure on Europe to suspend its austerity programs. Among those urging for continued deficit spending to overcome the economic crisis are Nobel Prize winner Paul Krugman, U.S. President Barack Obama and—in a nearby oped—his Treasury Secretary Tim Geithner and National Economic Council Director Larry Summers. Their advice is economically unreasonable, politically inappropriate and demonstrates a profound lack of understanding of European realities.

Europe has unfortunately a solid track record of failing to reform during good times. France, for example, has not run a balanced budget in almost 40 years, which includes many years of growth when it would have been much easier to rein in public spending without causing major social upheavals. Alas, it was not done.

And France is not alone. Across the European Union, countries have been piling up debt at record speed, allowing the state to take on more and more future obligations, particularly for pensions, often without the slightest strategy of how to pay for these entitlements down the road. Purporting to act in the cause of "social justice"—and purposefully oblivious to a demographic outlook of aging and declining populations—politicians cowardly shifted responsibility to future governments and generations. But the future is now. The moment of reckoning has finally come and it cannot be squandered.

Interestingly—and despite the recent criticism of ratings agencies' slow response to the subprime crisis—Standard & Poor's predicted back in 2006 that by 2050, the debt burdens in France and Italy would be well above 200% of GDP, and about twice as high in Portugal and Greece. Two years before the financial crisis hit in 2008, S&P concluded in a study on aging that "a collective slide down the ratings scale would commence early in the next decade"—i.e. now. What was done in response to that study? Absolutely nothing.

It is this historic inability to pro-actively respond to predictable future crises that makes those calls to keep on spending so dangerous. What would be improved if governments kept piling up more debt and squandered this moment when electorates for the first time in decades—as seen in the recent elections in the United Kingdom, Netherlands and Hungary—are finally ready to embrace and even vote for budgetary restraint? What would be gained if Europe responded to Greece's quasi sovereign default by continuing to run massive, sometimes double-digit budget deficits, as Spain did last year when its deficit clocked in at a whopping 11.2% of GDP? It would hardly give citizens or markets the necessary confidence that economic governance is sound and that pensions are stable. Sustainable growth cannot be not based on governments injecting cash they don't have, but is instead built on global competitiveness and sound economic management.

It is a grave mistake to call the current effort to cut deficits "austerity" for they are rather the first serious efforts to at least try to live within our means. Europe will never be able to return to previous spending levels due to its declining share in the global economy, its ageing populations and the continued pressure on public finances. Even if some cuts are made now, entitlement spending will keep on rising as the baby-boom generation gets ready for retirement, and the rapidly increasing number of older citizens will see steady rises in health-care costs. In other words, public finances will continue to be precarious for the foreseeable future, making the current efforts to rein in spending all the more necessary. Calls to renege on Europe's long-overdue return to something resembling fiscal discipline are therefore harmful.

It is not a coincidence that in Europe itself few voices have spoken up for continued stimulus spending. It is noteworthy that the toughest austerity measures are currently spearheaded by socialist governments in Greece, Portugal and Spain. These are administrations that neither have the ideological conviction nor the historical track-record of implementing spending cuts. The fact that they are pursuing them nonetheless tells us a lot about the severity of the situation. Europe has no other choice but to consolidate and cut back.

It is ironic that now that Europe is finally on the right path, voices from the other side of the Atlantic are urging us to waste this once-in-a-generation opportunity to finally get our fiscal and economic house in order.

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