



Europe Heads Toward Fiscal Discipline

John Williamson concludes that European countries are sending the right signals to markets with their initial steps toward greater fiscal austerity.

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Steve Weisman: The financial and economic crisis in Greece has ushered in a new period of fiscal discipline and austerity across Europe. Is that the right way to go for Europeans? This is Steve Weisman at the Peterson Institute for International Economics with John Williamson, senior fellow here at the Institute, to talk about the future in Europe. Thanks, John.

John Williamson: It's a pleasure. I think that the crisis has now reached a stage in which one is having to think about withdrawing fiscal stimulus. It's too early to withdraw the big stimulus, that's clear. But some indication that the countries are serious about laying down future plans. It shouldn't be just plans that are announced but there should be some down payment on action. And I think that's what Europe is essentially providing at the moment. And I think that's right. One has had to go further than that in Greece and in Ireland and in Iceland, a country outside the euro of course, but—

Steve Weisman: And also in other countries—Spain, Portugal.

John Williamson: Well, in Spain and Portugal they are much closer to the model that I was indicating of making a down payment to indicate the big restrictions coming in the future. And I think that's the right way to go. Certainly for the major countries like the UK, I think that's right. And one would not want to see a great deal of deflation introduced right at this time. But on the other hand, the specter of deficits continuing as far as the eye can see is very worrying, and one can understand bond market participants being worried about that.

Steve Weisman: What are the indications that the steps taken so far, the down payment, are stabilizing the markets?

John Williamson: I don't think there are great signs that they've worked in terms of stabilizing the markets as yet. Perhaps the markets aren't quite as nervous as they were last week. But there's still a great deal of volatility around. And the credit rating agencies aren't helping. I mean to downgrade countries when they've announced that they're taking those measures, it seems to me to be perfectly stupid. Credit rating agencies would have been well within their rights to downgrade months ago or a year ago or whatever. But to downgrade at this point, I think it just makes no sense.

Steve Weisman: You're referring specifically to the credit rating agencies doing that for Spain.

John Williamson: Yes, it was just the other day for Spain. That was the particular instance. But they've done it for the other countries as well. And in my view, it's too late once again.

Steve Weisman: Germany is heading toward a constitutional amendment for a balanced budget. Should Germany be embarking on that course as well?

John Williamson: I don't think we've had a very full account of the German balanced budget amendment in the American press. From what I've read, there appear to be several qualifications to the balanced budget amendment, which suggests that in a period when the economy is stacked as it is at the moment, there's no obligation to run a balanced budget. Indeed, there's a speed limit. There's an obligation to approach a balanced budget to improve the cyclically adjusted position, but not to run an actual balance or surplus in such a period. But it makes it much less dangerous than it's been portrayed in the American press.

Steve Weisman: Less of a straitjacket.

John Williamson: Right.

Steve Weisman: Let me circle back, before I get to Greece, to the United Kingdom. What marks are you giving this new government in terms of the fiscal side?

John Williamson: So far I think everything appears to be as well as it could be. They inherited a big budget deficit. There's no question that's worrying. But what was really worrying was the thought that it was going to be allowed to continue. And they've made it quite clear that that's not going to be the case. That in fact, there is going to be some unpleasantness in the pipeline. And I think as I say, that's essentially the right judgment.

There was some suggestion during the election campaign that the liberal Democrats in particular were opposed to withdrawing any fiscal stimulus at the current time. They argued, I think plausibly enough, that this was something for next year rather than this year. But then that would be pre-Greek crisis, and that has really changed the picture. One needs to make a down payment, which I think is what has been done.

Steve Weisman: On Greece, can they make it through their austerity plan without some sort of debt restructuring or haircut for bondholders?

John Williamson: Well, we wait and see. But the initial reaction of many people, including myself, was that no, this really wasn't a realistic proposition. Bill Cline has done the mathematics, looked at the IMF program and decided that it was realistic. I think it's realistic if everything goes as well as it possibly can do.

Now there's no guarantee that everything is going to go as well as it possibly can. There may well be some hiccups along the way, which are sufficient to dictate some restructuring of debt. It's certainly a very high debt level that is projected in the program and it's possible that Greece will not be able to make it without restructuring some of that debt. But I think we're still waiting to find out whether that's going to be necessary.

Steve Weisman: Finally, John, what lessons should American political leaders and policymakers draw in terms of when it's time to bring about some more fiscal discipline in this country?

John Williamson: I don't think that they can simply look at Europe and decide that it has to be done right immediately, because of what's happened in Europe. Probably the United States, like Germany, has a lot more rope and can continue with the deficit, running a deficit several years yet. But at some stage, there has to be a real promise of a turnaround and shrinking debt-to-GDP ratios rather than continuing at this high level that they are at now. So I think

that at some stage, there's indeed going to be a need to rein in the deficit.

Steve Weisman: In the next couple of years, three years?

John Williamson: Yes, I would certainly say within that length of time.

Steve Weisman: John, thank you.

John Williamson: My pleasure.

