Stimulus vs. Austerity in Europe

Anders Åslund says it is more important for ailing European countries to cut their budgets, reduce their debts, and win market confidence than to embark on economic stimulus right now.

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Steve Weisman: President Obama and other leaders of the G8 have met at Camp David, and there were reports that they agree that the Europeans need to put greater emphasis on stimulating their economies as a priority rather than fiscal consolidation and austerity. Anders Åslund, of the Peterson Institute for International Economics, is here with me, Steve Weisman, to assess that decision. Anders, is that the right way to go now in Europe?

Anders Åslund: I think that the fundamental thing is that you need to restore confidence, and how do you restore confidence? You make sure that there is sufficient finance available. Part of it is to provide the financing, the so-called firewall. The other part of it is that you get the budget deficit under control. You can only have fiscal expansion -- that is so-called stimulus -- if you have sufficiently strong finances. Otherwise, if the budget deficit increases, as we see in Spain, then the G8 bond yields increase, so that costs the government correspondingly more.

Steve Weisman: Of course the Greeks are balking at that and voters in Spain and other countries, and even Italy, may follow suit. What progress are these countries in the periphery making at all?

Anders Åslund: They have cut their budget deficit substantially and they need to cut it much more. If you compare with what the Baltic countries did, the Baltic countries did far more earlier on. The lesson here is very much that you need to have a frontloaded program and you need to focus on expenditure cuts rather than tax increase. People do not want to pay more taxes for less public services. It's much easier to sell to the population that the government is trying to trim itself with belt tightening. That makes much more sense to people, and it also drives structural reform, because the big problem in the south of Europe is too little competitiveness, too much unemployment, and too little growth. And the answer to these problems is more structural reform, in particular to open up labor markets.

Steve Weisman: You said these need to be frontloaded. It's been a year or two already. Is it too late?

Anders Åslund: In a way, it's never too late. It only costs much more later on. And the later you do it, the more it costs.

Steve Weisman: When the G8 was speaking of stimulus, though, weren't they referring to the countries like Germany that are in a better position perhaps, in terms of their market attitudes towards their finances. Which direction do you think Chancellor [Angela] Merkel [of Germany] is going to go in now?

Anders Åslund: I think that there are two things that Germany is likely to do, and which are the right things. The first is to allow more wage increases. The other is to liberalise service markets in Germany, so that Germany will import more because its market is more open. To have a larger budget deficit today, I don't think would be politically prudent, and I don't think it would be financially prudent. After all, Germany has a public debt that is more than 80 percent of the GDP. You don't have fiscal space.

Steve Weisman: When Martin Wolf of the Financial Times was here at the Peterson Institute a couple of weeks ago, he said it was not a question of Germany bringing about more inflation, but how could Germany avoid more inflation. I wonder if we're beginning to see that with these wage increases.

Anders Åslund: I don't think that one should worry about inflation for years to come really, given that we have a very deflationary environment. We have a lot of deleveraging going on. So I'm not concerned about that. But Germany has almost cut [its] unemployment by half in the last six years, which is a formidable achievement. And then, of course, you should have higher wage increases.

Steve Weisman: Where do you see the most progress being made in the periphery, and the least?

Anders Åslund: Generally, Northern Europe and the Baltic countries and most of Eastern Europe look very good. The Scandinavian countries and the Baltic countries are growing well, and are advancing. Latvia had the highest growth in the first quarter of this year, and the other Baltic countries -- Estonia, Lithuania -- are at almost the same level. Latvia had 6.8 per cent growth in the first quarter and we are seeing quite a lot of dynamism in that part of the world. This also includes Poland.

Steve Weisman: Is that enough to keep the whole region on the plus side, in terms of growth? There are reports of new fears of contraction.

Anders Åslund: No. It's mainly the small countries and also the poorer countries that are growing more so. What we are seeing is that the European Union as a whole is pretty flat right now.

Steve Weisman: How do you assess the leadership of the European Union in handling the crisis?

Anders Åslund: I think it has been very poor. And, if you look upon the top people of the European Union, they don't play any role. President Barroso or Herman van Rompuy or Catherine Ashton, they have no role at all. So, instead, the two EU people we are seeing playing a role, it's the European Commissioner for Finances Olli Rehn, and of course the President of the European Central Bank, Mario Draghi. And instead of the EU institutions, it's been of course German Chancellor Angela Merkel who takes the lead, and I don't think it's good for Europe. It's one country rather than an institution who leads. And I don't think it's good for Germany or for her either.

Steve Weisman: She's been criticized a lot for various things: slowness, indifference to the needs of the Southern countries. What's your opinion?

Anders Åslund: I heard that at a conference in Tallinn recently. Somebody said to the Germans: "Either you lead or you get out of the way." So the Germans have said, "We lead." And the others have led very slowly. They refused to consider a bailout program at all to begin with. They refused to engage with the IMF. They did not allow any bailout for a long time. They did not insist on sufficiently tough stabilization programs. So, by and large, the first year of the crisis, 2010, was wasted. That was very expensive, and of course, it's Germany now that has to pay for it.

Steve Weisman: And now Germany is showing some signs of moving in a better direction?

Anders Åsland: Sure. I think most of these lessons have come through. But we still have to see that the European Commission really gets strength, so that this European habit of selecting top people through negative selection is stopped.

Steve Weisman: Thank you.