Stimulating the economy or applying austerity measures?

In many Member States the question at the forefront of discussions is whether governments should stimulate the economy or impose austerity. With a recession ongoing, which according to the latest EU statistics is mild in some and deep in other Member States, economists and media rightly pose the question of whether budget-cutting measures will not aggravate the downturn to the point of becoming self-defeating: a shrinking economy will lead to lower tax income, and higher deficits, no matter how much austerity is imposed. The issue also divides politicians. French Socialist presidential candidate François Hollande wants to break open the 'fiscal compact' just agreed and to broaden the mandate of the ECB, in both cases in the interest of stimulating economic growth.

Budgetary restraint is necessary for a few reasons that are plain to see. Confidence of the financial markets hinges upon a return to fiscal prudence. Also, current generations cannot continue to burden their children and grandchildren with debts incurred by the spending of their forefathers. The greying of the population makes it imperative that government spending is reined in.

Nevertheless, austerity should be 'smart'. This means that investment in the future (repair and development of infrastructure, education) should be salvaged as much as possible. In addition, austerity should be fair, with healthcare and education spared as much as possible and with a heavy emphasis on lessening income disparities. The latter have become too big anyway according to recent OECD figures.

Clearly, austerity is not the answer to all our economic woes: structural measures opening up the economy and favouring efficiency are needed, too. It is with good reason that competition authorities in the Member States under a joint EU/IMF programme are allotted more instead of less funding. Finally, excessive public deficits were not in all instances the cause of the current predicament: housing bubbles, a bloated banking sector that threatened to go asunder, private-sector debts, as well as over-reliance on free markets remedying their own wayward outcomes played a role. And taking a holistic view of the economy instead of a narrow utilitarian one is called for.

Even reducing government deficits to 3% of GDP means borrowing at the expense of future generations and a stimulus equivalent to one-thirtieth of national income. Yet, one may question whether the path towards balanced budgets, with Member States' deadlines under the Stability and Growth Pact for correcting excessive deficits falling this year or next, is adequate or should be somewhat longer in order to be sustainable. This is particularly true for the Member States hardest hit by the crisis.

Is there still room for stimulating the economy? On the basis of individual Member States, not much room may be available. Moreover, in our open economies any stimulating measures affect the entire internal market rather than the individual stimulating State. Seen as a whole, the euro area is a more closed economy. It follows that stimulating should take place at EU rather than State level.

There is a case to be made for stimulating investment and organising projects on the ground that can give hope to the unemployed, particularly the young unemployed, funded by the EU. There are obvious areas for public investment, from solar energy and connectors between separate energy grids to innovative measures stimulating entrepreneurship and creativity of the young.

The Union should have the means at its disposal to effect such stimulating measures. Increasing the EU's 'own resources' is called for, whether in the form of the proceeds of a financial transaction tax (FTT) or through an increase in VAT remittance to the EU budget, or both. This calls for an EU Minister of Finance, and institutional innovation, propagated by former ECB president Jean-Claude Trichet. The role of the Ministry of Finance would extend to enforcing budgetary discipline and to decide on bank resolution including burden sharing among individual nation States. Having the Commissioner for Economic and Monetary Affairs also chair the Eurogroup and the Ecofin Council would combine competences worthy of the title 'EU Minister of Finance'. A precedent is available in the role of the EU Representative for Foreign Affairs and Security Policy. Catherine Ashton presides over the Foreign Affairs Council and is Vice-President of the European Commission. As such, she is politically responsible before the European Parliament like her colleagues in the EU executive body. Copying this arrangement to EMU affairs would amount to a worthwhile institutional innovation, like the issue of Eurobonds. But we should not wait for such developments - that require Treaty change - to think creatively about the mix of necessary austerity and creative stimulus.

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