

Data validate reform strategy

by Michael Heise

June 10, 2013

Contrary to some forecasts made last fall, the euro has neither been scrapped nor have individual countries left it. The fear on the financial markets has dissipated and there are early signs that business and consumer expectations are improving. That alone does not promise a turn for the better but it does at least show that the crisis is not going from bad to worse and that Europe is not sliding ever deeper into recession due to the German insistence on austerity. An economic recovery is occurring not despite the reforms and austerity drives launched but as a result of this policy. There are plenty of examples for this. Ireland, Latvia and Lithuania have demonstrated it in the current crisis, in the 1990s it was the Scandinavian countries. Less well known is that, in the mid-1990s, Canada managed to overcome its sovereign debt crisis with radical reforms and consolidation measures, ushering in a very long and impressive successful phase. And, notwithstanding all the criticism of Maggie Thatcher's austerity policy, the UK managed to turn itself around with the help of just such reforms a good 30 years ago.

So the eurozone countries should feel encouraged to stick resolutely to the path of consolidation and reform instead of chasing the chimera that high public deficits or currency devaluations mean high growth. At best they produce a flash in the pan. The EU Commission has extended the timetable for meeting the consolidation targets to such an extent that we can no longer talk of an exaggerated obsession with austerity. The focus needs to be less on tax hikes, more on spending cuts and on tackling reforms of labor markets, welfare systems, product markets and the public sector head on. When it comes to investment conditions, there is work to be done in Germany, too.

The fact that all this may not appeal to many voters should not be rated too highly. Nowhere is a revolution about to erupt if sensible economic reforms are implemented. Moreover, the recent pickup in sentiment suggests that the eurozone's strategy is gradually bearing fruit. Countries in dire straits are being given time thanks to the ECB measures, public sector support loans and extended consolidation timetables, and they are having to commit themselves to undertaking reforms. The countries would also need to address these reforms if they had their own currency. So it doesn't make sense for them to hazard the costs of

leaving the euro. They would be horrendous: the expectation of an exit alone would send the cost of government funding through the roof or bring it crashing down completely (haircut), even more capital would flow out of the countries than at the peak of the crisis, the banks would face an existential liquidity and solvency problem as their deposits evaporated and their government bonds were written off. As dubious as it is to claim there is no alternative, such a strategy is certainly not a suitable alternative.