Enough With European Austerity, Bring on the Stimulus

Germany isn’t such a success story. Its GDP growth is a paltry 2.2% over 2008-13. Time for Merkel to budge.

By ALAN S. BLINDER
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Usually I don’t gripe about other countries’ economic policies—at least not on this page. It’s their own business. Besides, there is normally more than enough bad policy right here at home. But I have to make an exception for current macroeconomic policy in the eurozone, for two main reasons. One is that it is impacting other countries, possibly even our own, though that effect is often exaggerated. The other is that the mistakes are so painfully obvious.

European economic performance since 2008 makes the lackluster U.S. look marvelous by comparison. Unemployment in the eurozone today is higher than it was in 2009-10. Not only is real GDP still below its 2008 level, but it hasn’t grown for more than three years and may be heading down again. Meanwhile, deflation is more of a worry than inflation.

But what about Germany? Isn’t it the success story of Europe? Well, cumulative German GDP growth over the five-year period 2008-13 is a paltry 2.2%. That’s not 2.2% a year, but 2.2% in total. Germany looks good only because the rest of the eurozone looks so bad. Furthermore, Germany’s comparative success can be traced mainly to reforms made prior to the financial crisis, not to what’s happened since.

Germany is of special interest to the rest of the world mainly because of the central role it plays in the eurozone, where the German obsession with austerity is holding back growth in two ways.

First, Germany’s central bank, the Bundesbank, is doing its level best to restrain
the European Central Bank, which, under Mario Draghi’s creative leadership, would like to do more to spur growth. “More” includes quantitative easing along Federal Reserve lines, which in Europe might mean buying sovereign debt, corporate bonds, or asset-backed securities. But Bundesbank President Jens Weidmann objects strenuously to further ECB stimulus, recently telling this newspaper that purchasing more government bonds would be moving down a “dangerous path.”

Then what about buying asset-backed securities? Mr. Weidmann sees “a risk that we will overpay for these assets.” Hmm. What about the risk that the eurozone economy falls flat on its face?

Mr. Weidmann has only one vote on the ECB’s Governing Council, but Germany is first among equals. And given the Bundesbank’s revered position in German society, its voice may be turning local public opinion against the ECB.

Second, the German government is cajoling other European governments to continue (or resume) the budgetary austerity programs that have held back European growth in recent years. Earlier this month Finance Minister Wolfgang Schäuble opined that “the worst thing we could do would be to repeat yesterday’s mistakes” by using deficit spending to boost growth. No, the worst
thing German policy could do would be to push Europe, including Germany, back into recession.

To be fair, the Germans are not alone in paying homage to fiscal austerity. You hear that sentiment in other countries, too—even in the U.S. But Chancellor Angela Merkel, Europe’s most powerful leader by far, has hitched her luminous political star to balancing the budget, and her nation is Europe’s dominant economy. If Germany says no, it is hard to get to yes.

And “to yes” is where Europe needs to go. The macroeconomic prescription is pretty clear. On the monetary front, the ECB should move strongly and quickly into the kinds of unconventional stimulus programs that Mr. Draghi clearly favors. On the fiscal front, those eurozone governments that still have fiscal space—a group that certainly includes Germany but probably excludes Greece—should lead the way with more public spending and/or tax cuts.

The rhetoric emanating from many European capitals, however, is less about expanding demand and more about the need for “structural reforms”—a potpourri of pro-market policies that would, for example, ease restrictive labor-market rules and reduce red tape in product markets. Sophisticated versions of the argument call for coupling structural reforms that augment supply with demand expansion to utilize that supply. But in policy circles, the demand part is often dropped.

Don’t get me wrong. Many of the proposed structural reforms are fine ideas. But concentrating political capital on such measures when your economy is slipping into, or is already in, a recession reflects utter confusion between long-run supply and short-run demand.

Structural reforms are designed to enhance a nation’s ability to supply goods and services, that is, to raise productivity. In the long run, nothing is more important to standards of living than that. But if the nation is in a slump, there is already lots of spare capacity. In Europe today, successful structural policies would just increase the volume of slack. The more pressing need is for greater demand.

The good news is that we know how to provide that, and Mario Draghi is champing at the bit. The bad news is that the German leadership won’t budge—at least not yet.

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