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Now we have a European growth crisis

The austerity cuts have been misguided – what the eurozone really needs is a clear strategy for stimulating its economies

Henning Meyer
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France's president Nicolas Sarkozy, right, and German chancellor Angela Merkel meet to discuss the debt crisis. Photograph: Philippe Wojazer/AFP/Getty Images

Watching the still-unfolding eurozone crisis is like watching Europe sleepwalk into an entirely preventable disaster. The latest figures have shown that even the German economy is now experiencing almost zero growth, following other countries, such as France, that already reported sobering figures last week. A Eurostat flash estimate released today gave evidence for the generally poor growth situation in the EU-27 and the eurozone: 0.2% in both cases. So instead of solving the debt crisis, we have generated another crisis: a growth crisis.

This was entirely predictable, as the misguided austerity politics is beginning to bite and an unresolved debt crisis adds to uncertainty about the future. Let's remind ourselves of what the problem with austerity measures is. If countries that trade with each other are all cutting back at the same time, it is almost certain to have a dampening effect on

growth. Leaving aside competitive currency devaluations for the moment – another factor in this game – such policies cut off all avenues to economic growth. Why?

When public consumption and investments are cut back, private consumption and investment under current circumstances will not compensate for this. Many private households are still in debt and face economic uncertainty, and will therefore not spend enough to compensate for public cuts. Companies see there is a lack of demand for products and services and therefore have no incentive to invest. This leaves only foreign trade to have a positive impact on growth – also often called a beggar-thy-neighbour policy, as growth relies on other countries consuming more than they produce. But as most important trading partners are cutting back too, with the effects explained above, consistently growing through export increases is also very unlikely – even for Germany.

This seems to be what happened in Germany in Q2 2011. The FT reported that German imports were growing faster than exports (Germany has had much less domestic austerity than its trading partners), which means the trade balance was slowing down growth. Even though trading partners such as China are becoming more important, almost two-thirds of German exports go into the EU and more than 40% into the eurozone. So what happens in other EU economies has a huge impact on Germany.

This interdependence also shows how misguided Angela Merkel's approach to play down the importance of the EU's economic health for Germany has been. Even though one has to be careful with figures for just one quarter, the trend seems to be clear: the German *Wirtschaftswunder 2* seems to run out of steam. So the net result of European politics is a still unresolved debt crisis and a growth crisis that has now caught up with the whole of the union rather than just the countries in severe debt or subject to the worst austerity politics (or both). It is fair to say that politics over the last year or so has made a difficult but manageable crisis much worse.

So where do we go from here? Against all public announcements it would be very helpful if Angela Merkel and Nicolas Sarkozy discussed eurobonds at their meeting today as they are the most potent way to stabilise the eurozone crisis. The issue of eurobonds needs to go hand-in-hand with rather complicated reforms of fiscal governance structures. So it would be much better if time was devoted to working out these details rather than again waiting until the point reality forces political leaders to adopt a certain measure – basically the approach so far.

Once this is done, there is an urgent need to devise a comprehensive growth strategy for Europe – one that should be targeted at creating more economic cohesion and generating jobs. The link between the debt crisis and the new comprehensive growth crisis is becoming ever more important: without economic growth, crisis countries stand little to no chance of turning their debt trends around and getting back on to a fiscally sustainable path. And it is high time to acknowledge this and act accordingly.

The European Financial Stability Facility (EFSF) is not the right mechanism to deal with the debt crisis as it is based on direct guarantees from richer to poorer countries and such a system has clear political and economic limits. We need to issue eurobonds backed by the European Central Bank as lender of last resort to put an end to the ongoing erosion of the eurozone – and we need a new European growth strategy. This is the task, but the doubts of whether Europe's political leaders are up to the challenge are growing by the day.

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