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In Europe, Arguing to Apply Some Stimulus Along With the Austerity

By LIZ ALDERMAN

PARIS — With much of Europe embarked on a program of budget-cutting and belt-tightening, doubts about whether more austerity is the answer to today's economic troubles are popping up in the strangest places.

On a concrete wall in Oporto, Portugal, where a tough austerity effort has hit hard, a somber graffiti mural depicts a submarine in a nose dive.

“Austerity doesn't save,” the caption warns. “It sinks.”

As Western countries grapple with lingering economic malaise, even some traditionalists within the policy-making fraternity are starting to worry that such slogans might be right. But as a phalanx of politicians, academics and other experts gathers this week at the [World Economic Forum](#) in Davos, Switzerland, perhaps the biggest question they will face is whether it is possible to develop policies to revive growth even as Western countries seek to reduce debt.

Europe and the United States are both locked into fiscal strategies based on curbing government debt and paring borrowing. Europe has been following a German prescription intended to save the euro zone. Meanwhile, Washington, which is in the throes of a heated presidential campaign, is divided over

whether to extend a [payroll tax cut](#) for the rest of the year and has committed, at least on paper, to cutting spending by \$1.2 trillion starting this year.

Whether austerity will help revive economies over the long term is the subject of an intensifying debate, especially as much of Europe heads into what looks like its second [recession](#) in three years. The United States — where belt-tightening, though painful, has not been nearly so severe — shows glimmers of a recovery.

“It is clear that austerity alone is a recipe for stagnation and decline,” said Joseph E. Stiglitz, a Nobel laureate and professor at Columbia University in New York. “The likelihood that things would work out well is extraordinarily small.”

Recently, there have been signs the tide is shifting. In the past several weeks, European politicians have begun to insist quite publicly that austerity can no longer be the sole answer to putting even the most heavily indebted economies on the path to a brighter future.

After months of talk of almost nothing but cuts, Prime Minister [Mario Monti](#) of Italy and President [Nicolas Sarkozy](#) of France delivered such a message to the German chancellor, [Angela Merkel](#), during recent visits to Berlin, with a surprising result: “Growth” has become the new watchword on everybody’s lips — even Mrs. Merkel’s.

“Budget consolidation is one of the legs Europe’s future must be built on,” Mrs. Merkel said this month after meeting with the Italian and French leaders. “But of course we need a second leg,” she added, which is “economic growth, jobs and employment.”

Germany is still insistent that the most foolproof path to sustainable recovery is through structural change, including the overhaul of rigid labor markets and changes to pension laws, much like those Germany painfully pushed through in the 1990s.

But the fruits of such labors often take years to emerge. In the meantime, the concern is that economies that are already in a slowdown will be weakened further by large cuts in national spending

and by tax increases that governments are embracing to satisfy lenders and to placate the financial markets.

“You could say that if there’s no austerity, growth might be higher,” said Stefan Schneider, the chief international economist at Deutsche Bank in Frankfurt. “But then again, no austerity would probably escalate the bond crisis in Europe, and then you would wind up with total chaos.”

In the United States, where the budget deficit remains high and President Barack Obama has pressed for more stimulus, there are tentative signs of an economic comeback. The unemployment rate fell to 8.5 percent in December, its lowest level in nearly three years, after about 200,000 jobs were added.

The outlook remains fragile. The phaseout of an earlier stimulus program cost the United States an estimated half a percentage point in growth last year, and could further reduce potential gains in 2012. Washington is also likely to provide less government support this year amid continued wrangling between Republicans and Democrats over economic policy.

But the U.S. Federal Reserve has been more accepting than the European Central Bank of keeping interest rates low and of pumping extra money into the banking system in a bid to restart the engines of the economy.

“The U.S. government has been willing to provide more stimulus than the Europeans, and the Federal Reserve has been more accommodative on monetary policy,” said Paul De Grauwe, a professor of economics at the Catholic University of Leuven in Belgium. “So America’s environment is easier right now because its macroeconomic policies are less contractionary than in Europe.”

In Europe, Mr. De Grauwe added, “excessive austerity, no fiscal stimulus and a European Central Bank not willing to do the same as the Fed is the wrong policy mix.”

That policy mix is showing signs of changing, however, with the E.C.B. starting to lend hundreds of billions of euros to banks to prevent a freezing of the financial system and in the hopes of greasing the

wheels of commerce.

Still, austerity remains the dominant feature in Europe. Ireland, one of the first countries to receive a financial lifeline in the current crisis, has been held up by Mrs. Merkel and others as a model for exiting the [sovereign debt crisis](#). But the group of creditors administering a bailout of €65 billion, or nearly \$85 billion at current exchange rates, for Ireland reported that even though the country had succeeded in reducing its staggering deficit last year, its sluggish economy would grow even more slowly in 2012 than first thought.

That could make it harder for the government of Prime Minister Enda Kenny to meet its deficit target and to return to borrowing at reasonable rates in financial markets.

Similarly, an austerity program in Britain appears to be falling short of its goals, largely because economic growth has consistently failed to measure up to government expectations. In Spain, austerity programs will lead the economy to contract an estimated 1.5 percent this year, the central bank said this week, instead of growing by that much, as originally thought.

Further south, Mr. Monti has grown increasingly alarmed about the risk that Italy will stumble into what he calls an “austerity trap.” On the morning of his visit this month to the German Chancellery, he warned in an [interview](#) with the German newspaper Die Welt that if Italians did not see concrete rewards for their willingness to cut and save, there would be protests against Europe and Germany, which “is seen as a ringleader of E.U. intolerance.”

Mr. Monti then headed back to Rome, where he put the finishing touches on a set of measures announced last week that aim to revive the sluggish, protectionist Italian economy by investing €5.5 billion in infrastructure and opening up professional guilds to competition.

In France, Mr. Sarkozy, who has pressed Mrs. Merkel to put greater emphasis on growth, took steps of his own this month toward economic renewal and job creation. Last week, he announced at a meeting of business and labor leaders a modest €430 million program for employee training and a separate set

of measures intended to help companies hold on to workers.

French unions denounced the measures as little more than a political ploy that would have little real effect on employment.

Would more stimulus spending help Europe?

Kenneth S. Rogoff, an economics professor at Harvard University and a former chief economist at the International Monetary Fund, says the most deeply indebted countries have little room to maneuver because increased borrowing would only make it more expensive for them to sell their bonds.

On the other hand, should European countries be “willing to be in a recession for five years just to prove their credibility?” Mr. Rogoff asked. “That’s not tenable.”

This article has been revised to reflect the following correction:

Correction: January 24, 2012

In an earlier version of this article, the name of Paul De Grauwe, a professor of economics at the Catholic University of Leuven in Belgium, was misspelled.



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