2)

4

E.U. risks making things worse

Paul Taylor

INSIDE EUROPE

PARIS Harsher enforcement of much-abused European budget rules may assuage the bloc's German paymaster, but it will not solve the euro zone's deeper problems.

Under proposals outlined by the European Commission last week, euro-zone governments would face mandatory deposits and fines if they breached E.U. debt and deficit limits, although how automatic the sanctions would be remains to be decided.

The prospect of sanctions might deter reckless fiscal behavior and statistical fraud, but economists warn that it could also condemn much of Europe to low growth and widen the economic divide in the currency area.

Without growth, the public debt of countries like Greece, Ireland and Portugal will eventually become unmanageable.

"Poor economic growth prospects, not high deficits, lie at the heart of the euro-zone crisis," said Simon Tilford, chief economist at the Center for European Reform, a research institute.

He and other economists contend that too much austerity will depress private consumption and government revenue and increase the bad debts held by state-guaranteed banks, raising the cost to taxpayers.

Ireland's ever-mounting bill for its stricken banks, weighed down with nonperforming property loans, is a case in point.

"The euro zone can only avoid permanent crisis by convincing investors that growth will be strong enough for the hard-hit members of the currency union to service their debts," Mr. Tilford wrote in an essay titled "How to Save the Euro." "As things stand, it is hard to see how they can grow their way out of trouble."

Since the euro zone's weaklings cannot devalue, they face a prolonged period of wage cuts, deflation and austerity to regain lost competitiveness with Germany, the zone's economic powerhouse.

Angry at having to bail out Greece and pledge money to a euro-zone safety net, Berlin is leading the drive for harsher automatic sanctions on deficit sinners.

But economists at the International Monetary Fund warned last week that the drive by some European countries to cut budget deficits would result in lower growth and higher unemployment.

I.M.F. research shows that a deficit cut equivalent to 1 percent of gross domestic product typically reduces G.D.P. by 0.5 percent and raises unemployment by 0.3 percentage point within two years.

That runs counter to the prevailing wisdom in the European Commission and the European Central Bank that shrinking the state fuels the private sector and stimulates private spending.

Both Greece and Portugal have fallen behind their revenue forecasts for this year because of economic contraction.

This raises the question of whether the bloc's new budget rules, which still have to be approved by member governments and the European Parliament, will be any easier or more practical to apply than the shredded policies they are meant to replace.

JOCK FISTICK/BLOOMBERG

The European Commission has proposed deposits and fines for euro-zone countries that exceed limits on debt and deficits.

The possibility of imposing sanctions, both deposits and fines, has been part of the European Union's Stability and Growth Pact since it was adopted in 1997, two years before the introduction of the euro.

The penalties have never been applied, partly because the system allowed for political discretion, and big countries like France and Germany mustered enough support among E.U. finance ministers to block the commission's proposals to discipline them.

But E.U. officials acknowledge that sanctions also remained a dead letter because impounding a chunk of a heavily indebted struggling country's G.D.P. would make no economic sense — an objection that appears equally valid for the new proposals.

"Poor economic growth prospects, not high deficits, lie at the heart of the euro-zone crisis."

Indeed, by requiring, say, Portugal to deposit 0.2 percent of its G.D.P. until it remedied an excessive deficit, the bloc might push the country closer to having to seek a bailout from the recently created euro-zone financial safety net.

The commission wants to curtail political discretion in decision-making by changing the rules so it would take a qualified majority of member states to overturn a proposal for sanctioning a country.

But the French are resisting, arguing that elected politicians rather than bureaucrats must have the final say.

Britain, which does not use the euro, says it will not agree to be bound by any such rules, on grounds of national sovereignty.

France, the biggest farming country in Europe, objects to calls that would see countries that breach the deficit rules lose their access to E.U. agricultural subsidies. Italy, with a debt pile of more than 100 percent of G.D.P., does not want fines to apply to excessive debt.

And Poland says it would be unfair to cut off E.U. structural funds to deficit sinners, since they go to the poorest countries.

Pressure from the bond markets is more likely to keep euro-zone governments on the fiscal straight and narrow than any threat of sanctions from Brussels.

Paul Taylor is a Reuters correspondent.

ONLINE: INSIDE EUROPE
Read past columns by Paul Taylor.
global.nytimes.com/business