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E.U. leaders warn against backsliding on budgets

SAARISELKA, FINLAND

Latest jitters about Spain spur officials to plead for resolve on spending cuts

BY PAUL GEITNER

Even above the Arctic Circle, where pristine snow sparkles under shimmering northern lights, European leaders still feel the heat from the sovereign debt crisis burning on the Continent below.

The latest flare-up of market jitters surrounding Spain, which saw its long-term borrowing costs start to climb again last week, drew attention away from some of the more big-picture agenda items at a small, weekend conference on economic issues organized by Jyrki Katainen, the prime minister of Finland.

Jörg Asmussen, Germany's new appointee to the European Central Bank's executive board, and Olli Rehn, the Finn who is vice president of the European Commission, used their attendance to renew stern public warnings against backsliding on budget-cutting commitments, despite the deepening sense of recessionary gloom that had been exacerbated by rising oil prices. The small country of Latvia, with a population of two million, was cited as a good, and rare, example for its relatively quick recovery from a 2009 bailout.

Mr. Katainen, the 40-year-old leader of one of the euro area's last remaining triple-A-rated countries, spoke more optimistically in his public comments of "growsterity," a form of austerity that allows for some targeted measures to encourage growth, like Finland's decision to grant tax relief for research spending by companies despite sharp budget cuts elsewhere.

"It's clear that if you cut expenditures and raise taxes, it will weaken the growth in the short term," he conceded. "But at the same time it will strengthen the credibility of the country. And once you earn back the credibility, the growth will follow, as we have seen in Ireland,

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E.U. leaders urge budget discipline

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for instance, or in Latvia, especially.''

Ireland is not out of the woods yet; it sank back into recession at the end of last year and expects only meager growth in 2012 as domestic demand remains weak. But Latvia's prime minister, Valdis Dombrovskis, also 40, attended the conference and was held up as something of a star pupil, even though the Baltic country does not — yet — belong to the euro club.

Sent reeling by the global financial crisis, Latvia was rescued with a €7.5 billion, or $9.9 billion, bailout from the European Union and International Monetary Fund in 2009. Mr. Drombovskis, who already had earned a reputation as a cost-cutter as a member of the European Parliament's budget committee, took office in February of that year and promptly slashed the budget, causing a sharp contraction in the economy. He refused to devalue the lats, the Latvian currency, and insisted on keeping the peg to the euro — which the country still hopes to join in 2014 — and using wage cuts and deflation to lift competitiveness.

Since then, the country has rebounded, and in the last quarter of 2011 gross domestic product grew 5 percent, the fastest rate in the European Union. Mr. Drombovskis recommends similar shock therapy to his southern partners, cushioned with some extra social spending to soften the blow.

''We did most of our adjustment in 2009, right in the middle of the crisis, but that's also the time when people understand that it's a crisis and you need to act,'' he said in an interview in his cabin after a full day of meetings, dog-sledding and snowmobiling.

At the same time, the government prolonged unemployment benefits, raised the minimum welfare allotment and created a temporary work program that found jobs for more than 100,000 people. All that was ''not so terribly expensive,'' relative to the cuts being made, he said, and helped maintain public support.

''In a sense, it was also important as a signal,'' he said, ''to say, 'O.K., we do all this austerity, we do all these wage cuts, we do all those tax raises and we lay off people in the public sector, and so on and so on. But at the same time, we also take care of those most affected by the crisis.' ''

Despite Latvia's progress, Mr. Dombrovskis said he worried that the recession across most of Europe was dragging his country down again. Latvia has already reduced its growth forecast twice for this year, to 2 percent from an initial 4 percent.

The Finnish prime minister urged "growsterity," a form of austerity allowing certain measures to spur growth.

''It's basically because of the euro zone crisis,'' he said. ''So it's not so far away after all.''

Reeling from that crisis, the Spanish government, in office barely three months, recently announced that it could not meet the official deficit-reduction target for this year because of the worsening outlook. The country is entering its second recession in less than three years, with nearly one in four Spaniards out of a job.

Even though Prime Minister Mariano Rajoy promised to still reach the 2013 target, markets reacted skeptically, a sequence of events that Mr. Rehn termed ''illustrative.''

''It is indeed very challenging to find the right balance in the case of Spain,'' Mr. Rehn noted. ''That shows how fragile the situation still is.''

Íñigo Méndez de Vigo, the Spanish secretary of state for the European Union, was the only official from Europe's troubled southern periphery attending the meeting, which also included Finland's energetic minister for European affairs and foreign trade, Alexander Stubb, another fresh face at 43, and Pascal Lamy, the two-term director general of the World Trade Organization, with a long career in Brussels behind him as well.

Mr. Méndez de Vigo professed not to feel intimidated, however. ''We have to act together,'' he said in a post-meeting interview, having sacrificed his chance to go on the ''husky safari'' organized for conference attendees through the sparse woods surrounding the town. ''The Spanish are very pro-European.''

The company that provided the excursions, by the way, recently downsized to about 160 dogs from around 300, selling the animals to operators abroad because it couldn't afford their food and upkeep as the economic crisis has cut into its business, according to one tour guide, Artjem Navko.

Mr. Méndez de Vigo, who has also spent two decades as a member of the European Parliament, noted that Madrid quickly agreed on a slightly tighter budget target for this year under pressure from the European Commission.

''If you had asked me when I first became an M.E.P. 20 years ago if something like that could happen, I would have said 'no,' '' he said.

He said he believed Spaniards would stand behind the government — it was expecting to bolster its majority with a historic victory in elections Sunday in the region of Andalusia — despite the steady stream of austerity measures and a general strike called for this Thursday.

''We are now at the worst moment,'' he said, referring to the austerity measures. ''It takes some time until they start producing growth.''

Bond markets would come around as well, he insisted, once they realized that Spain would do what it takes. ''You regain confidence if you are serious,'' he said, promising that: ''The sacrifices will be proportional to the development of the situation.''

Mr. Méndez de Vigo, who came to Saariselka in the Lapland region of Finland without any aides or even business cards in his pocket, said every government department was already making do with less.

''I have no money,'' he said. ''I don't even put out bottled water for my guests. I just fill a pitcher from the tap and pour.''

JUSSI NUKARI/LEHTIKUVA, VIA AGENCE FRANCE-PRESSE

Prime Minister Jyrki Katainen of Finland taking a break on Saturday from meetings on E.U. economic policies that were held in Saariselka, in the country's Lapland region.