Europe finds itself caught in vise of austerity

FRANKFURT

Divisiveness growing as pain of cutbacks leads to demands for stimulus

BY JACK EWING AND LIZ ALDERMAN

Citizens from Prague to Paris to Amsterdam have made it abundantly clear in the past few days that they are tired of the economic austerity forced on them by the euro zone debt crisis.

But as the budget-cutting pain of reduced government benefits and social services brings protesters to the streets and fuels support for nationalist or far-left parties, it remains unclear what the economic alternatives might be. Rejecting austerity budgets in favor of more government spending will not ensure growth, many economists say.

Governments in countries like Spain are having enough trouble financing their existing debt, much less coming up with stimulus money. Germany, the only large country in the euro zone with the budgetary room to increase deficit spending, is not willing to do so. Neither was the Netherlands, at least until its government collapsed Monday over a dispute that essentially reflects the austerity versus growth debate.

"We are getting more and more reform fatigue," said Jörg Krämer, chief economist at Commerzbank in Frankfurt. "It is a problematic phase in the sovereign debt crisis."

Financial markets were down deeply and broadly in Europe on Monday, on concerns over the austerity backlash, and the sell-off carried over to the U.S. markets. As more European countries teeter on the edge of recession or slip into one — and official figures released Monday confirmed that Spain had done so — even the policy-making elite has begun to question whether Germany and the European Central Bank have gone too far in insisting that fiscal discipline is a prerequisite to growth.

Euro zone unity is under strain as other Europeans resent what they perceive as Germany's self-righteous attitude in insisting that all countries in the currency bloc keep their promises to reduce government budget deficits to 3 percent or less of gross domestic product.

"A global undifferentiated rush to austerity will ultimately prove self defeating," Christine Lagarde, the managing director of the International Monetary Fund, said Saturday at the I.M.F.'s spring meeting in Washington.

But Ms. Lagarde also acknowledged the quandary facing European leaders. Most of them simply do not have the resources to pay for public works projects or social programs that would ease the

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PETER DEJONG/THE ASSOCIATED PRESS

The Dutch prime minister, Mark Rutte, top, leaving the royal palace in The Hague on Monday after giving his government's resignation to Queen Beatrix, the head of state.

At impasse, Dutch coalition quits

THE HAGUE

Failed effort on budget leaves leadership void and rattles euro zone

BY DAVID JOLLY

The Dutch prime minister, Mark Rutte, on Monday announced the resignation of his coalition government after its partners failed to agree on austerity measures, leaving the Netherlands with a messy leadership vacuum at a time of anxiety about the euro.

Mr. Rutte has been one of Chancellor Angela Merkel's allies on fiscal matters, as well as a strong voice in favor of austerity for other European countries. His inability to deliver on his promises signals a possible shrinking of the euro zone "core" around Germany and its insistence on tight fiscal discipline.

Mr. Rutte tendered his resignation to Queen Beatrix, the head of state, at her palace in The Hague, his office said.

The queen replied that she would take his offer into consideration, and asked that his cabinet — made up of ministers from Mr. Rutte's conservative VVD Party and the Christian Democrats — continue on in the interest of the nation. That paves the way for new elections to be held, possibly before the end of June.

The dissolution of the minority government became inevitable after an ally, the far right Freedom Party of Geert Wilders, on Saturday abandoned negotiations aimed at cutting a budget shortfall by €16 billion, about $21 billion, to meet targets agreed to last year in Brussels and to safeguard the Netherlands's coveted AAA credit rating.

The two Dutch coalition parties had managed to govern since taking office in 2010 only because Mr. Wilders, an anti-Muslim, anti-immigration firebrand, cooperated in Parliament to give them a majority.

Budget negotiations had been under way since March, when the government forecast that the 2013 deficit would come in at 4.6 percent of gross domestic product, well above the 3 percent maximum mandated by euro zone leaders.

But Mr. Wilders, whose supporters include many voters of modest means, argued that the measures would weigh too heavily on the weakest members of society.

Finance Minister Jan Kees de Jager has said he still intends to present a budget plan by April 30 for meeting the 3 percent target. That will require the help of opposition parties that are not keen to cut social spending and raise taxes.

A variety of economic and political news, including the fall of the Dutch government, contributed to a drop in world markets Monday. Major indexes in Europe were down about 3 percent for the day, while markets in the United States were more than 1 percent lower in afternoon trading.

On Tuesday, Mr. Rutte is expected to address Parliament to discuss the election schedule and explain how he intends to handle the national finances in the interim period. Getting a deal acceptable to both Brussels and the opposition parties will be a tall order.

Mr. Rutte's best hope may be a deal with the Labor Party, said Paul Brill, a columnist for the center-left daily Volkskrant. While the party has become slightly more militant recently, he said, "It has a tradition of being responsible, of being governmental."

For 2013, though, the Brussels-sanctified budget target "no longer looks realistic," Mr. Brill said, adding, "It's almost an impossibility."

Mr. Rutte could go to Brussels and say, "'We won't make it next year, but we will in 2014,'" Mr. Brill said. "Maybe Labor could agree to go along with that."

Mr. Rutte's party has 31 seats among the 150 in Parliament, while his coalition partners, the Christian Democrats, have 21. Mr. Wilders's Freedom Party has 23. The opposition Labor Party has 30, while the Socialists have 15.

Recent polls have suggested that Mr. Rutte's party and the Socialists can expect to gain seats, while Mr. Wilders's party, the Christian Democrats and Labor would all most likely lose seats.

But no party is expected to emerge with a commanding position, meaning the instability could last for some time.

"Even after the election you'll probably need at least four parties to form a government," said Maurice de Hond, a prominent Dutch pollster. "In the last election, the biggest winner" — Mr. Rutte's party — "had only 20 percent of the vote. So it's very hard to get a majority."

In Brussels, European Commission officials — who fear that the election will become a de facto referendum on the euro at a time when worries about Spain are back on the front burner — sought to remind the Dutch of their long role in governing the euro; even the so-called Maastricht criteria, the conditions countries must meet to join the euro, take their name from a Dutch city.

Amadeu Altafaj, a commission spokesman, said Monday that the European Union expected the Netherlands to stick to its commitments, "not because of a demand from Brussels or to win votes in an election, but because they will benefit the economy of the country and its citizens."

Asked whether the caretaker government's budget plan would be valid if it is not returned to power, Mr. Altafaj noted that governments made treaty commitments on behalf of the state.

"The commitments are not linked to one government," he said. "It would be the end of the E.U. if commitments were not respected."

Rules will not be "enforced blindly," he added, leaving room for negotiation, but would be discussed by ministers.

Paul Geitner contributed reporting from Brussels.

Divided Europeans caught in vise of austerity

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pain of rising unemployment and declining wages.

At the I.M.F. meeting, Timothy F. Geithner, the U.S. Treasury secretary, repeated his call for Europe to at least temporarily set aside budget cutting and engage in the sort of government spending stimulus that the administration of President Barack Obama prescribed for the American economy in 2009. But the United States can finance a gaping budget deficit because of the world's seemingly insatiable appetite for Treasury bonds.

The central issue facing the euro zone is how to escape a vicious cycle: Budget cuts drag down growth and push up unemployment, which in turn reduces the government's tax revenue. Economic growth seems absent from the equation.

On Monday, there was fresh evidence of the poor state of the euro zone economy. Official data confirmed that Spain was in recession, after economic output fell 0.4 percent in the first three months of the year. Spain joins countries including Italy, Belgium, the Netherlands and, outside the euro zone, the Czech Republic, in falling into recession. Even Germany may have slipped into recession in the first quarter, economists say, though official data is not yet out.

And a survey of European purchasing managers by the research firm Markit on Monday showed an unexpected decline in confidence during April.

Simon Tilford, the chief economist at the Center for European Reform in London, said countries were being forced to impose fiscal austerity at precisely the wrong point in the economic cycle.

"If they attempt to meet fiscal targets, investors punish them because they worry about growth; and if they ease austerity, markets get concerned about the long-term sustainability of their finances," Mr. Tilford said. "They're damned if they do and damned if they don't."

Signs of popular frustration are multiplying. In France, voters on Sunday gave the Socialist candidate, François Hollande, the most votes in the first round of presidential elections after he promised to delay budget balancing and instead hire more teachers and police officers and raise subsidies for industry.

The budget-tightening policies President Nicolas Sarkozy imposed in response to the euro zone crisis are part of the reason he is at risk of being voted out of office in the second round of the French voting on May 6.

ANDREA COMAS/REUTERS

Watching share prices fall in Madrid on Monday, where the benchmark index fell 2.8 percent as Spain's economy entered recession.

Austerity has resonated through ordinary European society and is seen as a factor in a surge in suicides.

In Prague, an estimated 90,000 people rallied Saturday to demonstrate their lack of faith in a government that had cut the budget while raising taxes and was facing accusations of corruption.

Even the Dutch face a political crisis as they try to agree on a budget. The far-right Party for Freedom of Geert Wilders walked out of budget talks rather than support the additional cuts needed to bring the deficit back in line with European Union rules.

These signs of unrest, though, do not seem to be mellowing Germany's insistence on strict austerity. Jens Weidmann, president of the German central bank, argued Monday that the core problem in the euro zone was a lack of faith in the soundness of governments' fiscal health.

The only solution, Mr. Weidmann said at the Economic Club of New York, was to get public finances in order. "There is little alternative," said Mr. Weidmann, who is an influential voice on the governing council of the European Central Bank. "In the end, you cannot borrow your way out of debt; cut your way out is the only promising approach."

Mr. Weidmann's views are widely shared in Germany. But Germany is becoming isolated in Europe as an increasing number of economists and policy makers argue that euro zone countries could do more to offset the social effects of austerity on ordinary Europeans — an impact that includes a surge in suicides.

In some cases, countries are being given more leeway on spending. Ireland was able to quietly strike a deal with its international bailout partners for relief from an austerity package, Michael Noonan, the finance minister, said recently in Paris. "We hope to show a return to significant growth in the economy," he said.

Among other things, Ireland will be able to invest a third of the proceeds from state asset sales in measures intended to stimulate its moribund economy, rather than devote the full amount to debt reduction.

Marie Diron, an economic adviser to the consulting firm Ernst & Young, said that Germany could slow down its own drive to balance the budget and do more to encourage domestic consumption. Other European states would benefit if Germany bought more of their goods.

"Austerity has to fit into a wider policy context," Ms. Diron said.

Last week, the I.M.F. called for Europe to begin issuing bonds backed by all members — so-called euro bonds — which would take pressure off the most indebted countries, whose high borrowing costs are contributing to their economic woes. Within Germany, there is little support for such measures. "It doesn't seem to be on the agenda at the moment," Ms. Diron said. "Germany is enjoying the fact it is one of the few fiscally sound countries."

There are also increasing calls for the E.C.B. to issue another round of low-cost three-year loans to banks, as it has already done twice since December. The E.C.B. should also cut its benchmark interest rate from 1 percent, economists say, or resume purchases of euro zone government bonds to hold down borrowing costs. But as it has in the past, the E.C.B. would probably take such steps only in return for an implicit guarantee from governments that they would do more to make their economies operate more efficiently.

Leaders like Mr. Sarkozy may complain about the stubbornness of Germany and the E.C.B. But economists also fault political leaders for doing too little to encourage investment and job creation within their own borders — for not doing the sorts of things that many experts say are the only way to achieve the long-term, sustainable growth that government spending can seldom achieve.

Most euro zone countries, including Germany, rank low on the World Bank's annual standings on the ease of doing business. The survey grades countries according to such factors as how long it takes to set up a new business or enforce a contract in court. Germany was only 19th in the most recent rankings, behind Malaysia and Thailand. Italy was a dismal 87th and Greece was in 100th place out of 183 countries.

In many cases, countries could improve their rankings by cutting regulatory hurdles, which would also save money. But changes to make it easier to start a business often run afoul of vested interests that fear increased competition.

"The last thing these economies need is a debt-financed stimulus program," said Mr. Krämer, the Commerzbank economist.

Even leaders in some of the afflicted countries say that fiscal stimulus could backfire, by reducing pressure on political leaders to make needed changes.

Vítor Gaspar, the finance minister of Portugal, said during an interview that his country — under a previous government — made a mistake when it responded to a downturn in 2008 by pumping money into the economy. The result, he said, was to exacerbate the debt problem without creating lasting growth.

"My country definitely provides a cautionary tale that shows that, in some instances, short-run expansionary policies can be counterproductive," Mr. Gaspar said.

Liz Alderman reported from Paris and Peter Eavis contributed reporting from New York.

Stocks jolted in Europe and beyond

NEW YORK

BY VICTORIA SHANNON

An abrupt change in the political and economic winds in Europe shook stock markets there and helped depress shares on Wall Street on Monday.

Major indexes in Europe were down nearly 3 percent for the day on the collision of negative indicators, while U.S. markets were more than 1 percent lower in afternoon trading.

On the political side, the leftist presidential candidate in France scored a narrow victory over the incumbent in the first round of voting Sunday, and the government in the Netherlands resigned Monday after failing to agree on budget cuts.

In the economy, official data from Spain confirmed that the country was in a recession; a survey of corporate purchasing managers in countries that use the euro fell to a five-month low, indicating that the private sector was contracting; and a German manufacturing index unexpectedly dropped in April.

The Euro Stoxx 50 index of blue-chip euro zone issues closed 2.9 percent lower at 2,244.83 points. In London, the FTSE 100 fell 1.9 percent to 5,665.57. In Paris, the CAC 40 sank 2.9 percent to 3,098.37. In Frankfurt, the DAX tumbled 3.4 percent to 6,523. In Madrid, the Ibex 35 index fell 2.8 percent to 6,846.60. In Amsterdam, the AEX index fell 2.6 percent to 301.27. The euro slid 0.6 percent against the dollar to $1.3114.

In afternoon trading in New York, the Dow Jones industrial average was off 1.1 percent at 12,890.88 points. The Standard & Poor's 500-stock index was down 1 percent, at 1,364.12, and the Nasdaq composite index fell 1.2 percent to 2,965.12.

The euro zone purchasing managers index published by Markit, intended to show near-term growth in the manufacturing and services sectors, fell in April to 47.4 points, compared with analysts' forecasts for a slight uptick to 49.3 from last month's 49.1.

The reading "supports the idea that euro zone economic activity is likely to experience recessionary conditions throughout the course of this year," Mark Miller, an economist at Capital Economics in London, wrote in a research note, according to The Associated Press.