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Europe faces difficult search for growth

AP By DAVID McHUGH | Associated Press – Mon, May 21, 2012

WASHINGTON (AP) — On paper at least, European leaders agree: They need stronger growth measures to help their economies expand out of their 2½-year-old government debt crisis. Figuring out exactly what those new steps might be will be the hard part.

Persistent political divisions — neatly bridged by a Group of Eight summit statement that advocates a mix of austerity and growth promotion — and lack of money stand in the way of a comprehensive European growth strategy. Analysts said markets were likely to look past the verbal deal, with news about Greece's struggle to stay in the eurozone and an informal European Union summit Thursday in Brussels more likely to set the tone.

At Saturday's G-8 summit, German Chancellor Angela Merkel — under urging from U.S. President Barack Obama and French President Francois Hollande — signed onto a statement that called for mixing painful cutbacks with growth-promoting measures to deal with a crisis that threatens the global economy.

The leaders warned that budget deficits have to come down. But they also acknowledged that an approach that's based mostly on austerity and longer-term reforms can't help countries out of recessions this year or next. That's the approach that has dominated the continent's German-led attack on the crisis since it erupted in late 2009, when Greece admitted its finances were broken.

"Our imperative is to promote growth and jobs," leaders said in their final declaration after Saturday's summit. While they "commit to fiscal responsibility," the leaders also supported spending on education and public works. They also said heavily indebted countries should have the chance to fix their budgets in ways that take into account how well their economies are doing at the moment and support "confidence and economic recovery."

They said little about specific steps and left exactly what to do up to individual countries, saying they recognize "the right measures are not the same for all of us."

The statement comes as markets look ahead to an informal European summit meeting Thursday, and to a June 17 election in Greece. An indecisive poll May 6 left no Greek party with enough votes to govern. A new government that rejects the austerity required under bankrupt Greece's €130 billion bailout from other eurozone countries could lead to it leaving the euro and spreading financial chaos.

Cornell University economist Eswar Prasad said the statement splits the difference among the leaders' positions and said Merkel, a chief advocate of austerity, had not altered her stance. The language "is cautious and guarded and leaves much room for difference of opinion so that each of the G-8 leaders can go back and say they got the other leaders to agree."

"Market expectations for the summit were quite low and those expectations have been met," he said. "I don't think this is going to make much difference for markets."

Asian stock markets struggled to make headway early Monday, as investors — already nervous about slowing growth in China and fears that turmoil in Europe could hit key export industries — saw little tangible progress stemming from the summit.

"Although G8 leaders made plenty of noises about combating the crisis and shifting focus towards growth, there was as usual little concrete news in terms of how they would do this," said analysts at Credit Agricole CIB in Hong Kong.

At the summit, Merkel openly rejected any sense that a pro-growth stance meant stimulus spending. It's a stance fed by annoyance among voters at home that Germany, which backs the biggest share of the European bailout fund, is helping rescue countries that were not careful with their finances. Germany faces national elections next year.

So where will growth come from?

In their summit fudge, European leaders were in effect recognizing limited steps that are already taking place in a modest and informal growth program. It's clear that the slack economy in Spain, for instance, means the country will not reach its target deficit of 3 percent of gross domestic product by next year, in effect taking more time to meet EU budget rules.

The slipping target underlines the austerity trap: To keep borrowing money by selling bonds to investors, Spain must show it is reducing its deficit, which was 8.9 percent of GDP last year. So it is severely cutting back spending. That removes stimulus from the economy. Partly as a result, the economy sank into recession. And as companies and people make less money, they pay less in taxes. The cutbacks make balancing the budget even harder.

In addition to letting deficit targets slip, European officials have talked about adding money to the European Investment Bank, a development bank that loans money for public projects, and finding ways to make quicker use of unspent EU aid funds that are typically used for things like roads, water treatment plants and ports to help poorer EU members catch up.

Prasad said such spending of EU funds could be "potentially useful if they can be packaged in a way that is politically acceptable in Germany."

Another trend happening in the background is larger wage settlements in Germany. Germany dominates as an exporter because it kept labor costs down with reforms in 2004. Some think less restraint on pay could boost consumption and spending on imports at home and even out trade imbalances within the eurozone. The top industrial union, IG Metall, won a deal for a 4.3 percent raise over 13 months in a key region in southwestern Germany over the weekend.

It's a trend that officials can bless, but it doesn't require action on their part.

Yet economists say that emerging measures such as slower deficit reduction and more EU infrastructure spending, while helpful, will not enough. Not enough money is involved.

A bolder growth strategy could include movement toward some form of group borrowing among all 17 eurozone countries to pay for public works projects, said Marc Ostwald, strategist at Monument Securities in London. That could be a prelude to eurobonds — collective borrowing and central control of budget spending. "The thing they absolutely have to decide is how they're going to move toward fiscal union," said Ostwald. "Germany may not want eurobonds right now, but there are going to be eurobonds."

Ostwald and other economists say dealing with Europe's banking system, on shaky ground for several years, would be one of the strongest measures Europe could take now.

An EU-wide guarantee for bank deposits could shore up depositors' confidence their money is safe no matter what happens at the national level. An EU-wide banking regulator with the power to force banks to restructure would improve the flow of credit and boost confidence. Europe's shakier banks are heavily dependent on emergency credit from the European Central Bank, a situation that has persisted for several years, starting with the onset of the global financial crisis.

"We have had a damaged financial system since 2007 and 2008 but it has never been addressed," said Nicolas Veron, senior fellow at economic think tank Bruegel in Brussels. He advocates a task force to restructure troubled banks along the lines of the one that led a restructuring of the U.S. automobile industry, in which General Motors and Chrysler shed debt and reshaped their businesses under bankruptcy court protection.

"As long as we have a sick financial system, it will be very tough to get investment and consumption back to levels compatible with robust growth in the eurozone," Veron said.

Yet all those more decisive solutions face obstacles. Germany is against collective borrowing to help more indebted countries, fearing it will pay the freight as the biggest eurozone member. National governments are reluctant to give up control over banks, wanting to promote their own financial industries. Letting countries slow down deficit reduction will only roil markets unless it is seen as part of a genuine effort to fix finances in the long term.

"There is no miracle," said Veron. "It is going to be a long hard slog in the best of scenarios."