

Scene set for G20 battle over fiscal strategy

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So, is there to be a fight over fiscal frugality in Toronto or not? That appears to depend not just on whom you ask, but on which day you ask them.

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Heading in to this weekend's meeting of the G20 heads of government in Canada, the scene appeared set for a battle over fiscal strategy between the US and most of the rest of the G20.

The US has appeared to place much more weight on the need to keep demand going in the short run, with most of the rest of the G20 – certainly the Europeans and the Canadians – preferring to emphasise rapid deficit reduction.

A letter by President Barack Obama released last Friday was widely read in Europe as thinly veiled criticism of Germany's plans to cut spending and raise taxes. But the US then struck a more emollient tone. Angela Merkel, Germany's chancellor, reported that Mr Obama had not criticised German policy during a phone call on Monday.

Meanwhile, a senior administration official in Washington said the US was content with the current fiscal stance across other G20 countries, and enjoined observers to watch what governments were actually doing rather than what they were saying.

Nonetheless, Wolfgang Schäuble, Germany's finance minister, felt the need to hit back in a column in Thursday's FT.

Americans, Mr Schäuble said, might not understand the historical revulsion against deficits and inflation in Germany. He contrasted the automatic fiscal stabilisers in the German economy with the situation in those countries criticising Germany.

Behind this, officials say, lies some frustration among other G20 members, particularly Germany, about mixed signals. They say they have received forthright criticism in private from US officials such as Tim Geithner, Treasury secretary, which contrasts with more emollient statements made in public.

The US denies any inconsistency. A senior administration official said: "There is no disagreement around the importance of fiscal consolidation ... The US isn't asking for any particular country-specific action. We are focused on ensuring there is durable global growth and job creation and have made it clear that the US cannot be the consumer of last resort."

G20 observers say that the US and other countries are treading fine lines between what they really think and what image it is safe to portray in public.

In the US, the administration is under attack from Republicans and some centrist Democrats for spending too much. Polls have shown rising public concern about deficits.

Similarly, Germany's fiscal plan is actually less draconian and more backloaded than it appears, but German official rhetoric is being modulated to reflect public opinion in favour of rapid deficit reduction.

Indeed, a US official notes that the US is forecast to have the sharpest reduction in its deficit over the next few years in the G20, thanks to the expiry of stimulus spending and other measures.

Much public and official opinion has shifted towards erring on the side of prioritising deficit reduction over short-term boosts to demand.

This week the UK, frequently a US ally in economic matters, unveiled a budget raising value-added tax and promising to slash spending. Stephen Harper, the Canadian prime minister, released a letter last week calling for faster deficit reduction.

Eswar Prasad, a former senior International Monetary Fund official now at Cornell University, says that with some emerging market countries such as India also becoming more concerned about deficits, the US itself is worried it will become the target rather than the source of pressure in the G20.

"The situation has definitely shifted," Prof Prasad says. "The question now has come whether the rest of the G20 will be pushing the Americans to fall into line."

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