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# Austerity Could Cause a Great Depression in EU

By Javier Solana

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It is now increasingly clear that what started in late 2008 is no ordinary economic slump. Almost four years after the beginning of the crisis, developed economies have not managed a sustainable recovery, and even the better-off countries reveal signs of weakness. Faced with the certainty of a double-dip recession, Europe's difficulties are daunting.

Not only is Europe running the risk of lasting economic damage; high long-term unemployment and popular discontent threaten to weaken permanently the cohesiveness of its social fabric. And politically, there is a real danger that citizens will stop trusting institutions, both national and European, and be tempted by populist appeals, as in the past.

Europe must avoid this scenario at all costs. Economic growth must be the priority, for only growth will put people back to work and repay Europe's debts.

Understandably, there is a debate about how to achieve recovery. Advocates of austerity argue that debt has a negative impact on growth. Proponents of further stimulus counter that it is low growth that generates public debt, not the other way around, and that austerity in times of recession only makes things worse.

But Europeans do not have to agree on everything to find a common course. We can disagree about the long-term effects of liquidity injections, but we can all agree that it is not right to allow profitable companies to fail because credit markets are not working. We do not have to see eye to eye on fiscal policy to understand that it makes more sense to promote investment than to see our productive structure languish. And it is more cost-effective to invest in retraining the jobless than to allow long-term unemployment.

In any case, doubts about the negative impact of austerity are becoming impossible to ignore. History shows that in a deep recession, it is far more dangerous to withdraw economic stimulus too early than too late.

An excessive cut in public spending in the current circumstances can lead to a contraction in growth, which is already happening. The International Monetary Fund now projects that the euro zone will shrink 0.5 percent in 2012. Structural reforms are important to guarantee future sustainable growth, but they do not generate growth in the short term, which is what Europe needs. Instead, in exchange for meager progress on debt reduction, Europe risks causing lasting damage to its growth.

Compared with a new recession, the long-term cost of stimulus policies is insignificant. In many countries, current budget deficits are the result not of reckless government overspending, but of temporary measures to deal with the crisis. With interest rates already low and the private sector deleveraging, there is little risk of expansionary policies causing inflation or crowding out private investment. By contrast, spending reductions could undermine economic activity and increase the public-debt burden.

Public debt, moreover, should not be demonized. It makes financial sense for states to share the cost of public investments, such as infrastructure projects or public services, with future generations that will also benefit from them. Debt is the mechanism by which we institutionalize intergenerational solidarity. The problem is not debt, but ensuring that it finances productive investment, that it is kept within reasonable limits and that it can be serviced with little difficulty.

Yet, ominously, the same arguments that turned the 1929 financial crisis into the Great Depression are being used today in favor of austerity at all costs. We cannot allow history to repeat itself. Political leaders must take the initiative to avert an economically driven social crisis. Two actions are urgently needed.

At a global level, more must be done to address macroeconomic imbalances and generate demand in surplus countries, including developed economies like Germany. Surplus emerging market economies must understand that a prolonged contraction in the developed world creates a real danger of a global downturn at a time when they no longer retain the room for maneuver that they had four years ago.

Within the euro zone, structural reforms and more efficient public spending, which are essential to sustainable long-term growth and debt levels, must be combined with policies to support demand and recovery in the short term. The steps taken in this direction by German Chancellor Angela Merkel and French President Nicolas Sarkozy are welcome but insufficient. What is needed is a grand bargain, with countries that lack policy credibility undertaking structural reforms without delay, in exchange for more room within the European Union for growth-generating measures, even at the cost of higher short-term deficits.

The world is facing unprecedented challenges. Never before in recent history has a deep recession coincided with seismic geopolitical change. The temptation to favor misguided national priorities could lead to disaster for everyone.

Only enlightened leadership can avert this outcome. European leaders must understand that adjustment programs have a social as well as a financial side, and that they will be unsustainable if those affected face the prospect of years of sacrifices with no light at the end of the tunnel.

Austerity at all costs is a flawed strategy, and it will not work. We cannot allow a misconceived notion of "discipline" to cause lasting damage to our economies and inflict a terrible human toll on our societies. All of Europe must agree on a short-term growth strategy — and implement it quickly.

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