EUROPEAN UNION ACADEMIC PROGRAMME
HONG KONG

DLB515, David C. Lam Building, Hong Kong Baptist University, Kowloon Tong, Hong Kong
T (852) 3411 6598 F (852) 3411 6588 E euaphk@hkbu.edu.hk

INSIGHT

LEUNG KIN PONG

26TH APRIL 2013

Austerity and growth debate

"So while this policy is fundamentally right, I think it has reached its limits in many aspects, because a policy to be successful not only has to be properly designed. It has to have the minimum of political and social support.", a comment from the European Commission President Barroso on 22nd April at the Brussels Think Tank Dialogue which has sparked a vivid discussion among media and analysts about whether the EU is changing its stance towards austerity.

Fiscal consolidation has been stringently adopted in the EU to meet the Eurozone Stability and Growth Pact requirement that the Euro members have to keep their annual budget deficit below 3% and debt to GDP ratio below 60% in order to ensure the stable functioning of the European Monetary Union (EMU). As commented by a senior EU official, *"it is widely acknowledged, based on serious academic research, that when public debt levels rise above 90% they tend to have a negative impact on economic dynamism, which translates into low growth for many years."* [1] Supporters also argue that tighter fiscal rules are the preconditions for growth.

Although the measures have successfully brought down the Eurozone countries' annual debt level to 3.7% in 2012, the overall debt level has increased to 90.6% of the GDP in 2012 and resulted in low growth[2] and high unemployment[3] in several countries. Some analysts suggest that deteriorating economic situation due to spending cut will lower tax revenues, necessitating further budget restraint, will lead to a vicious circle. Discontent caused by the economic plight has also led to the resurgence of populism and nationalism[4] as well as growing distrust towards the EU[5].

While the media interprets the above Barroso's comment as the EU's readiness to change its standpoint towards austerity, there is not yet a conclusive answer to whether austerity or stimulus, or well a combination of both is a better remedy for the EU's economy. It is however interesting to note a comment from Barroso at the end of his speech, *"I believe those who want to over simplify the situation putting it as a kind of an option between austerity and growth are completely wrong. We need sound fiscal policy. We need deeper reform for competitiveness and we need investment, namely with a social dimension."*

SPECIAL POINTS OF INTEREST:

1) In a letter from the European Commission Vice-President Olli Rehn to ECOFIN ministers. The academic research "Growth in a time of debt", from Prof. Reinhart and Prof. Rogoff, argued that the growth rate will diminish when debt to GDP ratio rises above 90%, based on empirical data of forty four countries spanning about two hundred years. However, the theory has been recently challenged with the omission of data of five countries in the analysis, namely Australia, Austria, Belgium, Canada and Denmark.
2) The GDP growth rate of Eurozone countries in 2012 is -0.5%. For more details, please refer to http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-14022013-AP/EN/2-14022013-AP-EN.PDF .
3) The employment situation is very divisive in the Eurozone countries, with Spain and Greece having 27.16% and 26.4 of unemployment rate, while the figure stands at 5.4% in Germany and 4.8% in Austria. For more details, please refer to http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-02042013-AP/EN/3-02042013-AP-EN.PDF.
4) The recent political deadlock in Italy is one of the examples.
5) A recent study from Eurobarameter shows that public distrust has significantly grown from 2007 to 2012.

Leung Kin Pong is *Senior Research Assistant* of European Union Academic Programme Hong Kong. He holds an MA in EU International Relations and Diplomacy Studies at the College of Europe and his research focus is on EU financial and economic policies and EU foreign economic relations.

Should you have any comments or feedbacks on the issue, please feel free to e-mail at kpleung@hkbu.edu.hk

The European Union Academic Programme (EUAP) is a consortium of four universities in Hong Kong (Hong Kong Baptist University, The University of Hong Kong, The Chinese University of Hong Kong and Lingnan University), co-financed by the European Union. It is designed to strengthen EU-Hong Kong relations through academic work and enhance the understanding of the EU.

This project is co-funded by the European Union

EUROPEAN UNION ACADEMIC PROGRAMME
HONG KONG

DLB515, David C. Lam Building, Hong Kong Baptist University, Kowloon Tong, Hong Kong
T (852) 3411 6598 F (852) 3411 6588 E euaphk@hkbu.edu.hk

INSIGHT

LEUNG KIN PONG

26TH APRIL 2013

References

European Commission, Austerity and growth debate: What President Barroso actually said at the Brussels Think Tank Dialogue (22 April 2013), http://europa.eu/rapid/press-release_MEMO-13-368_en.htm, 23.4.2012

Letter of Olli Rehn to the ECOFIN Ministers, http://ec.europa.eu/commission_2010-2014/rehn/documents/cab20130213_en.pdf, 13.02.2013

Carmen M. Reinhart & Kenneth S. Rogoff, Growth in a time of debt, National Bureau of Economic Research, 01.2010

Spiegel, http://www.spiegel.de/international/europe/controversy-simmers-over-eu-austerity-and-growth-remarks-by-barroso-a-896213.html , consulted on 25.4.2013

BBC, Europe: Retreat from Austerity, http://www.bbc.co.uk/news/world-europe-22269616, 23.4.2013

BBC, Reinhart, Rogoff…and Herndon: The student who caught out the profs, http://www.bbc.co.uk/news/magazine-22223190, 19.4.2013

The Guardian, Crisis for Europe as trust hits record low, http://www.guardian.co.uk/world/2013/apr/24/trust-eu-falls-record-low , 24.4.2013

EU Observer, Barroso: EU austerity has 'reached its limits', http://euobserver.com/economic/119904, 23.4.2013

Financial Times, Politics draws out accidental truth on becalmed Europe, 25.4.2013

Financial Times, Guido Westerwelle, Europe needs austerity and reform—not spending, 15.3.2013

The European Union Academic Programme (EUAP) is a consortium of four universities in Hong Kong (Hong Kong Baptist University, The University of Hong Kong, The Chinese University of Hong Kong and Lingnan University), co-financed by the European Union. It is designed to strengthen EU-Hong Kong relations through academic work and enhance the understanding of the EU.

This project is co-funded by the European Union