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Squaring austerity and growth: Europe's abstruse new policy

PARIS, Nov 20, 2011 (AFP) - - Reducing debt whilst enhancing growth -- the seemingly impossible conundrum faced by governments of crisis-struck European economies -- is possible to solve, say analysts, and is arguably the key to Europe's financial future.

With Greece, Portugal and Ireland already having received considerable bailouts, and Italy -- the eurozone's third-largest economy -- now hovering on the edge of trouble, Europe's politicians have already recognised that austerity measures alone are not going to save their economies.

On taking office this week, new Italian Prime Minister Mario Monti said he wanted to "stabilise the financial situation" and "get back on the path to growth".

Christine Lagarde, before arriving at the head of the IMF, caused a stir when she coined a term for the new policy by creating an oxymoron in French -- "ri-lance" -- combining the words for austerity (rigueur) and encouraging growth (relance).

This mix of growth-encouraging cuts and structural reforms for the long-term is gradually being adopted -- even by social democrat governments -- and is certainly the favoured formula of the Organisation for Economic Cooperation and Development (OECD).

There are, says OECD analyst Jean-Louis Schneider, a whole number of measures governments can take to reduce their debt without harming growth including reducing public spending, scrapping useless fiscal "niches" and increasing both VAT and taxes on property.

This strategy "can be a winner as from today", Schneider says.

"In the case of Italy, what the markets worry about is its long-term perspectives. If they see that the problem is being tackled, they will lessen the pressure," he predicts.

For Schneider, austerity measures would be accompanied by reforms of a country's pension and health systems, relaxed selection procedures for certain professions and a more flexible job market.

Michael Burda, an American analyst at Berlin's Humboldt University, agrees that the equation can be resolved by making substantial changes to the status quo.

"The problem with countries like Greece and Italy is that a large part of the economy is run or governed by the state. What you need in those two countries is to liberate some of the forces that have been restrained for so long", says Burda.

The Greek and Italian economies can make big changes "relatively cheaply" through privatisation and opening up various sectors to be competitive, he says.

But even if making the changes is feasible, it is hard.

"It is of course painful because you take things away," he says, giving the example of Greek taxi drivers.

"They spent a lot of money to get a licence and then the International Monetary Fund says you should liberate the taxi market to let more people offer a taxi service. The losers will be the people who own a taxi now, but the winner will be the economy in general in the future."

Putting these reforms in place takes time, he says, and is all the more difficult given growing public discontent -- particularly in Portugal and Greece where workers have staged a series of strikes in recent weeks -- at tough austerity programmes that include job cuts and higher taxes.

It could take "three years, possibly five years" before Europeans start seeing any benefits, Burda estimates.

But the positive effects of employing such a complex double pronged strategy will not be felt in even five years, argues Jean-Paul Fitoussi, from the French Economic Observatory (OFCE).

"We defend structural reform to resolve a crisis that is happening now, whereas its benefit will really be felt, at best, in the long term," he says.

Years of austerity before growth would likely produce a negative effect, he adds, because of the feeling of precarity that workers have which makes them save, rather than spend.

Some analysts, such as Roberto Perotti from Milan's Bocconi University, believe that tough austerity programmes are the only way to calm tense markets, and ensure stability.

But Fitoussi maintains that the series of austerity measures adopted across Europe only worsens the situation and feeds the "vicious circle" of recession-austerity-recession.