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Don't Expect a Breakthrough on Austerity at G-20 Summit

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No need to turn on the TV to witness the latest battle of the heavyweights. If, that is, you are willing to settle for an intellectual and policy slugfest among economists and politicians. In the red ink corner we have no less than President Barack Obama; White House aide [Larry Summers](#); Ed Balls, the should-have-been U.K. shadow chancellor; Nobel laureate economists Paul Krugman and Joseph Stiglitz; and economists at the International Monetary Fund.

In the black-ink corner we have U.K. Chancellor George Osborne; European Central Bank President Jean-Claude Trichet; leaders of Spain, Ireland, and Greece; and Harvard economists Alberto Alesina and Silvia Ardagna.

The differences between these two camps are not mere minor matters of nuance. The team in the red corner believes that austerity—now is a major error that risks throwing a fragile world economy into recession, or worse. As they see it, cutting deficits removes spending power from economies already afflicted with excess capacity, consumers too nervous to unzip their wallets, and businesses too uncertain of the future to invest. In the manner of St. Augustine, they do agree that austerity will some day be in order, but please, finance ministers, not yet.



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Larry Summers's economic analysis applies not only to the U.S.

The black-ink corner sees things entirely differently. Breaking ranks with almost all of his central-bank colleagues, Mr. Trichet argues that by reducing deficits, red-ink nations can shore up confidence in their futures, encourage private investment, and accelerate their economic recoveries. He has a strong ally in Mr. Osborne, who trumpets the fact that his planned draconian spending cuts and non-trivial tax increases have driven yields on 10-year gilts from around 4% to below 3% since he got his hands on fiscal policy. This earned Mr. Osborne the approbation of World Bank President Robert Zoellick on the eve of the convention of finance ministers in Washington this past weekend.

Little wonder that the poor (no pun intended) average citizen doesn't know whom to believe. And therefore relies on the guide that he has found most reliable in the past—self-interest. In Greece, France, and other austerity-minded countries, members of the public sector trade unions, scheduled for layoffs, and for reduced salaries and pensions, say that now is not the time for cuts, although they fail to specify when such a time might arrive. They nominate the bankers to take their place.

In Britain, middle-class citizens about to lose some of their benefits would not be so gauche as to take to the streets, but they do know how to take to the voting booths at the next opportunity. Meanwhile, bankers and creditors preach the virtue of fiscal rectitude, honoring contracts, cutting spending and raising taxes if necessary to avoid default. And German chancellor Angela Merkel, reconverted to the virtues of balanced or almost-balanced budgets, wants the profligate whipped into line so that German taxpayers do not have to bear the

cost of bailing out Greece & Co. —even though a failure to do so would add to the pressure on Germany's shaky banking system, overburdened with sovereign debt from Greece and similarly situated countries.

Perhaps the best arguments for continued spending come from two sources. The first is economic reality. The effective unemployment rate in America (counting those too discouraged to look for work and forced to work short hours) is over 17%. In Spain, one out of every five workers is unemployed. In Ireland, growth has ground to a halt as the deficit, including bank bailouts, hits 32% of GDP.

To demand greater austerity from these countries might well stifle the growth on which recovery ultimately depends. Indeed, both Greece and Portugal have failed to realize their revenue projections because their economies are shrinking. The IMF numbers crunchers predict that a deficit cut equivalent to 1% of GDP can cut growth by anywhere from 0.5% to 1%, and raise unemployment by 0.3%.

The second comes from Larry Summers, he of the famed IQ and lack of patience with lesser mortals, which means just about everyone. The soon-to-again-be Harvard professor argues that stimulating weak economies is not the only reason for continuing to run deficits. In an analysis applicable not only to the U.S., Summers says this is a time to build the infrastructure that successful, high-productivity economies need. Interest rates are low, making borrowing to pay for construction of bridges, roads and other infrastructure about as cheap as it will ever be. Labor is in plentiful supply, especially in the construction industries, and employing it will reduce the burden on the benefits system without placing upward pressure on wages. Invest now and stimulate growth not only in the near-term, but in years to come.

The gulf between the contestants is too wide to expect agreement. So don't expect the G-20 summit meeting in Seoul one month from now to produce a unified response to slow growth, excessive debts, the threat of future inflation, trade and currency wars, or anything except the time of the photo op.

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