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Don't save it for later

Nordic-style budget discipline won't solve the next crisis. Finland's Social Democrats want coordinated European fiscal policy

Read this article in German.

The latest German statistics make the alarm bells ring: industrial production is shrinking faster than at any point since 2009. As Germany is the most important destination for Finnish exports, its problems will also be ours at short notice. There is no need to raise the threat of a new crisis, for economic recession rarely turns into full-scale depression. However, the mere fact of a slowdown is a cause for concern, since we have yet to recover fully from the last financial crisis.

Yet recessions are not inevitable. We have the means to alleviate their effects. The instruments of monetary policy have proved easiest to use: the European Central Bank (ECB) played a key role in warding off the worst consequences of the financial and euro crisis. The ECB again showed its readiness to act by deciding on 12 September to cut its interest rate on commercial bank deposits to –0.5 per cent, thus going deeper into the negative. At the same time, the ECB decided to increase the amount of money in circulation by relaunching bond purchases.

However, monetary policy may be less effective than we hope. Once interest rates fall below zero, the price of money obviously cannot be the main barrier to investment and growth. So we need something more. ECB President Mario Draghi issued a statement showing that the central bank knows that monetary policy, which it controls, is not omnipotent. He called on the eurozone countries to shoulder their part of the burden through fiscal policy. According to Draghi, this is not the time for them to tighten the screws on public spending and taxation; instead, they should pursue fiscal policies that stimulate demand.

Being wary of debt

Fiscal policy is a tough act politically, however. Here in Finland, in

particular – but also in Germany, the Netherlands and many other countries – it is safer to demand that everyone live within their means. We are wary of borrowing, and avoiding debt bolsters our sense of security. We should also bear in mind that macroeconomics experts speak the language of economics when evaluating fiscal policies, whereas politicians are well aware that taxes raise issues of fairness and that the welfare society depends on government spending. Political considerations thus influence the way fiscal policy is used.

Fiscal policy is particularly hard for the EU – or the eurozone – with its many member states. For fiscal policies to be successful, they must apply to the whole EU. If, for example, Finland borrows money to revive its economy, a part of that debt – roughly corresponding to imports – will seep into financing the economic recovery of our trading partners. Such seepage occurs even from large EU countries. The impact on demand thus spreads across the entire economic area, whereas the borrower is burdened with the whole debt.

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The challenges to fiscal policy can be overcome, however. A particularly volatile component of central government spending is investment. During boom periods, the government can postpone investment decisions to the next bust. Taxation also contains elements that can be used to regulate demand temporarily.

Coordinating fiscal policy between EU member states is a bigger challenge. We need a coordinated, jointly implemented fiscal policy: if we stimulate our economies simultaneously, the net effect on demand will not be snapped up by our neighbour. We therefore need to move on from just thinking and talking about fiscal policy coordination to actually doing it.

Coordination is everything

The hardest part of fiscal policy is putting our money where our mouth is. Take today's situation. We respect our agreements and worry about exceeding the debt limits of the EU's Stability and Growth Pact. In itself, the demand for fiscal discipline is easy enough to understand. During the euro crisis, we feared for good reason that the common currency area would make us liable for the debts of others.

However, a level-headed assessment of the situation requires deeper analysis. First, only in Greece could excessive debt be attributed to mismanagement of public finances. In Spain, and even more so in

Ireland, when problems in the private sector spilled over to the banks, financial crisis loomed. Second, even if we dismiss the analysis of causes as hair-splitting and look only at the end result – increased public debt –, an active fiscal policy does not per se mean joint liability. Coordination of fiscal policy does not alter the fundamental principle that every state is liable for its own debts. This principle applies in the United States, which is a federal state. All the more reason that it should apply in the European Union, which is a league of independent states.

For Finland, this means a political sea change. We have come to think of sound financial management as a zero-sum game in the EU. However, when the next recession swoops across the world, it will hit us too. Any wobble in the economies of major importers of investment goods, such as China, will mean a major shock for countries like Finland. An effective fiscal policy coordinated across the EU is therefore particularly important to us.

That's why Prime Minister Antti Rinne's government programme spells out our intention to strengthen the European Semester, which means closer coordination of fiscal policy. Such coordination will be sorely needed if the threat of recession becomes a reality.



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