Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Europe's new austerity, an economic and political danger

Austerity by any other name is making a comeback across Europe, from Keir Starmer's "difficult choices" in the UK to widespread spending cuts expected across the Euro zone's major economies this fall.

The belt tightening affects both high debt countries, such as France and Italy and low-debt ones, such as Germany and the Netherlands.

The cuts, often combined with increased taxation, might make sense from a fiscal perspective but could further squeeze economic expansion on the already low-growth continent.

Politically, they can be disastrous in an increasingly populist environment that feeds in part on more than a decade of economic uncertainty.

Political and economic circumstances may vary widely but all the budget cutting countries have several challenges in common, including some global phenomena, such as the still looming spectre of inflation, higher debt-servicing outlays due to elevated interest rates and the costs of climate disruption.

But there are also some Europe-specific issues, particularly compared to the US, including more severe energy supply challenges, pressure to increase defence spending, a more rapidly aging population and overall low productivity - and economic - growth.

Collision course with the EU

The Netherlands, the Euro zone's fifth largest economy, will see its first government that includes the far-right present the budget on 17 September. It is expected to include swingeing cuts to, for example, the education budget and will solidify newly raised VAT levels on cultural activities, sports and books.

The Dutch populist far-right, of Geert Wilders' PVV party, is seen as socially more protective on issues such as pensions and the minimum wage but they rule with fiscally hawkish centre-right parties. The result can be seen in the cuts mainly affecting what are often targeted as 'elite pastimes.'

France, still lacking a new Prime Minister, let alone a functional government, is supposed to have a new budget presented by 1 October but nobody sees how that can be seriously achieved.

> Alarm bells are ringing over France's projected 2025 deficit

The best the country can hope for is a stopgap draft that the caretaker government is preparing and that includes € 10 billion less spending than last year's budget.

In the meantime, on falling revenues, alarm bells are ringing over France's projected 2025 deficit, 6.2 percent compared to this year's possible 5.6 percent, thus further increasing its debt, which is already standing at 110 percent of GDP.

It would put France further on a collision course with the European Union over it missing the targets set under the renewed Stability and Growth Pact.

Reducing aid to Ukraine

Germany is a whole different ballgame again, with relatively low debt but a pesky constitutional debt-brake that constrains borrowing. Having thought that the fractious, ideologically coalition had reached a budget deal months ago, there was a re-negotiation in August that shaved a further € 5 billion off spending.

This will be achieved by rescheduling the way that aid to the country's malfunctioning railway, Deutsche Bahn will be disbursed. That might not sound like much but any delay to fixing Deutsche Bahn will feed into popular anger over things no longer working in Germany, and nobody wants a populist party campaigning with the promise to make the trains run on time.

Of course, this comes on top of Germany next year reducing its aid to Ukraine and shifting around some defence spending creatively to keep meeting NATO's 2 percent of GDP target. There will also be cuts to money spent on climate action and humanitarian aid, among others.

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While the German budget includes a record investment boost to stimulate growth, experts are sceptical that it will suffice and only predict the package will increase growth by at most 0.2 percent. The budget still has to be discussed in the Bundestag.

Italy and Spain, with very different governments, far-right and centre-left respectively, also face high-debt and pressure to cut spending. The difference between the two countries is that where Spain is aiming to meet European Union budget rules, Italy, along with France, Belgium and several others, has received a reprimand for being in breach.

A recipe for political polarisation

The EU reactivated its adjusted Stability and Growth Pact (SGP) earlier this year after having suspended the previous version during the COVID pandemic in 2020.

The SGP is meant to safeguard the bloc's, and especially the Euro zone's, financial stability by prodding member states towards government debt of below 60 percent of GDP and an annual budget deficit of under 3 percent.

The original SGP rules were somewhat loosened post-corona, allowing a more differentiated approach, to avoid countries falling into austerity.

The new fiscal measures will lead to € 100 billion in spending cuts by 2027

The Breughel think tank, based in Brussels somewhat blandly estimates that, "the new framework will require ambitious fiscal adjustments from high-debt countries, though less than would have been required by the previous framework."

Many, especially on the left are increasingly concerned that the rules will both strangle economic growth and stifle spending to make the EU countries more competitive.

Yanis Varoufakis, the former Greek finance minister, has called the approach by the EU and the IMF to Europe's finances "austerity-light" and warned it would boost the far-right.

And a study commissioned by the European Trade Union Confederation predicts that the new fiscal measures will lead to € 100 billion in spending cuts by 2027.

That it's not only the EU rules that place severe constraints on government budgets, can be seen from the case of the UK, which is well outside the EU by now, and never was part of the Euro zone.

The new Labour government is undoubtedly facing both a very high debt level and a, probably somewhat, larger than expected deficit and can reasonably be expected to take steps to increase fiscal sustainability in the budget that is due at the end of October.

But the talking down of the economy by

Labour figures, including a baffling remark about having feared a run on the Pound, makes it also look as a political exercise to cement the party's economic bona fides in the eyes of the electorate.

Many have pointed out that Britain, like its European neighbours, is in fact not currently facing an economic crisis and that spending cuts, such as ending winter energy payments for pensioners, will be a very hard-sell across the political spectre.

With high levels of outlays required on debt servicing, climate adaptation, energy transition, defence and an ageing population, to name but the obvious culprits, European countries can be expected over the next decades to be increasingly faced with this conundrum of seemingly adequate economic performances but sharply reduced spending options. It's a recipe for political polarisation.