THE ROLE OF THE STATE IN ECONOMIC GROWTH

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# The Role of the State in Economic Growth in Europe

*A policy brief by Leszek Balcerowicz*

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# The Role of the State in Economic Growth in Europe*

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It is a bit misleading to focus on the growth in Europe as an aggregate as there has been a tremendous variation in a longer economic growth in Europe across time and space. Periods of acceleration and slowdown had occurred in the respective European countries until 2008.[1] Accelerations were caused by the improving institutional and/or macroeconomic framework or by credit booms; slowdowns by the deteriorating institutional or macroeconomic framework and/or by the busts resulting from the previous credit booms.

Economic growth in the EU during 2008 – 2013 has also varied very much. In the euro area it ranged from +5% in Slovakia to – 23% in Greece. Outside the euro area it ranged from +2,5% in Poland to -4,1% in Britain.

The differences in the economic growth in the euro area during 2008 – 2013 have resulted from the interaction between the initial conditions (which largely reflected the previous policies) and the policies pursued since 2008.

Better growth performers had avoided the credit booms and – thus – the ensuing busts (Slovakia, Germany, Austria). However, not all countries which avoided credit booms belong to better growth performers: Italy and France have performed rather poorly because of the accumulated microeconomic distortions (and in Italy, in addition, because of high public debt to GDP ratio).

Worse performers had included countries which experienced an intense credit boom – and the resulting bust (Greece, Cypres, Slovenia, Spain, Ireland). However, there is a large variation of economic growth in this group , eg. Ireland has fared much better than Greece. Besides, Bulgaria, Estonia, Latvia and Lithuania (the BELL) - countries with euro-based currency boards also suffered an acute credit boom and the resulting bust, but recovered very quickly due to a rapid and decisive fiscal consolidation and – if necessary – structural reforms. This strategy was also followed by Ireland. These facts suggest that national policies during 2008 – 2013 mattered very much: a rapid and decisive policy adjustment turned out to be much better for economic growth than a delayed or wrongly structured one (eg. first tax increases, only later spending cuts, and even later structural reforms, like in Greece).

*[*] A few remarks on conference organized by the Columbia Center on Global Economic Governance, Paris, October 5-6, 2014.*

*[1] I am drawing in this note on: Balcerowicz, L.; Rzońca, A.; Łaszek, A.; and Kalina, L. (2013) "Economic Growth in the European Union." Brussels: Lisbon Council (e-book). Balcerowicz, L., 'Euro Imbalances and Adjustment: A Comparative Analysis (2014)', CATO Journal, Fall.*

Against this background the popular demonization of ‘austerity’ (i.e. fiscal consolidation) has been very unfortunate and counterproductive.

There has been too much rhetoric about the ‘European’ solutions, which have mostly meant more unconventional monetary policy (UMC) by the ECB. This policy cannot substitute for the fiscal and structural reforms in the respective countries. What is worse, it risks, as in Japan, slowing down the pace of banks’ and enterprises’ restructuring and weakening the politicians’ incentives to lunch reforms. These effects contribute to the growth slowdown, which is then blamed on ‘austerity’ or on ‘secular stagnation’, and used as a justification to demand more of unconventional monetary policy.

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