

Engler, Philipp; Klein, Mathias; Wittenberg, Erich

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"A more balanced policy mix would be more successful": Seven questions for Philipp Engler and Mathias Klein

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SEVEN QUESTIONS FOR PHILIPP ENGLER AND MATHIAS KLEIN



Dr. Philipp Engler and Mathias Klein, Research Associates in the Department of Macroeconomics at DIW Berlin

»A more balanced policy mix would be more successful«

1. Mr. Engler, Mr. Klein: In 2010, several European countries started implementing austerity measures to reduce their sovereign debt. Of these countries, you studied the southern European countries of Spain, Portugal, and Italy as examples. To what extent was the austerity policy successful there? **Philipp Engler:** The austerity measures were not successful. The absolute level of sovereign debt has risen further, as has the public debt-to-GDP ratio in the three countries. This is why at this stage we think that the austerity policies were counterproductive.
2. Why was the policy not successful? **Philipp Engler:** We offer two explanations. First, private household debt – which was very high in the three countries during the period when the austerity measures were implemented – was reduced. This led to a simultaneous drop in private consumption, and the austerity measures triggered a deep recession. Our second observation was that the recession exhibited typical behavior. That is, it took hold for the long term and relief was delayed. In a phase like this, austerity measures amplify the process.
3. How did the austerity measures impact private households? **Mathias Klein:** In Spain, Portugal, and Italy, households used a large part of their disposable income to service their outstanding debt. In situations like these, reduced government spending or tax rate increases have more pronounced negative effects than in a normal environment. This is why we think that the massive deleveraging of private households has further amplified the negative effects of austerity.
4. That means private consumption fell? **Mathias Klein:** Yes: in the data, we saw that private consumption dropped strongly, which is primarily responsible for these negative effects. Corporate investment did not show such a pronounced effect. We also saw that employment fell sharply. Under these circumstances, the fiscal policy measures not only had a negative impact on the real economy, but they also caused upheavals in the job market.
5. How did the austerity policy affect the countries' productivity? **Philipp Engler:** We observed a typical trend for recessions. Namely, recovery started very slowly and the downturn was persistent. Overall economic productivity suffered – as we saw based on the example of these three countries.
6. Why is it persisting? **Philipp Engler:** You will find a number of different explanations in the literature. One is that during a recession companies invest less in research and development, so afterwards fewer product developments are launched into the market. This in turn weakens economic growth. Another explanation is that long-term unemployment increases and as a result, the job market loses skills and abilities it requires. Austerity measures reinforce these processes.
7. Would it be more successful to loosen up the austerity policy in the southern European countries? **Mathias Klein:** In our opinion, loosening up the strict austerity policies and instating a rather balanced mix that focuses more on structural reforms would lead to better results.

Interview by Erich Wittenberg
To hear the recorded interview in German, visit www.diw.de/interview.



DIW Berlin – Deutsches Institut
für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
T +49 30 897 89 -0
F +49 30 897 89 -200

Publishers

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