AUSTERITY: AN EFFECTIVE CURE-ALL PILL OR A TRULY DANGEROUS IDEA?

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ABSTRACT:
GOVERNMENTS TODAY IN BOTH EUROPE AND THE UNITED STATES HAVE SUCCEEDED IN CASTING GOVERNMENT SPENDING AS RECKLESS WASTEFULNESS THAT HAS MADE THE ECONOMY WORSE. IN CONTRAST, THEY HAVE ADVANCED A POLICY OF DRACONIAN BUDGET CUTS - AUSTERITY - TO SOLVE THE FINANCIAL CRISIS. WE ARE TOLD THAT WE HAVE ALL LIVED BEYOND OUR MEANS AND NOW NEED TO TIGHTEN OUR BELTS. THIS VIEW CONVENIENTLY FORGETS WHERE ALL THAT DEBT CAME FROM. NOT FROM AN ORGY OF GOVERNMENT SPENDING, BUT AS THE DIRECT RESULT OF BAILING OUT, RECAPITALIZING, AND ADDING LIQUIDITY TO THE BROKEN BANKING SYSTEM. THROUGH THESE ACTIONS PRIVATE DEBT WAS RECHRISTENED AS GOVERNMENT DEBT WHILE THOSE RESPONSIBLE FOR GENERATING IT WALKED AWAY SCOT FREE, PLACING THE BLAME ON THE STATE, AND THE BURDEN ON THE TAXPAYER. THAT BURDEN NOW TAKES THE FORM OF A GLOBAL TURN TO AUSTERITY, THE POLICY OF REDUCING DOMESTIC WAGES AND PRICES TO RESTORE COMPETITIVENESS AND BALANCE THE BUDGET.
MEANWHILE, THE EUROPEAN ECONOMY SEEMS TO BE SLIDING FROM BAD TO WORSE, AND WITH IT THE PLANET'S MARKETS.

KEY WORDS: AUSTERITY, ECONOMY, DANGEROUS IDEA, MARKETS, DEBT

INTRODUCTION

The title of this paper as well as the topic was inspired by Mark Blyth's[2] 2013 Book: ”Austerity: The History of a Dangerous Idea” in which the author's fascinating discussion focuses on the historical underpinnings of austerity, first formulated by enlightenment thinkers Locke, Hume and Adam Smith, around the *good* idea of parsimony and the *bad* idea of debt (Kirkus Reviews). It is not often that economists are so influential that their policies set a standard. Adam Smith is the standard-bearer for free markets, though his caveats and stress on the plurality of human motivations, the connections between ethics and economics, and the importance of institutions have often been ignored by enthusiastic free marketers, who have turned Smith on his head. More recently, John Maynard Keynes has been another much misquoted economic guru.

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Albert Einstein famously said that doing the same thing over and over in the expectation of different results is the definition of madness. That observation applies to the practice of economic austerity, according to political economist Mark Blyth.

Ultimately, Blyth believes that austerity is a ”zombie economic idea because it has been disproved time and again, but it just keeps coming”[3]. The problem, according to political economist Mark Blyth, is that austerity is a very dangerous idea. First of all, it doesn't work. As the past four years and countless historical examples from the last 100 years show, while it makes sense for any one state to try and cut its way to growth, it simply cannot work when all states try it simultaneously: all we do is shrink the economy. In the worst case, austerity policies worsened the Great Depression and created the conditions for seizures of power by the forces responsible for the Second World War: the Nazis and the Japanese military establishment[4]. As Blyth amply demonstrates, the arguments for austerity are tenuous and the evidence thin. Rather than expanding growth and opportunity, the repeated revival of this dead economic idea has almost always led to low growth along with increases in wealth and income inequality. *Austerity* demolishes the conventional wisdom, marshaling an army of facts to demand that we recognize austerity for what it is, and what it costs us.

The austerity measures that have been propounded by the Germans as the way to fix the European Union mess (save more, spend less) are clearly not working since everybody can’t be saving at the same time: Debt is someone else’s asset. Austerity may have worked for Germany, in the form of *ordo-liberalism* (“order-based”), and select other countries in the 1930s and 1980s, but Blyth shows how conditions are respectively unique and results hardly perfect. (Kirkus Reviews)

The refuted, faith-based doctrine is allowed to stagger on for two reasons. First, the common-sense hunch that more debt cannot cure debt remains seductively simple. Second, austerity is a neat excuse for conservatives to cut public services and run their bugbear, the welfare state, out of town.

Unfortunately or not, depending on one’s point of view, the central irony of financial crisis is that while it is caused by too much confidence, too much lending and too much spending, it can only be resolved with more confidence, more lending and more spending. This is exactly what is denied by austerity doctrines, and it is precisely the case that Austerity makes with more wide-ranging depth than any other study I have encountered. This makes it an important if flawed book. Keynes, after all, was the one who said: “Words ought to be a little wild, for they are the assaults of thoughts on the unthinking”[5].

Reliant on public services, the poor lose out, effectively funding the banks that, according to Blyth, caused the 2008 global financial crisis and then begged for a bailout. In his view - shared by many economists - the banks are nearly entirely to blame for the woes afflicting the US and Europe. The monetarist claim that everyday citizens have lived beyond their means and should tighten their belts is more of a science-fiction theme.

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[3] Mark Blyth, *Austerity: The History of a Dangerous Idea*, (Oxford: Oxford University Press, 2013)

[4] ”In such an unequal and austere world those who start at the bottom of the income distribution will stay at the bottom, and without the possibility of progression, the *betterment of one's condition* as Adam Smith put it, the only possible movement is a violent one”. Blyth, *Austerity: The History of a Dangerous Idea*.

[5] Lawrence Summers, *The End of the Line*, Financial Times, April 12, 2013, accessed at 10.03.2014. http://www.ft.com/intl/cms/s/2/5097537a-a034-11e2-a6e1-00144feabdc0.html#axzz2wBDQIruK.

IMPACT ON THE ECONOMY OF EUROPE

Europe is sinking into a protracted period of deepening poverty, mass unemployment, social exclusion, greater inequality, and collective despair as a result of austerity policies adopted in response to the debt and currency crisis of the past four years.

Mass unemployment - especially among the young, 120 million Europeans living in or at risk of poverty - increased waves of illegal immigration clashing with rising xenophobia in the host countries, growing risks of social unrest and political instability estimated to be two to three times higher than most other parts of the world, greater levels of insecurity among the traditional middle classes - all combine to make a European future more uncertain than at any time in the postwar era[6].

In the EU, one must admit that the grave impact of the crisis was not confined to the crisis-ravaged, bailed-out countries of southern Europe and Ireland, but extended to relative European success stories such as Germany and parts of Scandinavia. Last year the Spanish Red Cross launched a national appeal to help people in Spain, the first ever. Suicides among women in Greece have at least doubled. Many employed in Slovenia have not been paid for months. In France 350,000 people fell below the poverty line from 2008 to 2011.

Despite Germany's vaunted success in avoiding the high levels of unemployment prevalent across much of the EU, a quarter of the country's employed are classified as low-wage earners, almost half of new job contracts since 2008 have been low-paid, flexible, part-time so-called mini-jobs with little security and usually no social benefits. In July last year 600,000 employed in Germany with social insurance did not have enough to live on. The problems are also affecting Europe's wealthiest societies, such as Denmark and Luxembourg.

In the Baltic states and Hungary up to 13% of the populations have left in recent years due to economic hardship. Recent and often studies reports a mounting trend of intra-European migration, mainly from east to west, in search of work. The jobs crisis is one of the most debilitating issues facing the EU and the eurozone. Of more than 26 million unemployed in the EU, those out of work for longer than a year stands at 11 million, almost double the level of five years ago when the international financial crisis broke out in the US.

The social impact is immense. In Greece and Spain adult children with families are moving back in with their parents, several generations are living in single households with one breadwinner between them. It is now a common sight to find formerly prosperous middle-class men and women sleeping rough in Milan, Italy's financial capital.

Youth unemployment figures in a quarter of the countries surveyed ranged from 33% to more than 60%[7]. But more destructive to the families, in general, is the soaring jobless

[6] "As the economic crisis has planted its roots, millions of Europeans live with insecurity, uncertain about what the future holds. This is one of the worst psychological states of mind for human beings. We see quiet desperation spreading among Europeans, resulting in depression, resignation and loss of hope. Compared to 2009, millions more find themselves queuing for food, unable to buy medicine nor access health-care. Millions are without a job and many of those who still have work face difficulties to sustain their families due to insufficient wages and skyrocketing prices. Many from the middle class have spiraled down to poverty. The amount of people depending on Red Cross food distributions in 22 of the surveyed countries has increased by 75% between 2009 and 2012. More people are getting poor, the poor are getting poorer". Ian Traynor, *Austerity pushing Europe into social and economic decline, says Red Cross*, The Guardian, October 10, 2013, accessed at 28.02.2014, http://www.theguardian.com/world/2013/oct/10/austerity-europe-debt-red-cross.

[7] "The rate at which unemployment figures have risen in the past 24 months alone is an indication that the crisis is deepening, with severe personal costs as a consequence, and possible unrest and extremism as a risk. Combined with increasing living costs, this is a dangerous combination". Ian Traynor, *Austerity pushing Europe into social and economic decline, says Red Cross*, The Guardian, October 10, 2013, accessed at 28.02.2014, http://www.theguardian.com/world/2013/oct/10/austerity-europe-debt-red-cross.

levels among 50-64 year-old which has risen from 2.8 million to 4.6 million in the EU between 2008 and 2012.

Despite the perceived success of Germany, Europe's economic engine, one study takes the EU's biggest country to illustrate the widening wealth gap, raising questions about the longevity of the EU's traditional model, the social market economy. According to Germany's Bertelsmann Foundation some 5.5 million Germans have lost their middle-class social status over the past decade and fallen into the ranks of low-income earners while at the same time half a million others made the grade as high-income earners.

The European economy is pegged to the euro, and "the euro is a patently flawed construct"[8]. It is flawed because its architects had not yet formed the perfect - or even an imperfect - financial union sufficient to back the unified currency, expecting its flaws to be corrected, "if and when they became acute, by the same process that brought the European Union into existence"[9].

Fiscal austerity is normally a sensible response to a loss in confidence in a country's solvency, as has occurred in parts of Europe. But the current situation is exceptional. Short-term interest rates are very low, so large rate reductions to offset the negative impact of budget cutting are impossible.

In addition, the troubled countries of Europe are part of a common currency area. This means that the other obvious tool for stimulating growth during a time of fiscal austerity - depreciating the currency relative to that of their main trading partners - is not available, either. The result is that austerity is uniquely destructive right now. Indeed, because of the harsh effect of budget cutting on growth, debt-to-G.D.P. ratios in Europe have continued to rise.

If stringent belt-tightening isn't the answer, what is? It's not to just ignore the deficit. Many European countries have long-run fiscal situations that are unsustainable and must be dealt with.[10] The core of a more sensible approach is to pass the needed budget measures now, but to phase in the actual tax increases and spending cuts only gradually - as economies recover. To use economics terminology, the measures should be back-loaded[11].

Europe faces a "lost decade", with the number of people trapped in poverty across the continent set to rise by up to 25 million by 2025 unless austerity policies are reversed, according to a damning new report from aid agency Oxfam[12].

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[8] George Soros, *Financial Turmoil in Europe and the United States: Essays*, (New York: PublicAffairs, 2012)
[9] Soros, *Financial Turmoil in Europe and the United States: Essays*.
[10] Flavius Cristian MĂRCĂU and Mihaela Andreea CIOREI, **„**STATE – THE MAIN ACTOR OF INTERNATIONAL RELATIONS**"**, *Research and Science Today*, Supplement No.1(3)/ June 2012, Tg. Jiu, 120-121.
[11] "They should also be specific - no more deficit targets without specifying how they'll be achieved. Instead, lay out right now whose taxes will be raised and what spending will be cut. And specify when the measures will take effect - either along a set schedule, or tied explicitly to indicators of economic recovery. (...) History shows that countries have done such gradual consolidations before. In 1983, for example, the United States passed a Social Security reform plan that was back-loaded in the extreme: it specified tough changes, including higher taxes and increases in the retirement age, to be phased in over almost three decades. They've all occurred on schedule and without debate. Likewise, in 1995, Sweden laid out a plan to cut its deficit by a whopping 8 percent of G.D.P. over the next three years. It worked as intended. Australia did the same thing on a somewhat smaller scale starting a year later".
Christina D. Romer, *Hey, Not So Fast on European Austerity*, The New York Times, April 28, 2012, accessed at 03.03.2014, http://www.nytimes.com/2012/04/29/business/austerity-is-no-quick-answer-for-europe-economic-view.html?_r=0
[12] Teresa Cavero and Krisnah Poinasamy, *A Cautionary Tale. The true cost of austerity and inequality in Europe*, Oxfam Briefing Paper no. 174, September 2013.

Using research carried out by think-tank the Institute of Fiscal Studies into the likely impact of austerity on poverty levels in the UK, and extrapolating it across 27 European Union member-states, Oxfam predicted that relative poverty, defined as the number of people living below 80% of median income, could rise between 15 and 25 million people by 2025[13].

Countries in Latin America and Asia that turned to the IMF for help in the 1980s and 1990s were often forced to slash public spending and liberalize their markets in exchange for rescue loans[14].

The sovereign debt crisis in the euro-zone has seen a series of countries, including Greece and Portugal, accept swingeing public spending cuts, mass privatization and drastic market reforms, as the price of receiving bailouts from the IMF and their European neighbours.

Financial markets have been calm in recent months, but a number of senior European officials, including German finance minister Wolfgang Schauble, have conceded Greece is likely to need a new rescue package, worth up to €10 billion.

The European Union softened its demands for austerity eventually when it gave France, Spain and four other member states more time to bring their deficit levels under control so that they can support their ailing economies. The EU Commission, the 28-nation bloc's executive arm, righteously assumed the countries must instead overhaul their labor markets and implement fundamental reforms to make their economies more competitive. Issuing a series of country-specific policy recommendations in Brussels, Commission President Jose Manuel Barroso said that the pace of reform needed to be stepped up across the EU to kick-start growth and fight record unemployment[15].

But austerity has also inflicted severe economic pain.[16]

Slashing spending and raising taxes have proved to be less effective at reducing deficits than initially thought. As economies shrink, so do their tax revenues, making it harder to close those budget gaps. Besides France and Spain, the commission is also granting the Netherlands, Poland, Portugal and Slovenia more time to bring their deficits below the EU ceiling of 3% of annual economic output. That means they will be allowed to stretch out spending cuts over a longer time as they try to fight record unemployment and recession. The Netherlands and Portugal are now granted one additional year, whereas France, Spain, Poland and Slovenia are granted two additional years each.

CONCLUSION

Europe is stuck in a recession - which has led to an increasingly bitter debate over the merits of austerity as a way to solve the region's problems economic problems. With rising unemployment, there is a growing consensus that governments must shift their policies

[13] ”The European model is under attack from ill-conceived austerity policies sold to the public as the cost of a stable, growing economy, for which all are being asked to pay. Left unchecked, these measures will undermine Europe's social gains, creating divided countries and a divided continent, and entrenching poverty for a generation”. Teresa Cavero and Krisnah Poinasamy, *A Cautionary Tale...*, Oxfam Briefing Paper.

[14] ”These policies were a failure: a medicine that sought to cure the disease by killing the patient. They cannot be allowed to happen again. (....) We were founded in 1942 because of the famine in Greece; no one would have believed we would be here 70 years later, saying, Greece is in a terrible state”. Max Lawson, Oxfam's head of advocacy.

[15] After Europe's crisis over too much debt broke in late 2009, the region's governments slashed spending and raised taxes as a way of controlling their deficits – the level of government debt as a proportion of the country's economic output.

[16] See Emilia Andreea DUȚĂ, 'The paradigm of Strategic Security Enviroment', *Research and Science Today*, nr.5/March 2013, Tg. Jiu, 2013, 102-121.

toward fostering growth to end the downward economic spiral, even in countries like Germany that have long insisted vehemently on rigorous fiscal policies.

The new measures, however, are not a sign that Europe has abandoned its message of austerity and strict budgetary discipline altogether[17]. In its recommendations, the Commission urges France to cut red tape, improve conditions for small and medium sized companies and strengthen competition in the country's service and energy sector. Moreover, bailed-out Greece, Ireland, Portugal and Cyprus still have harsh deficit targets they have to meet to continue getting bailout loans. Spain, the euro zone's fourth-largest economy, with an unemployment rate of 27 per cent, now has until 2016 to bring its deficit under control. It is set to drop from 6.5% of GDP last year to 2.8% afterwards. To achieve this significant amount, the Commission says Madrid must scrutinize spending programmes, push ahead with labour market reform, revise the tax system, reduce costs in the health sector and push through pending bank recapitalisations.

Some countries were also dropped off the Commission's list of nations whose budgets are under increased surveillance because of an excessive deficit. They include Italy, Latvia, Hungary, Lithuania and Romania. The most important of these decisions was on Italy, the euro zone's third-largest economy, where the Commission expects the deficit to come in at 2.9% and then to shrink even more towards 1.8% within the next period[18]. However, the experts in Brussels gave the new government in Rome a long list of measures, including labour market reforms and an overhaul of the tax system, to be pushed through.

Governments across the 17-nation euro zone slashed their budget deficits by about 1.5% of their combined annual GDP in structural terms, which takes into account the sluggish economy. That pace is set to be halved between 2013 and 2014. Since the debt crisis erupted, EU nations have agreed to give the bloc's executive arm more powers in scrutinizing national budgets, complete with the ability to punish or issue binding policy recommendations for countries running excessive deficits.

In practice, however, the Commission wields considerable power in its dealings with smaller member states, but big nations like France are hard to bring into line. Though even with smaller countries, imposing fines in economically difficult times has proven difficult. This was the case with Belgium, host to most EU institutions, which was lucky enough to escape punishment after missing its 2010 and 2011 deficit targets – a period when the country was without a government for 541 days[19]. A leading international body warned last year that the recession in Europe risks hurting the world's economic recovery as whole. The Organization for Economic Co-operation and Development said the eurozone's economy was expected to shrink by 0.6% in 2013-2014, against a predicted drop of 0.1% in the latest outlook a few months ago.

The EU Commission monthly forecast assumes that the eurozone's economy would shrink by 0.4 within the next period. It estimated the wider EU – which includes the now eleven nations such as Britain that don't use the euro currency – would suffer a 0.1% contraction.

[17] Barroso rejected suggestions that the Commission bowed to political pressure and switched focus away from austerity. Singling out France, the 17-nation euro zone's second-largest economy, as an example of how the EU is still keeping an eye on its members' economies, Barroso said that "this extra time should be used wisely to address France's failing competitiveness. (...) French companies market shares have experienced worrying erosion in the last decade, in fact beyond the last decade, we can say the last 20 years".

[18] The EU's top economic official, Olli Rehn, insisted Italy still had little leeway to go on a spending binge or lower taxes. "Italy has a very low safety margin to keep the budget under the limit".

[19] Olli Rehn also said that "It went into injury time but Belgium used it effectively and scored during this injury time. It would neither be fair nor legally sound to apply it retroactively to those years".

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