Austerity or bust

Written by **Vuk Vukovic** | Thursday 24 May 2012

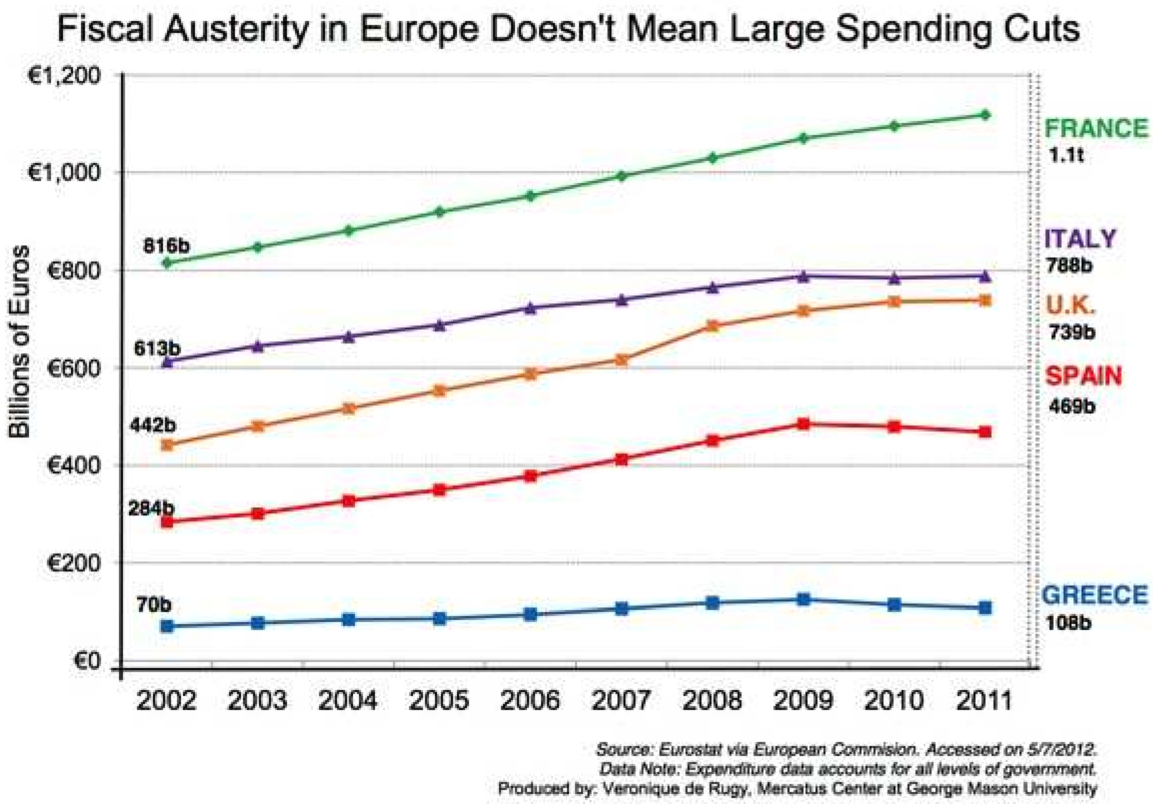
The austerity vs stimulus debate is the focal point of attention once more, as the recent results of Greek and French elections show an increasing opposition against Europe's unique type of redistributive austerity. But few understand what austerity really means. They refer to it as "painful cuts that are hurting growth". Even by phrasing the choice as 'austerity vs growth', it is obvious that people don't really understand what austerity is, and even less what their governments are doing.

Recent posts from the Mercatus Center, Cato Institute, Tyler Cowen and many others shed some light on this, and have pointed to the inconvenient fact that there is no real austerity in Europe, at least not the type that could theoretically help these economies recover. In fact, Tyler Cowen asks what austerity is, trying to come up with a precise definition in order to overcome the biases behind the term and its policy effects. Looking at Wikipedia and Investopedia he finds the following:

> *"In economics, austerity is a policy of deficit-cutting, lower spending, and a reduction in the amount of benefits and public services provided."*
>
> *"A state of reduced spending and increased frugality in the financial sector. Austerity measures generally refer to the measures taken by governments to reduce expenditures in an attempt to shrink their growing budget deficits."*

Defining the term is particularly important for policy reasons. As you can see, there is no mention of tax increases in any of the two definitions. However, governments do often tend to use tax hikes to lower the deficit. But the very definition of austerity implies cutting spending and cutting entitlements in order to create more scope for the private sector to grow on its own. In other words, to remove the dependency mentality from people and from businesses.

Then comes the following graph from Veronique de Rugy of the Mercatus Center:



Where is the austerity here? Where are the significant cuts in spending necessary to address public and private sector dependency on the government and to reform the labour market? Particularly interesting examples are UK and France, where no signs of decreasing spending can be seen. In the UK, public spending to GDP has reached a 50-year historical high (46% of GDP). Some cuts have been made, but everything that was saved up was again used to steer the economy. And so Britain saw schemes that want to pick industrial winners, guide investment projects, subsidize housing, subsidize unemployed young people, and even control the amount and prices of loans in the economy. How do any of these address systemic dependency and how do any of these fit in the aforementioned austerity definition?

In France, the painful burden of redistributive austerity was one of the causes of Sarkozy's electoral defeat. The French were apparently fed up with it. Still, I'm struggling to see the actual austerity in France. I may be wrong, but maybe what's bothering the people in France is the same thing bothering people in the UK — taxes are going up, people are left with less and less disposable income, nothing is done to address the endemic dependency of the people or businesses to the state, private sector growth is unlikely, banks are in an uncertain position and refusing to lend. In France, as a result, people are resort to radicalism, which was evident on both French and Greek elections where ultra-right and ultra-left parties won seats in parliament and got a dangerously significant portion of the votes.

The very idea of depicting the debate as austerity vs growth is wrong. This implies that the solution is the opposite of austerity — a monetary or fiscal stimulus to close down the nominal GDP gap. Even if a short-term fiscal or monetary stimulus can temporarily boost growth, that isn't the way towards a proper restructuring of the economy. I know the logic behind these views: "let's just get the economy going and all will be better afterwards". The idea that it's much easier to do structural reforms after things are going well is a wrong approach, since no politician will have the power, strength or the courage to engage into painful but necessary reforms after what the world economy is going through at the moment.

We should expect austerity to be an unpopular policy. Its primary goal is to cut the dependency to the government. This does not come easily and will cost votes. But doing what the European politicians are doing currently has no chance of achieving growth any time soon, is constraining the population from spending (through tax hikes) and the businesses from investing (by causing uncertainty, sending bad signals, and offering no institutional support), and will result in a double loss — of elections and the recovery. As Margaret Thatcher once said: "If you want to cut your own throat, don't come to me for a bandage". This precisely sums up what Europe's allegedly austere governments are doing — cutting their own throats and hoping they stay alive. Not likely.