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Austerity Is Blamed Not Praised

By Jeff Harding, on May 9th, 2012

This article is by Cato's Richard Rahn. Professor Rahn is a senior fellow of the Cato Institute and the Chairman of the Institute for Global Economic Growth. He is also a weekly economic columnist for The Washington Times, and serves on the editorial board of the Cayman Financial Review. He developed the famous Rahn Curve. This article pierces through the fog of disinformation spread by Paul Krugman and other leftists about the "failure" of austerity in Europe and the U.S. This article first appeared in the Washington Times and then on Cato. — JH

Austerity Is Blamed

By Richard Rahn

Denial is leading to collective economic suicide in Europe and the United States. The French on Sunday elected a socialist president who wants to raise taxes on those elusive rich and keep spending as if there is no tomorrow.

Many on the left, including European socialists, the New York Times and its economist Paul Krugman, are falsely claiming that Europe and even the United States are being saddled with austerity. Their claim is that governments are not spending enough to reduce unemployment. They want higher taxes on the most productive plus bigger government. They suffer from a collective memory loss. Don't they remember that socialism did not work? Every time the big-government "solution" has been tried for the past two centuries, it has failed, but those on the left seem to be incapable of learning.

When the current economic crisis began — largely caused by a government-created housing bubble — we were told that if the government spent an extra trillion dollars or so and ran up the deficit, all would be well. Did it work as advertised in the United States? No. In the United Kingdom? No. In France? No. In Italy? No. In Spain? No. And not even the left wants to talk about Greece. The accompanying chart shows that rather than the austerity the left is whining about, government spending has risen as a share of gross domestic product (GDP) in all of the major economies. Again, the left said unemployment rates should have come down by now, but the opposite is happening. The U.S. unemployment rate has come down slightly, but the percentage of the labor force at work continues to decline, so the real unemployment rate is approximately 15 percent.

The irony is that the refusal by those on the left, in both Europe and the United States, to deal with the "entitlement" problem is going to cause an involuntary austerity in which real incomes are going to fall for most people. Incomes have not been rising as fast as inflation in the United States and most places in Europe, but what has happened is only a very mild introduction to what is going to happen.

GDP-to-debt ratios keep rising in all the major economies, and realistically, this will continue until a reversal in policy or a surge in inflation begins to erode the value of the debt. Chancellor Angela Merkel in Germany has demanded that her fellow Europeans reverse the growth in spending to deal with fiscal reality and save the euro. The elections in France and Greece show that Mrs.

Merkel's advice will be ignored and the European Central Bank will be pressured to keep printing money — by sovereign bond purchases and/or rate cuts on loans to banks — which ultimately will mean a lot more inflation, resulting in a real drop in incomes.

Of the major economies, only Germany has managed to reduce unemployment, and that was largely by major labor reforms, which now make it possible to fire German workers so employers no longer are so reluctant to hire new workers. Even so, the German economy is slowing down and may be dragged into the new recession that the other European economics are in or about to enter.

	Government Spending as a % of GDP		Unemployment Rate % (latest numb for 2012)	
	2007	2012*	2007	2012
US	36.7	40.0	4.6	8.1
UK	40.3	45.3	5.4	8.3
Germany	43.5	45.1	8.8	6.8
France	52.6	55.8	8.4	10.0
Spain	39.2	42.0	8.3	24.1
Italy	47.6	50.1	6.1	9.8

* estimated
Sources: International Monetary Fund, The Economist

The next year is not going to be pleasant. The new European recession will only deepen and spread as, once again, the socialist "solutions" add to the problems. The United States is facing a massive 3.6 percent of GDP tax increase on Jan. 1, which will occur unless Congress extends the George W. Bush tax cuts and the other major personal and business tax provisions that are set to expire at the end of the year. The extensions will require both houses of Congress to pass them and President Obama to sign them into law. Even if the Republicans win both Houses of Congress and Mitt Romney is elected president, the Republicans will not take office until January — after the tax provisions' expiration date.

There is no guarantee that Mr. Obama and the Democratic Senate will pass the necessary tax extensions during the lame-duck session, whether they win or lose. Even if the Republicans win, they will not have the necessary 60 votes they might need in the Senate if the Democrats refuse to go along with the extensions. The uncertainty about what is going to happen will build through the remainder of the year, which will inhibit business expansion and job growth. This, coupled with the ongoing avalanche of new bank regulations, and foreign interest and dividend reporting requirements, is going to drive productive capital out of the United States. The rich in Europe and the U.S. are not just going to sit around to be fleeced by corrupt and incompetent governments. Being rich means you and your capital are mobile. There are many nice places on the globe where rich people and their money are well-treated.

Europe is in recession, and the odds are that by January the United States will be back in recession. The central banks will inflate the currency to deal with the government debt problems, the people will be poorer, and the rich will have left. It is all so unnecessary.