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Put Off Badly Needed Budget Cuts? Austerity Doesn't Mean No Growth

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Growth And Deficits
An international comparison

Countries practicing fiscal austerity	GDP growth in past year	Deficit as a % of GDP
Hong Kong*	6.8%	3.0%
Singapore	12.5	0.7
Chile	7.0	1.1
Sweden	6.9	1.5
Thailand	6.7	1.5
Taiwan	9.8	1.7
S. Korea	4.4	1.9
China	9.6	2.2
Brazil	6.7	2.3
Mexico	5.3	2.5
Germany	3.9	3.7
Canada	3.4	3.7
Turkey	5.5	4.0
Countries practicing fiscal stimulus		
France	1.7%	7.8%
U.S.	3.2	8.9
Spain	0.2	9.6
Greece	-4.5	9.7
U.K.	2.7	10.1

*3% figure is surplus

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A recent New York Times editorial, "About That $100 Billion," takes Speaker of the House John Boehner to task for not personally identifying "which specific programs and services Republicans are willing to cut."

It was a rhetorical jibe, of course, because no political party would expect or allow the speaker of the House to unilaterally preempt congressional budget committees or the Office of Management and Budget.

The editorial also feigned contempt for the likelihood that proposed Republican cuts for fiscal 2011 will fall short of $100 billion, because half the fiscal year will be over by March. This too was a meaningless distraction.

The Times' real point was to argue that, "Whatever the sum .. . cutting billions would be foolish at a time when joblessness is high and the recovery needs stimulus, not tightening. ... Spending cuts need not and should not start today, but the nation needs to put a credible plan in place now to reduce the deficit as the economy recovers."

The trouble is that procrastination is never a credible plan. If Congress avoids doing even a little budget pruning right now, why expect it to do much more later? Promises to do something unpopular in the future could easily be undone by a future Congress, just as Congress repeatedly undoes the supposedly credible "doctor fix" (an absurd pledge to slash Medicare payments to physicians).

The Times' argument has another big hole: If spending borrowed money is really as effective a "stimulus" as they assume, why are countries with the biggest budget deficits doing so much worse than those with the smallest?

The table in the next column divides countries into two groups. Those with the smallest budget deficits (less than 4% of GDP) are classified as practicing "fiscal austerity," while those with the largest deficits (more than 7.5% of GDP) are practicing what the Times calls "fiscal stimulus."

According to the conventional Keynesian creed, it would be foolhardy for countries in the fiscal stimulus camp to make the slightest effort to emulate the fiscal austerity countries. Yet it doesn't require an advanced degree in statistics to see that economies of countries with smaller deficits have grown more rapidly over the past year than economies with larger budget deficits.

Champions of fiscal stimulus will insist this comparison is unfair, because small budget deficits in the fast-growing economies are the result of rapid economic growth. That is surely true, up to a point, which highlights the importance of minimizing tax and regulatory impediments to progress.

But to argue that countries with small deficits were somehow magically blessed with rapid economic growth begs the question of how such economies managed to grow so rapidly without guzzling the Keynesian Kool-Aid.

Besides, the enormity of U.S. government borrowing is not merely the consequence of a weak economy. Even after adjusting the U.S. deficit to reflect the fact that the economy is operating below potential, the resulting cyclically adjusted deficit is much higher than it has been at any time since World War II — about 6.5% of potential GDP, according to the Congressional Budget Office.

If fiscal stimulus worked, the U.S. economy should have been booming while the fiscal austerity countries lagged behind. Contrary to Keynesian doctrine, however, countries that explicitly shunned such "fiscal stimulus" schemes are outperforming the U.S. Unemployment has fallen to 7.5% in Germany and 7.1% in Sweden, for example.

In the U.S., federal nondefense spending rose to 20.5% of GDP in 2010 from 15.4% in 2000, with most of that enormous increase happening in 2009. Government growth has been a big drag on the private economy, not a stimulus.

Social Security and Medicare account for 31% of federal spending, and do indeed need "credible" long-term reform (see downsizinggovernment.org).

But the difficulty of doing anything quickly about senior "entitlements" is no excuse for leaving the other 69% of the budget on automatic pilot, heading skyward.

The Keynesian excuse for budgetary procrastination is as tempting to politicians as St. Augustine's famed prayer, "Lord, give me chastity and self-restraint, but not yet." But it is a bogus excuse, wisely shunned by the fastest-growing economies of the world.

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