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Austerity, This Is Not

Europeans revolting against 'balanced approach' to deficit reduction

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A string of anti-incumbency elections in Europe this week has many wondering if the "end of austerity" is nigh for the debt-plagued continent.

Some left-wing commentators are hailing what they view as the failure of European austerity measures–deficit reduction policies enacted in the wake of the 2008 debt crisis. In the eyes of many liberals and Democratic politicians, the French and Greek vote is also a stinging rebuke of the Republican budget reforms authored by House Budget Committee chairman Paul Ryan (R., Wis.), which some have described as "austerity on steroids," or in President Obama's words, a "radical vision" of "Social Darwinism."

But that would be precisely the wrong conclusion to draw from Europe's troublesome flirtation with austerity, experts say.

"I'd say that what we're seeing in Europe is the failure of a 'balanced' approach to reducing deficits and debt—an approach that involves serious tax increases combined with modest spending increases," said Yuval Levin, editor of *National Affairs*. "The Ryan budget is not European-style austerity."

Unlike Ryan's budget, which would reduce the deficit by $5.3 trillion over ten years through a combination of spending cuts, entitlement restructuring, and comprehensive tax reform, "European-style austerity" has relied heavily on tax increases.

According to the Organization for Economic Co-operation and Development (OECD), tax hikes accounted for nearly 50 percent of France's deficit-reduction package. The percentage was even higher in Greece and Portugal.

Meanwhile, government spending as a percentage of gross domestic product (GDP) has increased in all of the major European economies. In many cases, spending levels are higher than they were before the financial crisis and ensuing recession.

The ratio of tax increases to actual spending cuts among European countries between 2010-2011 was nearly 9-to-1, according to official European Union statistics.

Studies have shown that raising taxes is a particularly ineffective form of fiscal consolidation. One report produced by the American Enterprise Institute examined data from select OECD countries between 1970-2007 and found "strong evidence that expenditure cuts outweigh revenue increases in successful consolidations."

"Lasting reductions in debt stem from expenditure cuts, and less so from revenue increases," the report's authors write, concluding that spending cuts should account for at least 85 percent of any successful deficit-reduction package.

"To facilitate success in future consolidations, our results and the previous literature indicate that a suitable low-end target for the expenditure share is around 85 percent of the total fiscal consolidation," they write.

The findings echo those of a recent OECD report, which concluded: "International experience shows expenditure-based fiscal consolidation tends to be more successful."

This was the approach adopted in Europe, noted Veronique de Rugy, a senior research fellow at the Mercatus Center. "The most important point to keep in mind is that whenever cuts took place, they were always overwhelmed by large counterproductive tax increases," she writes. "This approach to austerity—some spending cuts with large tax increases—is what President Obama has called the 'balanced approach.'"

Obama's fiscal year 2013 budget calls for nearly $2 trillion in tax increases over the next decade, or about half of the total deficit reduction claimed by the White House. Analysts have noted, however, that the president's deficit reduction plan is even more heavily weighted toward tax hikes than it appears, due to the budgetary gimmicks used to inflate the amount of savings achieved through spending cuts.

"It's ironic because if you look at the details of President Obama's proposals for deficit reduction, such as they are, what you see is a European-style austerity package without most of the spending cuts," a House Republican aide told the *Washington Free Beacon*.

Senate Democrats have not passed a budget resolution in more than three years, but Senate Budget Committee chairman Kent Conrad (D., N.D.) has indicated that a 50-50 split between spending cuts and tax increases would be appropriate.

Only Ryan's plan can accurately be described as "expenditure-based fiscal consolidation." It cuts spending, reforms entitlement programs—by far the biggest drivers of the national debt—and simplifies the tax code by lowering rates and eliminating loopholes and tax shelters.

“We’re trying to avoid European-style austerity,” said the aide. “Our plan shows how to do this without raises taxes, which is the worst way to reduce the deficit because it hurts economic growth.”

Obama’s most recent budget, if enacted, would have a negative impact on long-term economic growth, according to the non-partisan Congressional Budget Office. One reason is the president’s failure to meaningfully reform federal entitlement programs such as Medicare, which is projected to run out of money by 2024. European countries have shown a similar reluctance to address their long-term structural problems.

That is a recipe for self-inflicted austerity, critics say.

“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,” writes Richard Rahn, a senior fellow at the Cato Institute.

Europe’s problems ought to serve as a cautionary tale of what awaits the United States if lawmakers do not take decisive action to get deficits and long-term debt under control, Republicans argue.

“The European upheaval is a warning that cleaning up the mess from chronic over-borrowing is a long and deeply painful process, both economically and politically, and that the best option is to clamp down on government profligacy before it gets out of hand,” a House Budget Committee aide told the *Washington Free Beacon*.

“Everybody wants to avoid sudden, steep cuts to programs people are relying on right now,” said another GOP aide. “We would avoid that kind of austerity from happening. The president’s plan would make it inevitable.”

Far from recommending immediate austerity measures, Ryan has proposed to phase in spending cuts and other reforms gradually. For example, Ryan’s Medicare reforms—which are based on a plan co-authored by Sen. Ron Wyden (D., Ore.) but remain a favorite target of Democratic lawmakers—would not go into effect until 2023.

Moreover, despite accusations from Democratic lawmakers and many members of the media that Ryan’s budget would “slash” or “gut” spending on federal programs, the difference between the Republican plan and the president’s plan are less glaring than such rhetoric suggests.

Obama’s budget proposes to increase federal spending from $3.8 trillion in 2012 to $5.8 trillion in 2022, a net increase of $2 trillion, or 53 percent.

Ryan’s budget, on the other hand, proposes to increase spending slightly less dramatically—from $3.6 trillion in 2012 to $4.9 trillion in 2022, a net increase of $1.3 trillion, or 36 percent.

Under Ryan's plan, federal spending would grow at a rate of about 3 percent a year, which is roughly equivalent to the average rate of U.S. GDP growth since World War II. Under Obama's, spending would increase by about 4.5 percent per year.

"Hardly draconian, I would argue," Ryan said of his budget during a recent event at Georgetown University. "But that's sort of the way Washington works, which is if you don't sign up to the massive proposed increase and you increase spending at a slower rate or something, that's considered a big cut."

Even with respect to domestic discretionary spending, which encompasses many of the social welfare programs Democrats accuse Republicans of "gutting," Ryan's plan would spend, on average, just $35 billion less per year than Obama has proposed, or less than 1 percent of what the federal government plans to spend in 2012.

Federal spending as a percentage of GDP would reach 19.8 percent by 2022 under Ryan's proposal. That is in line with the historical average from 1950-2000. Federal spending under Obama's plan would rise to 22.8 percent of GDP over the same period.

Revenue under the Ryan plan would reach $4.6 trillion by 2022, or about 18.7 percent of GDP. That is slightly higher than the historical average since World War II of 18.1 percent. Obama's plan projects that total revenue would rise to $5.1 trillion by 2022, or 20.1 percent of GDP, well above the historical average.

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