

Austerity

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Why austerity?

- Why did austerity economics get such a powerful grip on elite opinion in the first place?
- In the beginning was the bubble!! And next...
- Panic and fear as guides for economic policy
- Spreads exerted their influence on policy makers and led them to apply severe austerity measures

Definition

- 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.
- The most common example of "austerity measures" occurs when a sovereign government's bond rating is downgraded. This makes borrowing more expensive, and usually forces the government to impose these new measures.

Martin Callanan, leader of the European Conservatives and Reformists

- As Angela Merkel has said, austerity means living within your means. The problem in Europe was too much spending and too much borrowing, and we won't solve those problems by spending and borrowing even more.

“Have austerity measures finally started working?”

Debating.europe.eu

Sparpolitik!

- Although, strictly speaking, in Germany, austerity is actually not called austerity at all (it sounds “evil” as Angela Merkel has pointed out). Instead, the term used is sparkurs (savings course) or sparpolitik (savings politics). Or as a verb; Hausaufgaben machen – to do your homework. The opposite is schuldenpolitik (debt politics) or Schulden machen (to make debt).
 - Mats Persson, The Telegraph, april 2013

Gallup / Debating Europe Poll

- DEBATING EUROPE: AUSTERITY POLICIES
- KEY RESULTS OF AN OPINION SURVEY, SEPTEMBER 2013
- Which countries interest is served by these policies?
- Germany 77%
- Denmark 12%
- Better alternatives: 60% yes, 16% no

"Citizens! Forgive us for not arresting those truly responsible for this crisis: bankers and politicians," 17/11 2012



José Castro Caldas (2012): The Consequences of Austerity Policies in Portugal:

- The austerity turn on the indebted periphery of the Eurozone may be interpreted as a strategy by creditors – banks and other financial institutions – to secure their financial and political positions, combined with the right-wing political intention of precipitating an institutional restructuring of welfare regimes in Southern Europe which could not be obtained by democratic means.
 - International Policy Analysis

Denmark august 2011

- Denmark, which slid back into a recession in the fourth quarter, is committing to budget cuts even as it tackles a regional banking crisis that has claimed two lenders this year and stalled a housing-market recovery.

Denmark will force through budget cuts to appease bond investors even as a global equity slump and a deepening European debt crisis threaten to derail a recovery, Finance Minister Claus Hjort Frederiksen said.

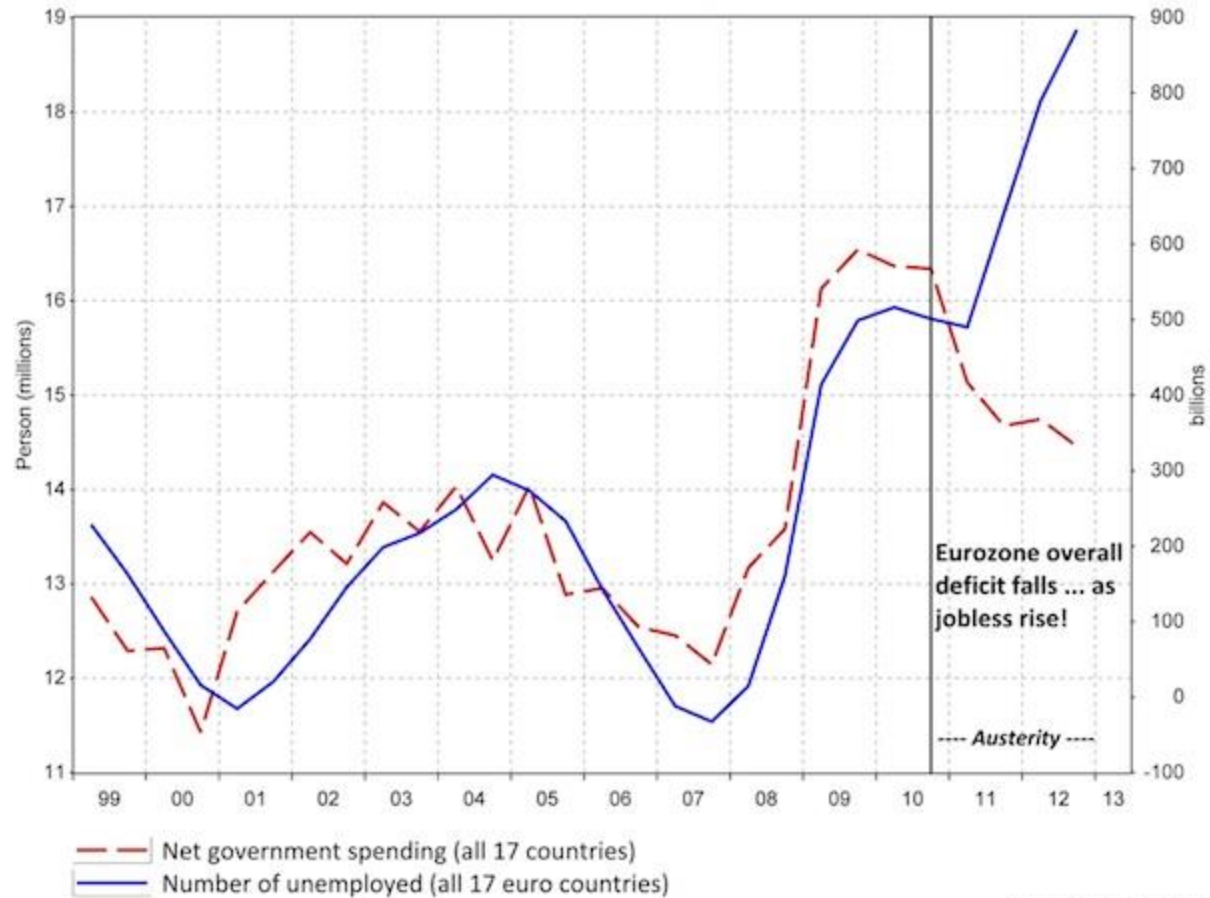
- "We need to continue consolidation," Claus Hjorth Frederiksen said in a phone interview in Copenhagen yesterday. "Two things are dangerous in the current situation. One is to raise taxes, the other is to raise debt levels in Denmark. That would send a wrong signal to the international financial markets."

- bloomberg.com/news/2011

Denmark: Less austerity but...

- Public sector wage freeze 2011 – limited increase in 2012
- Cutting budgets – “2020-plan”: public sector growth of 0,8%. Public investment 1,8% of GDP
- Tax reform
- Unemployment benefit reform
- Reform of the voluntary early retirement

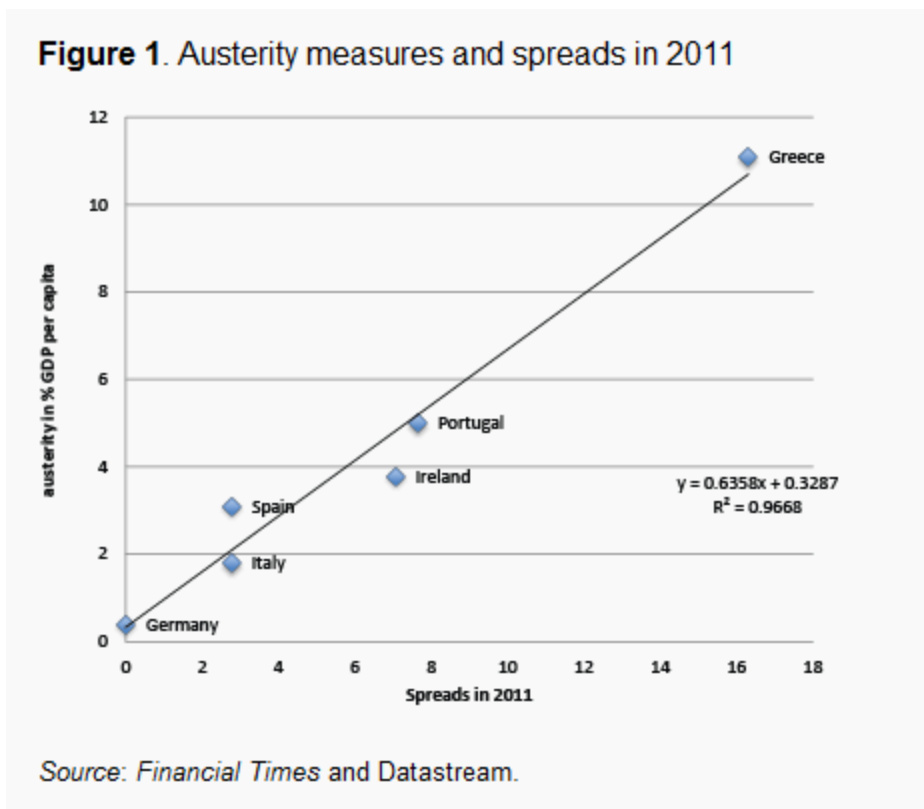
How austerity broke stability and growth in the Eurozone



Source: Reuters EcoWin

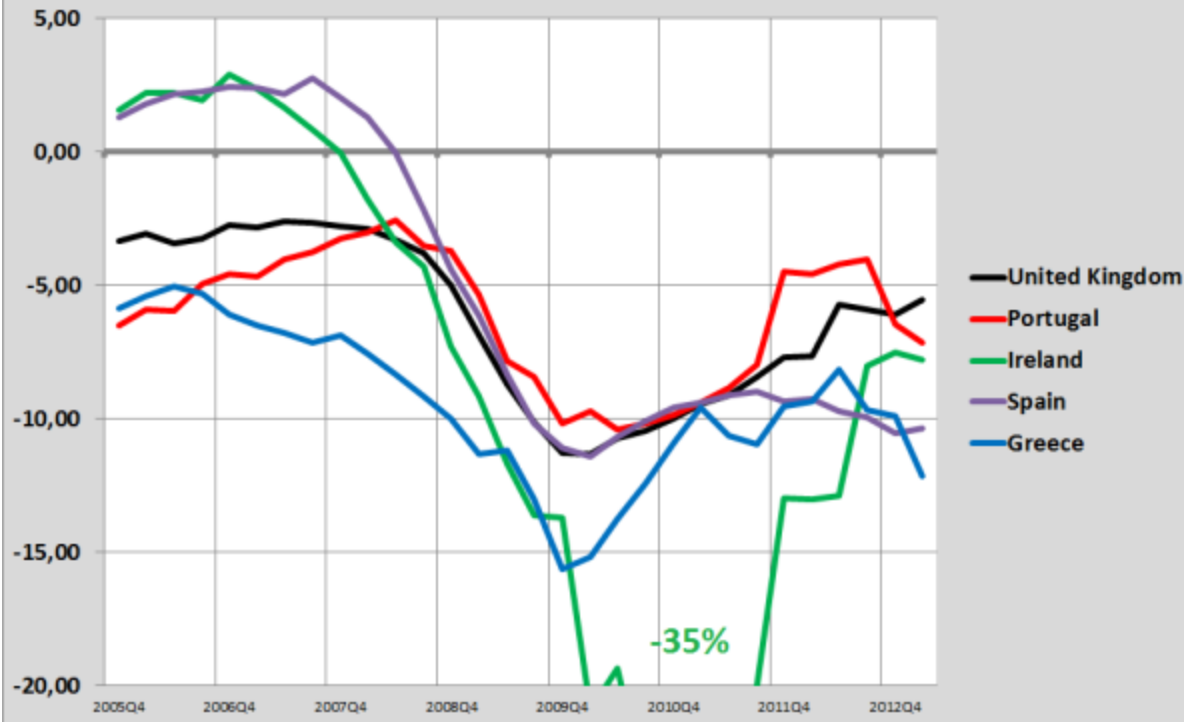
- **Andrea Terzi is a Professor of Economics at Franklin College Switzerland and a Research Associate at the Levy Economics Institute**
- **Social Europe Journal, 30/07/2013**

Austerity and spreads



Germany did not face any pressure from spreads and did not do any austerity!

Government deficits, selected EU countries (% of GDP)



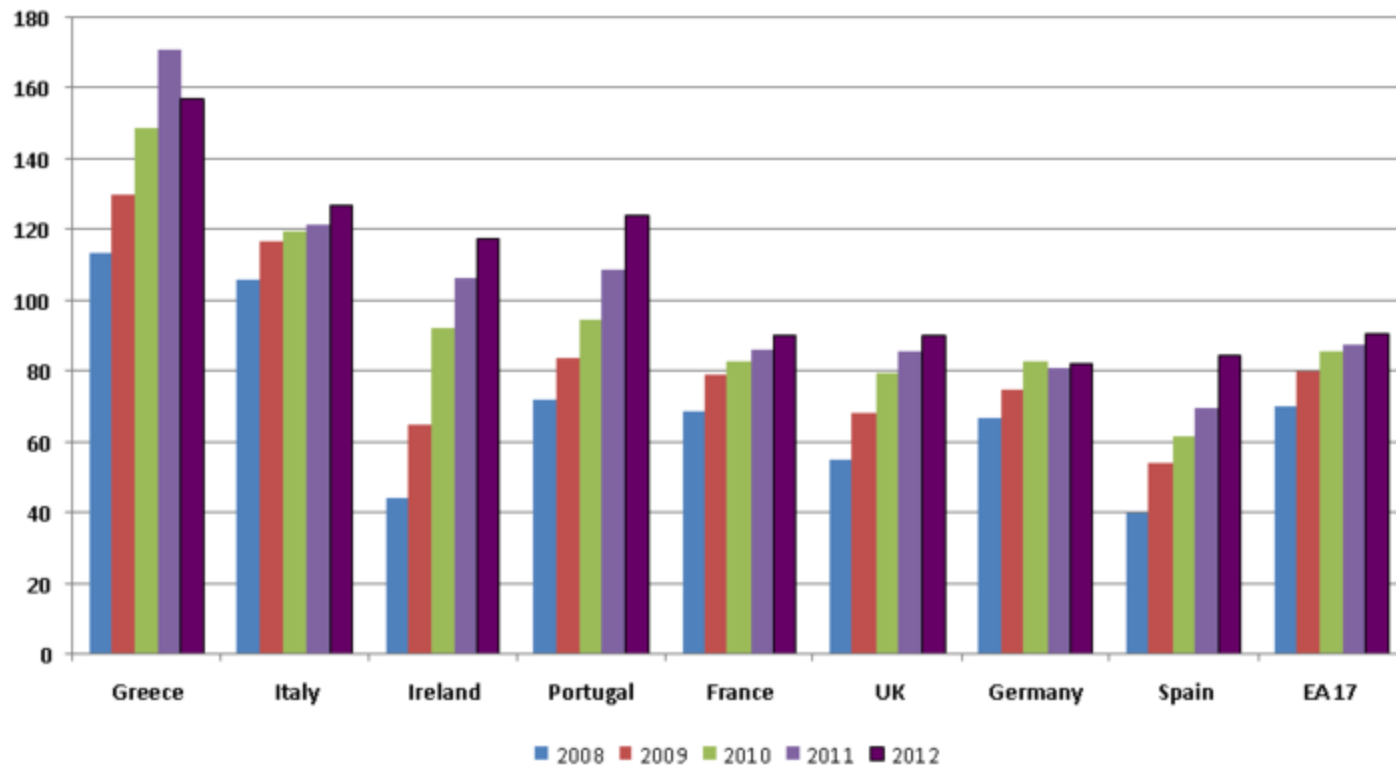


SOURCE: WWW.TRADINGECONOMICS.COM | EUROSTAT

- Kilde: Tradingeconomics.com

Debt to GDP Ratio for Selected European Countries

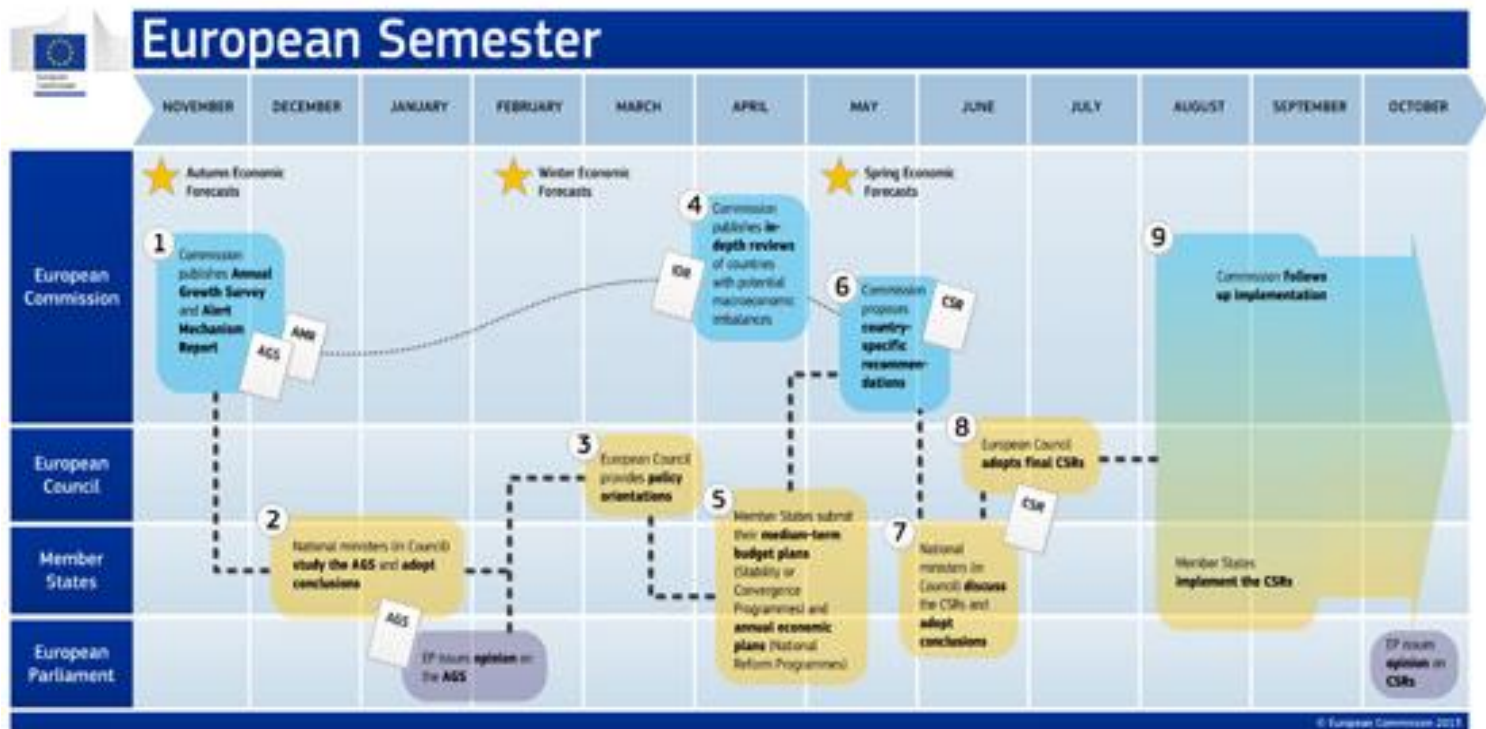
% GDP



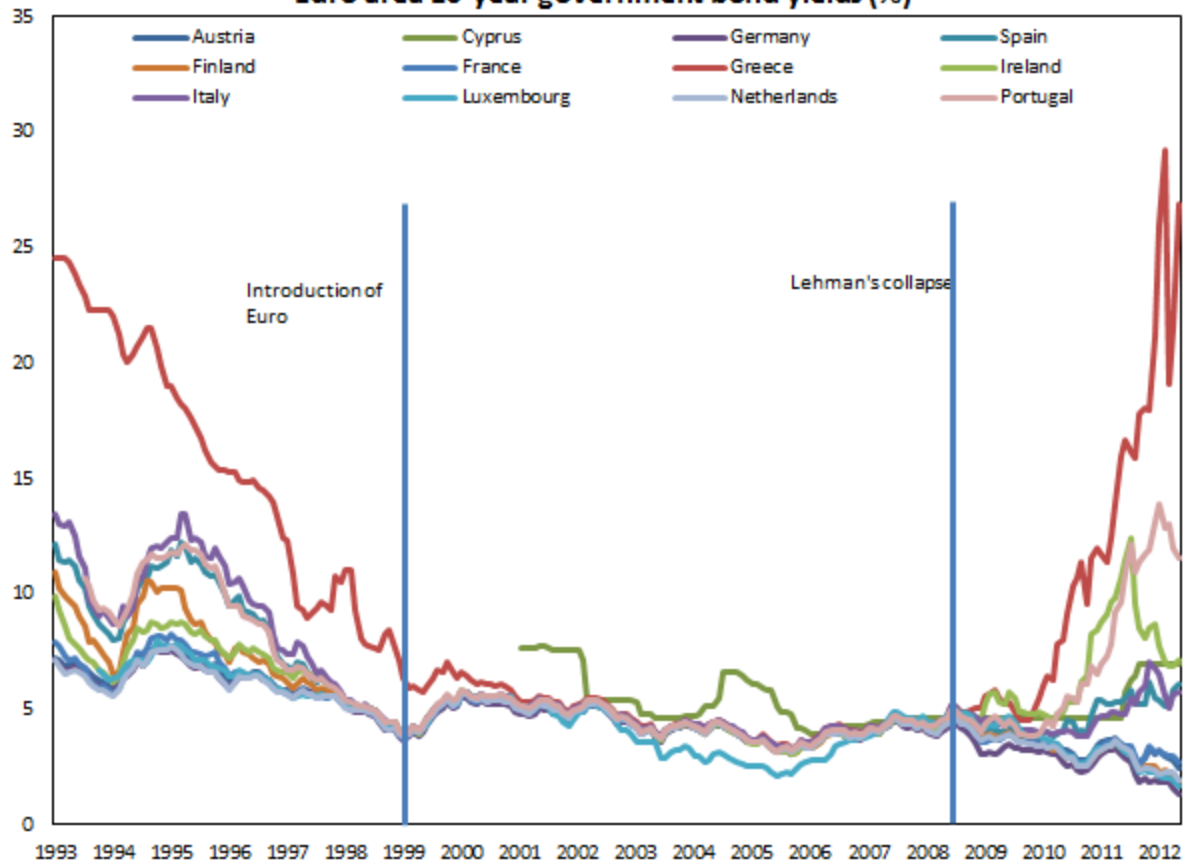
Reinforced austerity, march 2012: **European Fiscal Compact**

- The Excessive Deficit Procedure – time limit (Stability and Growth Pact Deficit-Rule of 3%)
- Structural deficit constraint under the Fiscal Compact – below 0,5% of GDP
- A new debt related branch of the Excessive Deficit Procedure calls for a 1/20th annual reduction of the excess of the debt-GDP ratio over 60% threshold of the SGP

'Upstream' policy coordination



Euro area 10-year government bond yields (%)

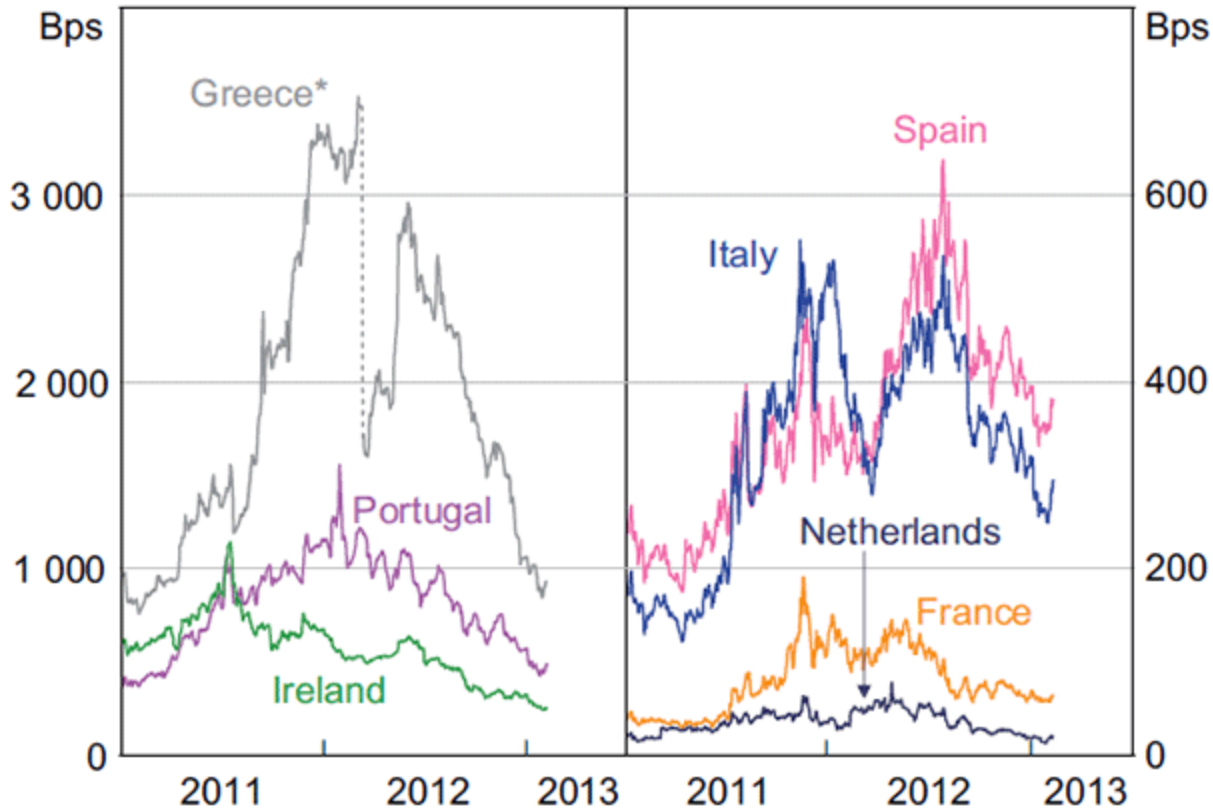


<http://www.alsosprachanalyst.com>

September 2012

- The European Central Bank's outright monetary transactions (OMT) or bond-buying programme was announced by Mario Draghi, president of the European Central Bank, in September 2012. Under the outright monetary transactions programme the ECB would offer to purchase eurozone countries' short-term bonds in the secondary market, to bring down the market interest rates faced by countries subject to speculation that they might leave the euro.
- By adopting OMT earlier, the ECB could have prevented the panic that drove the [bond] spreads that justified the austerity. It did not do so. Tens of millions of people are suffering unnecessary hardship. It is tragic." Martin Wolf, FT

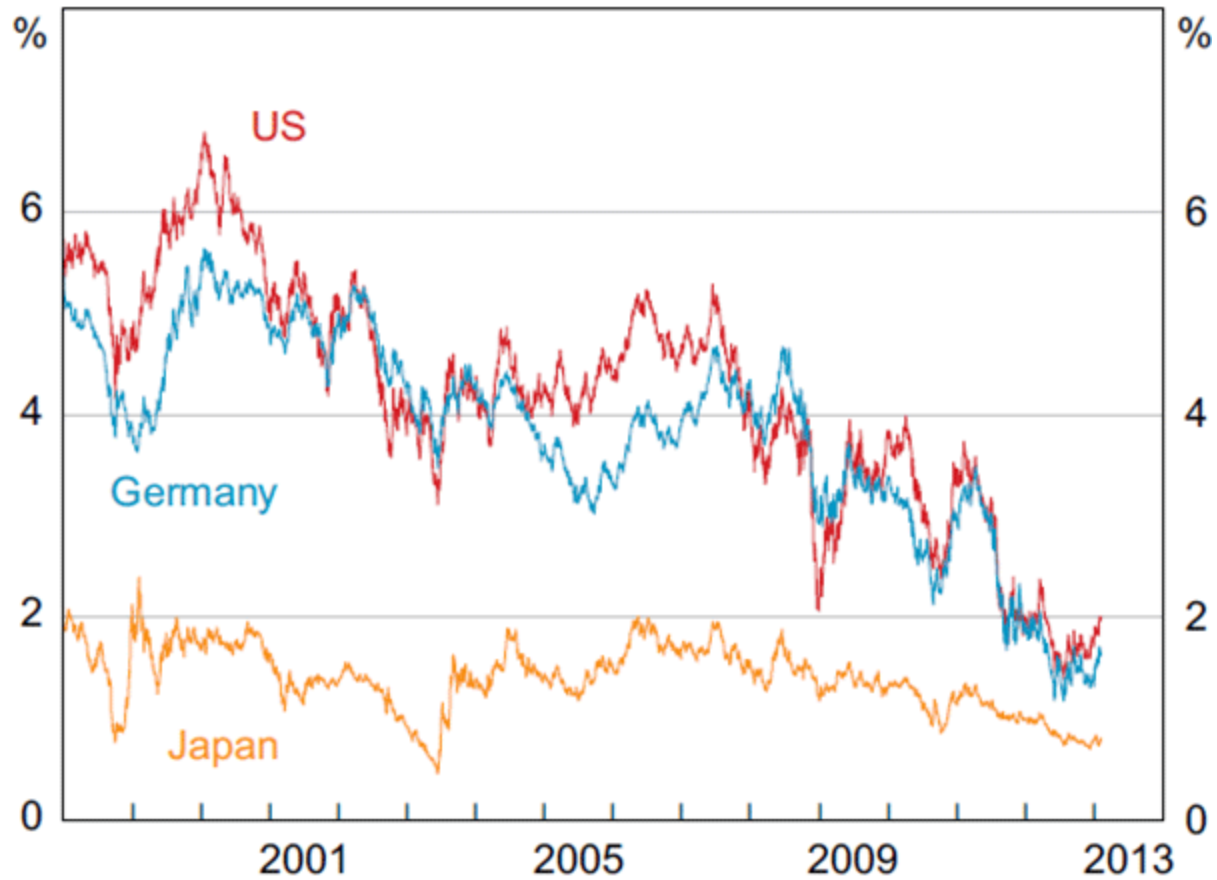
Euro Area Government 10-year Bond Spreads To German Bunds



* Data from 12 March 2012 are yields on Greek bonds post first private sector debt swap

Source: Bloomberg

10-year Government Bond Yields

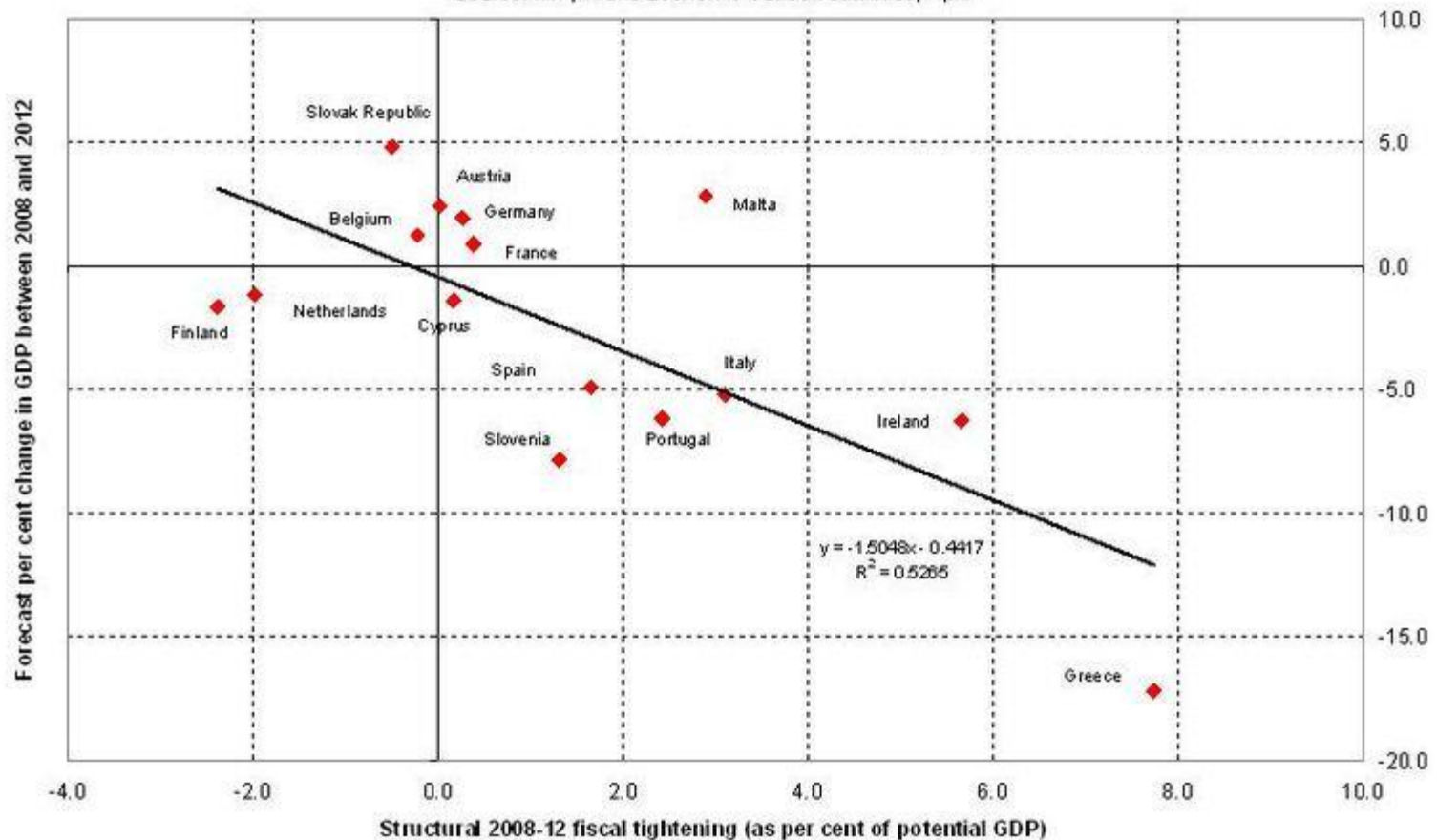


Source: Bloomberg

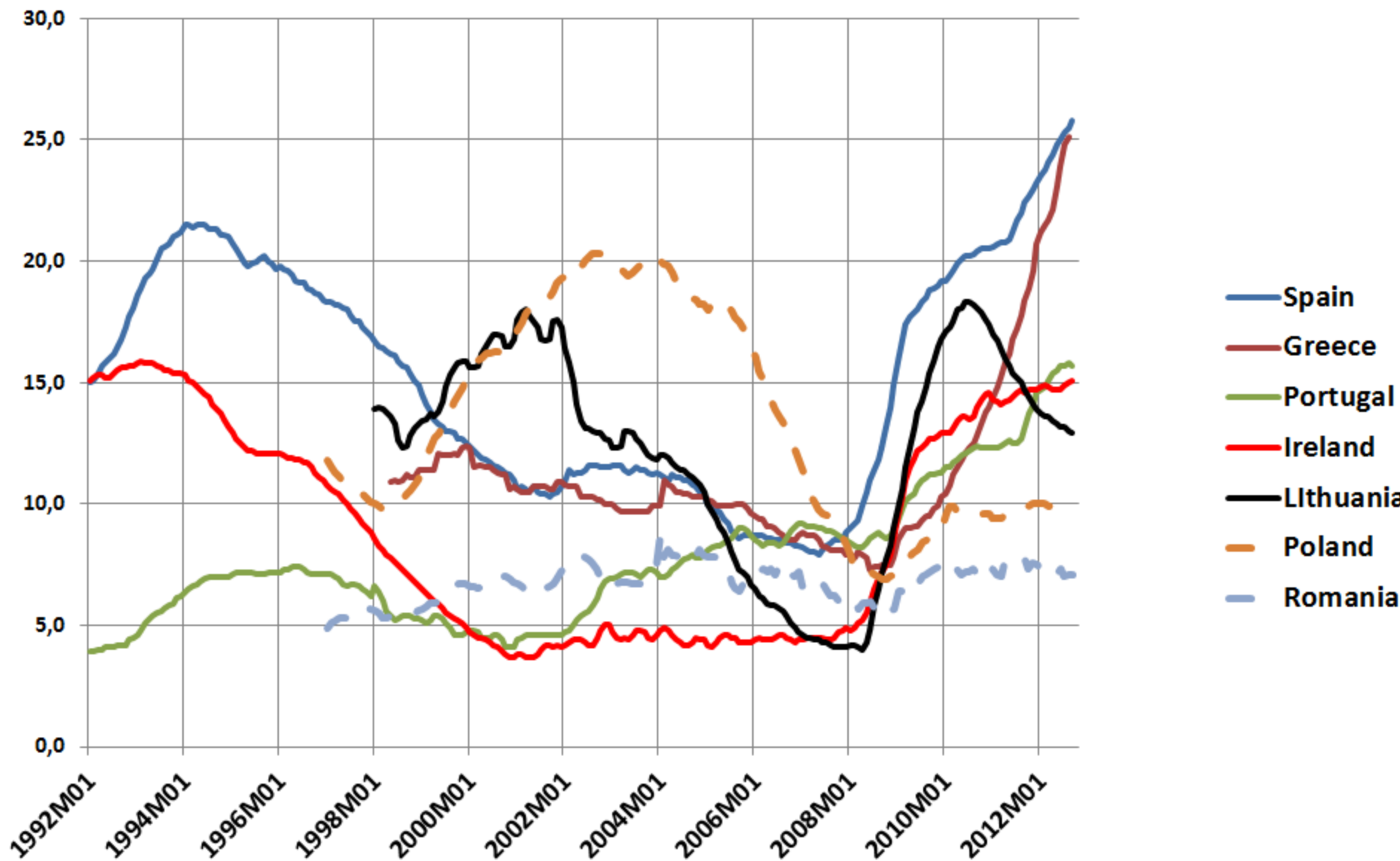
GDP and Fiscal Tightening

FISCAL TIGHTENING AND EUROZONE GDP 2008-12

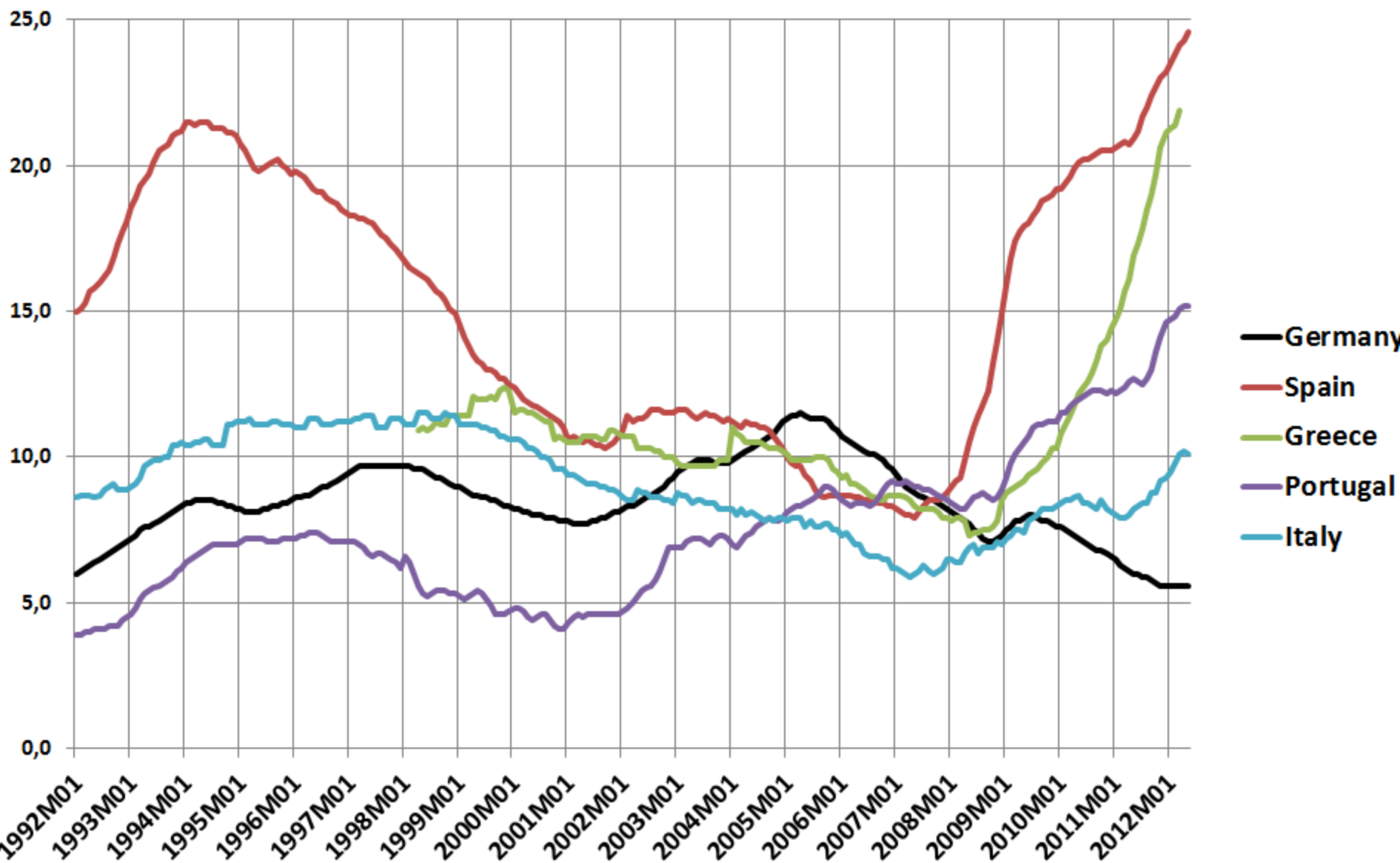
Source: IMF, World Economic Outlook database, April



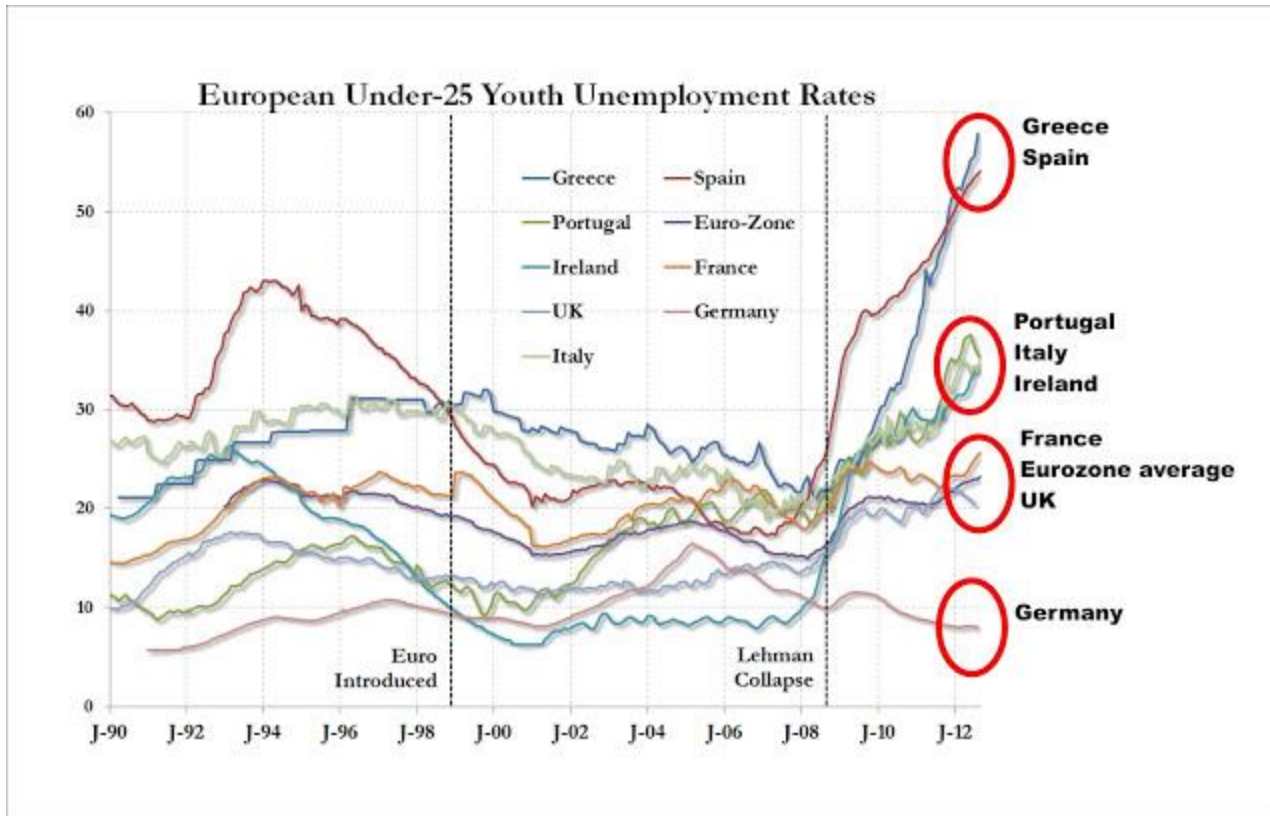
Unemployment, %, some Euro /Europeg and some non-Euro countries



Unemployment, Germany and southern Europe, 1992-2012 (may)



And more seriously ...



Lessons to be learned

- Financial markets are perfectly capable of acting irrationally. Market panic drove extreme austerity in Southern Europe.
- Extreme austerity has proved self-defeating – it means debt/GDP ratios are higher not lower.
- Markets can be ‘schizophrenic’ – they initially reward harsh austerity measures and then panic when they, predictably, lead to weaker growth.
- The end result is that market panic, followed by policy-maker panic, has imposed huge economic and social costs across Europe.

We must ask for an intellectual showdown!!

- The Reinhart-Rogoff declaration – the decisive argument for austerity
- Crisis as a problem of moral hazard

But

- Blanchard & Leigh, IMF Working Paper/13/1:
The size of fiscal multipliers

Blanchar & Leigh, IMF Working Paper/13/1:

- We find that, in advanced economies, stronger planned fiscal consolidation has been associated with lower growth than expected, with the relation being particularly strong, both statistically and economically, early in the crisis. A natural interpretation is that fiscal multipliers were substantially higher than implicitly assumed by forecasters.

What can be argued?

- Stop fighting automatic stabilizers
- Fiscal expansion where there is room
- Wage growth where there is room
- Balanced budget expansions everywhere
- European Investment Bank
- Issue Eurozone-bonds
- ...

“The boom, not the slump, is the right time for austerity at the Treasury.”

J. M. Keynes (1937): Collected Writings