Austerity: From outrage to progressive alternatives

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Social democracy in Europe is not in good shape. Perhaps the main reason for social democratic parties losing support has been their perceived association with austerity policies. Where, however, the centre-left has more categorically rejected austerity, as in the case of Antonio Costa's Socialist Party in Portugal and Jeremy Corbyn's Labour, its popularity has remained high or even increased. But what exactly austerity is and how it should be rejected is not as obvious as it seems.

Deconstructing the concept of austerity

Austerity is an unhelpful concept in the analysis of economic policy. Originally, the word described a trait of general human behaviour, whereby it simply means 'sternness' or 'severity of manner or attitude'. When turning to economics, Wikipedia defines austerity as "difficult economic conditions created by government measures to reduce public expenditure".

While it is more than obvious that austerity is a concept in macroeconomics, it is connected with fiscal measures and also linked to some form of hardship, it could arguably be about the reduction of public expenditure or the reduction of the budget deficit. There is an important difference between the two, therefore one needs to decide whether austerity is (A) deficit reduction in general, or (B) deficit reduction by public expenditure cuts, or perhaps both (A and B). Similarly, we need to decide whether we call all deficit or expenditure reduction austerity (1), or only if it causes a fall in the GDP growth rate (2), or we reserve this word for situations when the cuts result in real economic contraction, i.e. negative growth (3).

If all this is austerity, perhaps it makes sense to develop a typology: 'mild austerity', if a growth rate moderately falls as a result of a modest deficit reduction; 'severe austerity', if GDP itself falls when expenditures are cut; and 'savage austerity', for cases where a country does not simply reduce the deficit but achieves a budget surplus despite experiencing heavy losses of income and employment.

Consequently, one needs to decide whether we use austerity as a binary concept (i.e. it either exists in full or it does not exist at all), or it is something that has various degrees. Could it be like medicine, which leads to an expected (positive) effect if applied in a certain quantity, but causes harm or even tragedy when overdosed? Opening the door in this direction creates a difficulty for the definition effort, since we would need to answer *what fiscal measures* conducted under *what circumstances* qualify for austerity. And, of course, we need to open up some space for fiscal consolidation without any significant real economic sacrifice.

Views regarding what measures we consider austerity at all, and how harmful we believe it is can differ significantly among those using this expression in their economic policy analysis. Moreover, in the economics literature various shades of austerity appear not only in terms of different degrees, but also of what one considers to be the goal, the implementing measures, the circumstances and the outcome of the actions we want to describe.

Varieties of austerity definitions

Simon Wren-Lewis defines austerity as "a fiscal contraction that causes a significant increase in aggregate unemployment." By speaking about fiscal contraction Wren-Lewis leaves it open whether we speak about cutting government spending or budget deficit or both. On the other hand, he is very specific in defining the outcome as increasing unemployment, which reveals a more conventional Keynesian attachment (as opposed to linking austerity to decelerating or negative GDP growth).

Interestingly, another prolific author on austerity, Mark Blyth, applies a completely different approach. For him austerity is "a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting state's budget, debts and deficits." As compared to Wren-Lewis (and a more conventional interpretation of the concept) for Blyth the toolkit of austerity goes beyond fiscal cuts and includes wage and price cuts, and the goal of the exercise is neither the reduction of the fiscal deficit or public expenditure but enhancing competitiveness.

Barry Ritholtz, who coined the word "austerian" to describe those advocating the policy in question, describes it as "the desire to slash government spending and cut deficits during a time of economic weakness or recession". Unlike the above two authors, he underlines the importance of the timing of the measures in question, suggesting that the same measures (cutting deficit or spending) with a better timing may not qualify for austerity. It is as important to choose *when* we do something as *what* we do, and thus avoid pro-cyclical intervention.

Probably the highest profile critic of austerity is Joseph Stiglitz, who in essence equates austerity with an obsession with balanced budgets, and a fixation on fiscal deficits. While this very general definition allows for many different measures to be collected under the austerity umbrella, Stiglitz makes it clear that the main problem with the approach is that it makes cuts in expenditures (including social expenditures) a policy priority when public revenues fall at a time of recession. This is counter-productive not only by producing more social inequality instead of less, but also by undermining the long-term growth potential of the given country instead of enhancing it.

Further complications with interpretation

For most authors, austerity is essentially about fiscal cuts, and more specifically pro-cyclical reduction of public expenditure. However, the actual effects of fiscal cuts can be difficult to estimate *ex ante* in the event of simultaneous shifts in monetary policy. Both *fiscal and monetary policy* can be pro-cyclical (simultaneous tightening undermining growth and leading to recession), which certainly was the case for instance in 2010-11 in the EU. Given the involvement of multiple actors, whether the austerity outcome is calculated or unintended can sometimes become a legitimate question.

Among multiple actors we also count the „rest of the world", especially as regards small and open economies. Consequently, the outcome of austerity policy (measures) may well depend on geography and not only on timing. For some, with a growing environment and a particular trade profile, a set of measures can work out, while for others, especially with simultaneous fiscal contraction in different countries, the same policy can lead to recession. Macroeconomic strategy thus always needs to be tested against the "fallacy of composition". An example of this problem was when some proposed modeling the Eurozone crisis response on one smaller EU member state, Latvia.

Authors and critics often avoid investigating why exactly austerians behave as they do, especially if the harm they enact is so obvious. When this question is asked, more often than not, ideology appears as the main explanation, and economic thinking may be analysed as a type of religion. However, beyond ideology there are other factors at play. External pressures or constraints do play an important part, and so does special interest. Austerity can be damaging for many but it can also be beneficial for some, so treating it purely as grave misunderstanding or a lack of education in macroeconomics may miss the point.

Ideology indeed can be a powerful guide for government action, and so is the perceived necessity within a „rule-based" system or creditor conditionality in case of indebted countries. Very often, austerians do not recognise themselves as austerians, but as implementors of either the laws of economics, or international rules and agreements. We have seen the mix of all these factors at the time of the eurozone recession, together with the preference of politicians in peripheral countries to use ideology, if evidence is against them, as opposed to being forced to act in a particular way despite their own better conviction.

There are indeed significant macroeconomic limits imposed upon individual members within a monetary union, while a greater discretionary and ideological role exists elsewhere. An example of the second was the UK in 2010-3, unnecessarily lengthening the recession and deepening internal imbalances, thus generating the bad mood in society that eventually resulted in the Brexit vote. In the UK the choice of austerity by the Conservative—Liberal Democratic coalition was also linked to neoliberalism (preference for a smaller state, i.e. less redistribution, regulation and public ownership). Austerity and neoliberalism can be seen as connected concepts, but they are definitely not the same. There were many examples of austerity in the centuries before the rise of neoliberalism, while in our times neoliberal bias can be a major ideological factor behind choosing austerity measures to address existing imbalances as opposed to more progressive solutions.

Towards clarification: What we really mean

Policy debates require clarity which can only be delivered if our language avoids simplifications and the circulation of catch-all phrases remains limited. The point is not political correctness or preference for euphemisms, but a need for accurate analysis without which the development of policy alternatives is more difficult.

Using austerity as a blanket concept does not help in finding the ways to undo austerity, especially in the EMU. Alternatives to (over-) using "austerity" exist and they should be preferred to avoid misunderstandings and a dialogue of the deaf. The most important alternatives are :

- **"Fiscal consolidation"** should be used when government policy addresses a major fiscal imbalance (debt or deficit) through either spending cuts or revenue increases *(potentially but not necessarily leading to weakening economic performance).*
- **"Pro-cyclical fiscal policy"** should be preferred when macroeconomic governance ignores the business cycle and fiscal measures amplify rather than mitigate it (e.g. reducing the budget deficit either through cuts or tax increases leads to weaker growth or recession).
- **"Internal devaluation"** should be preferred when a combination of various measures (public expenditure cuts, wage cuts, pension cuts) is used as a substitute to currency devaluation with the intention of gaining competitiveness in the short term.
- **"Stability bias"** should be used when in a system of economic governance (fiscal and monetary) stability appears as a higher priority (more and stronger instruments supporting it) as compared to economic growth, employment and social cohesion.

Summary

The word austerity has been used to describe a variety of government actions in different situations but usually similar economic and social outcomes (less growth and more inequality). Alternative expressions help create clarity about the specific challenges governments face, their motivations and also options in terms of policy tools.

“No austerity” is not a policy. If austerity is used to describe ideological, neoliberal or conservative policy choices, an alternative (progressive or enlightened) economic strategy has to be defined in a positive way, that is listing the possible measures austerians overlook, oppose or refrain from using.

As regards the EU, a differentiated critique of austerity is needed not only for the sake of analysis but also for charting the progressive way forward. Outlining what needs to be done, as opposed to what needs to be undone, can lead to more fruitful political discussions and decisions.

Make no mistake, both stability and growth have their legitimate place in economic policy. However, within the EU their balance is not right and this calls for a more comprehensive reform and not simply better choices in specific national contexts. The EU economic architecture suffers from a stability bias, which has been associated with the Maastricht model ever since its inception. This cannot be cured by one-off investment campaigns or *ad hoc* flexibility regarding fiscal rules.

The rule-based nature of EU economic governance, the insistence on intergovernmental decision-making and a minimalist fiscal capacity at the community level, together with the opposition to systematic cross-country transfers in the Eurozone represent serious limitations to dealing with cyclicality as well as asymmetry. These limitations make it hard to design and implement robust recovery policies in case of crises, which in turn erode the long-term growth potential of the Eurozone as well as social and political cohesion in the EU as a whole. Thus undoing austerity is not simply a matter of ideological shift but a broader institutional reconstruction.

Austerity is not only a factor that undermines short-term growth and employment. Arguably, the original (Maastricht) model of EMU cannot be reconciled with all EU countries being democratic welfare states. The transition has started to a more complete and sustainable model, but progress is very slow, and it is a responsibility of progressive forces to accelerate this

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