New York Times
Op-Ed Columnist

Europe's Austerity Madness

By PAUL KRUGMAN

Published: September 27, 2012

So much for complacency. Just a few days ago, the conventional wisdom was that Europe finally had things under control. The European Central Bank, by promising to buy the bonds of troubled governments if necessary, had soothed markets. All that debtor nations had to do, the story went, was agree to more and deeper austerity — the condition for central bank loans — and all would be well.
Fred R. Conrad/The New York Times

But the purveyors of conventional wisdom forgot that people were involved. Suddenly, Spain and Greece are being racked by strikes and huge demonstrations. The public in these countries is, in effect, saying that it has reached its limit: With unemployment at Great Depression levels and with erstwhile middle-class workers reduced to picking through garbage in search of food, austerity has already gone too far. And this means that there may not be a deal after all.

Much commentary suggests that the citizens of Spain and Greece are just delaying the inevitable, protesting against sacrifices that must, in fact, be made. But the truth is that the protesters are right. More austerity serves no useful purpose; the truly irrational players here are the allegedly serious politicians and officials demanding ever more pain.

Consider Spain's woes. What is the real economic problem? Basically, Spain is suffering the hangover from a huge housing bubble, which caused both an economic boom and a period of inflation that left Spanish industry uncompetitive with the rest of Europe. When the bubble burst, Spain was left with the difficult problem of regaining competitiveness, a painful process that will take years. Unless Spain leaves the euro — a step nobody wants to take — it is condemned to years of high unemployment.

But this arguably inevitable suffering is being greatly magnified by harsh spending cuts; and these spending cuts are a case of inflicting pain for the sake of inflicting pain.

First of all, Spain didn't get into trouble because its government was profligate. On the contrary, on the eve of the crisis, Spain actually had a budget surplus and low debt. Large deficits emerged when the economy tanked, taking revenues with it, but, even so, Spain doesn't appear to have all that high a debt burden.

It's true that Spain is now having trouble borrowing to finance its deficits. That trouble is, however, mainly because of fears about the nation's broader difficulties — not least the fear of political turmoil in the face of very high unemployment. And shaving a few points off the budget deficit won't resolve those fears. In fact, research by the International Monetary Fund suggests that spending cuts in deeply depressed economies may actually reduce investor confidence because they accelerate the pace of economic decline.

In other words, the straight economics of the situation suggests that Spain doesn't need more austerity. It shouldn't throw a party, and, in fact, it probably has no alternative (short of euro exit) to a protracted period of hard times. But savage cuts to essential public services, to aid to the needy, and so on actually hurt the country's prospects for successful adjustment.

Why, then, are there demands for ever more pain?

Part of the explanation is that in Europe, as in America, far too many Very Serious People have been taken in by the cult of austerity, by the belief that budget deficits, not mass unemployment, are the clear and present danger, and that deficit reduction will somehow solve a problem brought on by private sector excess.

Beyond that, a significant part of public opinion in Europe's core — above all, in Germany — is deeply committed to a false view of the situation. Talk to German officials and they will portray the euro crisis as a morality play, a tale of countries that lived high and now face the inevitable reckoning. Never mind the fact that this isn't at all what happened — and the equally inconvenient fact that German banks played a large role in inflating Spain's housing bubble. Sin and its consequences is their story, and they're sticking to it.

Worse yet, this is also what many German voters believe, largely because it's what politicians have told them. And fear of a backlash from voters who believe, wrongly, that they're being put on the hook for the consequences of southern European irresponsibility leaves German politicians unwilling to approve essential emergency lending to Spain and other troubled nations unless the borrowers are punished first.

Of course, that's not the way these demands are portrayed. But that's what it really comes down to. And it's long past time to put an end to this cruel nonsense.

If Germany really wants to save the euro, it should let the European Central Bank do what's necessary to rescue the debtor nations — and it should do so without demanding more pointless pain.
A version of this op-ed appeared in print on September 28, 2012, on page A35 of the New York edition with the headline: Europe's Austerity Madness.