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Austerity has stormed back into fashion after the most dramatic financial meltdown in our recent history. Countries in Europe have led the charge in the implementation of austere policies. Portugal, Ireland, Italy, Greece and Spain are the usual suspects, but also other countries, such as Romania, Estonia, Bulgaria, Latvia and Lithuania (REBLL), have adopted austerity as their creed, with the support of the International Monetary Fund, the European Central Bank and the European Commission. These types of policies have also found their intellectual support in the seminal work of Carmen Reinhart and Kenneth Rogoff [1]. These Harvard economists argued back in 2010 that countries with a high debt to GDP ratio will have reduced growth rates. European leaders and policymakers, as well as U.S senators have used Reinhart and Rogoff as ammunition to encourage expenditure cuts and increase taxes.

In his new book on this contentious terrain, Mark Blyth carries out a thorough analysis of the origins and evolution of the idea of austerity while delivering a devastating critique of its record. The author provides the intellectual and practical background of this fiscal policy template and shows how it has gained significance both in the United States and in Europe.

In the first part of the book, the author analyzes the reasons marshaled by those arguing that the world needs to be austere. Blyth explores, in two different chapters, the causes and consequences of the post-Lehman crisis in America and in Europe. At this point it is clear that, although governments have been pointed at as being the

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culprits of the crises, the real blame lays on the private sector. The banking sector had to be bailed out in both continents and this eventually led to higher public debt and austerity, especially in Europe.

The second part of the book is devoted to what Blyth calls the intellectual and natural history of austerity. First the author traces austerity back to John Locke, David Hume and Adam Smith, passing through the British New Liberalism of the early 20th century, American liquidationism in the late 20s, German ordoliberalism of the midcentury postwar period and, second through the role of the Austrian School of economics in American thinking, Friedman’s monetarism, the Washington Consensus and the IMF’s monetary model. Through this examination of the intellectual history Blyth shows how austerity gained its pied-a-terre both in America and Europe.

Chapter 4 focuses on what Blyth calls the prehistory of austerity (1692-1942). The analysis in this chapter centers on the role of the market and the state. Markets were seen as an antidote to the inefficiency of states, he argues, pointing that Locke and Hume granted the state a minimal role, while Smith acknowledged the importance of the state but worried about the cost of maintaining it. The chapter ends with the twentieth century debate between Keynes and Schumpeter. The story moves forward in Chapter 5 as the author describes how austerity found a home in Germany’s ordoliberalism and in Austria’s distinct school of liberal economics. Blyth then depicts how austerity was put forth as a set of ideas through the Washington Consensus.

Finally, chapter 6 is devoted to what the author calls the “natural” history of austerity. Here he takes the work of the so-called “Bocconi Boys” as reference: founders of a school of public finance started at Bocconi University in Milan and then spread to economics departments in United States and Britain. Blyth convincingly demonstrates how most of the cases shown as supporting the argument that austerity is expansionary (Ireland, Denmark and Australia) are dubious at best and how those conditions are not present in today’s Europe. The author then uses key cases of austerity in the United States, the United Kingdom, Sweden, Germany, Japan and France, to show the dangers of austerity. His analysis makes clear that there are exceptional forms of austerity that combines devaluation with large-scale labor agreements that can result in growth, but these cases are, according to Blyth, vastly outnumbered by negative cases.
This chapter ends with the analysis of austerity in the REBLL countries following the Lehman crisis. As a result of frontloaded austerity packages, these countries have experienced dramatic contractions in their economies and have had difficulty reaching pre-crisis output levels, all of this accompanied by higher public debt and increased unemployment. The author questions the IMF’s stance on supporting these countries as a model for the rest of Europe, when it’s very clear that austerity has failed to achieve the main goal: the reduction of public debt. Critically, he shows why even if one buys into the REBLL success story, their experience cannot be easily translated into the multitudes of contexts in the crisis-stricken Eurozone “periphery.”

In the final part of the book, Blyth envisions a way to deal with the problems brought on by the crisis, without having to rely on austerity. The author compares the cases of Ireland, which carried out a very strict austerity package and Iceland, which took a heterodox route out of the crisis. The two countries went through similar problems; however, while Ireland is facing a harsh reality with many years of sluggish economic performance ahead, Iceland has left the worst of the crisis behind and is now experiencing economic growth, placing them at the top of OECD countries. Blyth advocates for similar measures to those taken in Iceland, specially taxing the top earners, which can help raise public revenue and reduce public debt. This solution also addresses the moral hazard issue produced by the crisis, where gains were privatized, but losses were socialized. However these recommendations may only be helpful to small economy countries like the REBLLs that don’t have a large impact in the world economy. Iceland was able to let the banks fail because they weren’t global banks; could this have been possible for the United States or the United Kingdom, where imploding could have brought down the global financial system with them?

In conclusion, austerity is a dangerous idea that has not worked as well as we are commonly led to believe by some orthodox economists. Austerity leads to less growth and higher debt, which in turn cripples the economy and leads to sluggish performance that can last for many years. Blyth proposes a different way of dealing with the crisis; one based on burden sharing, expansionary macroeconomic policy supported by capital controls, tax hikes on top earners and measures to help low and middle-income families. This will lead to more debt in the near future, but that can help the economy jump start so that a more coordinated fiscal consolidation can be carried out later. This is a very useful book for anyone that wants to learn about the
current economic situation of the world, how we arrived to this point, and where we could start looking for long-term solutions.

References


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