The austerity delusion

Paul Krugman

Portugal's government has just fallen in a dispute over austerity proposals. Irish bond yields have topped 10 percent for the first time. And the British government has just marked its economic forecast down and its deficit forecast up.

What do these events have in com-
ıon? They're all evidence that slash-
ıg spending in the face of high unem-
oyment is a mistake. Austerity
'vocates predicted that spending cuts
ıld bring quick dividends in the form
sing confidence, and that there
ld be few, if any, adverse effects on
'th and jobs; but they were wrong.
too bad, then, that these days
› not considered serious in Wash-
ı unless you profess allegiance to
me doctrine that's failing so dis-
in Europe.

ıs not always thus. Two years
:ed with soaring unemployment
·ge budget deficits — both the
uences of a severe financial
most advanced-country lead-
ningly understood that the
s had to be tackled in sequence,
mmediate focus on creating
ıbined with a long-run strategy
. reduction.

ıot slash deficits immediately?
› tax increases and cuts in gov-
spending would depress econ-
rther, worsening unemploy-
ıd cutting spending in a deeply
ɜd economy is largely self-de-
ven in purely fiscal terms: Any
ıchieved at the front end are
'set by lower revenue, as the economy shrinks.

So jobs now, deficits later was and is the right strategy. Unfortunately, it's a strategy that has been abandoned in the face of phantom risks and delusional hopes. On one side, we're constantly told that if we don't slash spending immediately we'll end up just like Greece, unable to borrow except at exorbitant interest rates. On the other, we're told not to worry about the impact of spending cuts on jobs because fiscal austerity will actually create jobs by raising confidence.

How's that story working out so far?

Self-styled deficit hawks have been crying wolf over U.S. interest rates more or less continuously since the financial crisis began to ease, taking every uptick in rates as a sign that markets were turning on America. But the truth is that rates have fluctuated, not with debt fears, but with rising and falling hope for economic recovery. And with full recovery still seeming very distant, rates are lower now than they were two years ago.

> **You're not considered serious in Washington unless you profess allegiance to the same doctrine that's failing so dismally in Europe.**

But couldn't America still end up like Greece? Yes, of course. If investors decide that we're a banana republic whose politicians can't or won't come to grips with long-term problems, they will indeed stop buying our debt. But that's not a prospect that hinges, one way or another, on whether we punish ourselves with short-run spending cuts.

Just ask the Irish, whose government — having taken on an unsustainable debt burden by trying to bail out runaway banks — tried to reassure markets by imposing savage austerity measures on ordinary citizens. The same people urging spending cuts on America cheered. "Ireland offers an admirable lesson in fiscal responsibility," declared Alan Reynolds of the Cato Institute, who said that the spending cuts had removed fears over Irish solvency and predicted rapid economic recovery.

That was in June 2009. Since then, the interest rate on Irish debt has doubled; Ireland's unemployment rate now stands at 13.5 percent.

And then there's the British experience. Like America, Britain is still perceived as solvent by financial markets, giving it room to pursue a strategy of jobs first, deficits later. But the government of Prime Minister David Cameron chose instead to move to immediate, unforced austerity, in the belief that private spending would more than make up for the government's pullback. As I like to put it, the Cameron plan was based on belief that the confidence fairy would make everything all right.

But she hasn't: British growth has stalled, and the government has marked up its deficit projections as a result.

Which brings me back to what passes for budget debate in Washington these days.

A serious fiscal plan for America would address the long-run drivers of spending, above all health care costs, and it would almost certainly include some kind of tax increase. But we're not serious: Any talk of using Medicare funds effectively is met with shrieks of "death panels," and the official Republican position — barely challenged by Democrats — appears to be that nobody should ever pay higher taxes. Instead, all the talk is about short-run spending cuts.

In short, we have a political climate in which self-styled deficit hawks want to punish the unemployed even as they oppose any action that would address our long-run budget problems. And here's what we know from experience abroad: The confidence fairy won't save us from the consequences of our folly.