



Written by [Thomas R. Eddlem](#) on May 21, 2013

If This Is the End of “Austerity,” When Did Austerity Begin?

Keynesian economist Paul Krugman crowed in the June 6 edition of the *New York Review of Books* that “the case for austerity has crumbled,” but careful analysts should be cautioning “real austerity was never even attempted.”



The centerpiece in the Princeton University economics professor’s gleeful call for expanded government spending was a study released in April by researchers at the University of Massachusetts at Amherst. That [U. Mass. study](#) partially debunked a widely cited 2010 study by Harvard Professors Carmen Reinhart and Kenneth Rogoff, which claimed economic growth falls off a cliff when government debt exceeds the 90 percent of gross domestic product (GDP). “Reinhart-Rogoff may have had more immediate influence on public debate than any previous paper in the history of economics,” Krugman wrote, noting that the Harvard study had been cited by Rep. Paul Ryan and top European officials. The Nobel Prize-winning economist noted that the U. Mass. professors revealed that Reinhart and Rogoff had made multiple mistakes in analysis, including, in [Krugman’s words](#):

one actual coding error, although that made only a small contribution to their conclusions. More important, their data set failed to include the experience of several Allied nations — Canada, New Zealand, and Australia — that emerged from World War II with high debt but nonetheless posted solid growth. And they had used an odd weighting scheme in which each “episode” of high debt counted the same, whether it occurred during one year of bad growth or seventeen years of good growth.

The University of Massachusetts research paper [concluded](#): “Overall, the evidence we review contradicts Reinhart and Rogoff’s claim to have identified an important stylized fact, that public debt loads greater than 90 percent of GDP consistently reduce GDP growth.” Two of the co-authors of the U. Mass. study, Robert Pollin and Michael Ash, concluded that “Reinhart and Rogoff are wrong about austerity” in an [op-ed](#) for the April 17 London *Financial Times*, claiming instead that “judicious deficit spending remains the single most effective tool we have to fight against mass unemployment caused by severe recessions.”



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The analysis by Krugman and the U. Mass. authors above is accurate only so far as they pointed out errors in the Reinhart and Rogoff study; the U. Mass. scholars did find a coding error and omission of some data by the Harvard professors.

From there, Krugman's analysis (as well as that of the U. Mass. authors) took a leap into fantasy land. "Without these errors and oddities" in the Reinhart and Rogoff study, Krugman argued, "there was still a negative correlation between debt and growth — but this could be, and probably was, mostly a matter of low growth leading to high debt, not the other way around." Krugman makes these claims without any evidence whatsoever. The April University of Massachusetts study confirmed that the price of high government debt is heavy, a reduction of some three-quarters of a percent of GDP annually for every 50 percent of GDP government debt. While the penalty of high government debt may not be a cliff, as claimed by Reinhart and Rogoff, the data reveal it's a steep and slippery slope. This was the same percentage reported by *The New American* in its [cover story back in October](#). One [graph published by the U. Mass. study](#) looks amazingly like the [graph published by *The New American* six months earlier](#).

And of course, no government obtains a high debt of more than 90 percent of their economy solely as a result of a severe economic recession. Many nations are able to maintain balanced budgets despite long periods of minimal economic growth. Claiming low growth creates deficits is not only completely without empirical evidence (and contrary to common sense, as historically many nations enact severe spending cuts that more than compensate for lower tax revenues), it also puts to lie the Keynesian economic dogma that deficit spending creates growth. In that sense, the Keynesian school of economics essentially worships at the altar of the self-contradictory.

Krugman then [claimed](#) that European nations began following the flawed research of Reinhart and Rogoff, a policy that led to economic disaster. "By the summer of 2010, then, a full-fledged austerity orthodoxy had taken shape, becoming dominant in European policy circles and influential on this side of the Atlantic. So how have things gone in the almost three years that have passed since?" So was Krugman correct in claiming European nations engaged in the practice of balanced budgets and paying off debt? No. Nearly all the European governments — like the United States — continued to pile up debt over the past three years. Despite this fact, Krugman [claims](#), "The turn to austerity was very real, and quite large."

Krugman goes on to [claim](#) that "Greece imposed spending cuts and tax increases amounting to 15 percent of GDP; Ireland and Portugal rang in with around 6 percent; and unlike the half-hearted efforts at stimulus, these cuts were sustained and indeed intensified year after year. So how did austerity actually work? The answer is that the results were disastrous — just about as one would have predicted from textbook macroeconomics." Of course, Greece, Ireland, and Portugal did engage in some moderate spending cuts from their historic high deficit levels, but these cuts were imposed by international financial markets rather than internal "austerity" impulses. And these cuts were not nearly enough to balance their budgets — not even in one year. If continued passage of massive government spending deficits constitutes "austerity" in the mind of Krugman, one has to ask: What does the word "austerity" mean, other than as an economic cuss-word employed by the political Left?

Krugman relies upon the key Keynesian fallacy — the futility of balancing budgets in a weak economy — for his analysis, which he [defines](#) as "interdependence: your spending is my income, and my spending is your income. If both of us try to reduce our debt by slashing spending, both of our incomes plunge — and plunging incomes can actually make our indebtedness worse even as they also produce mass unemployment." But that dogma is founded upon error. While there can be a very small and short-term



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(a year or less) GDP impact from increased or decreased government spending, the data reveals government spending levels are not a major indicator in economic growth. Krugman fails to take into account the factor of National Savings Rates, which have a far stronger impact on economic growth than does even government debt. [Higher savings rates correspond with higher economic growth](#), which is the opposite of Krugman's "interdependence" theory of demand leading economic growth. Indeed, each of the nations excluded from the Reinhart-Rogoff study — Canada, Australia, and New Zealand — which had strong growth after World War Two despite a heavy government debt also had extraordinarily high savings rates at the time. Those nations, which were emerging from the rationing of World War Two, almost forced consumers into savings by the war-era rationing.

It is savings that creates economic growth, as suggested by the [Austrian school of economics](#), rather than the spending and demand claimed by Keynesians. [Nations with low debt and high savings rates grew the fastest in the past 30 years, while nations with low savings and high debt hardly experienced any economic growth at all.](#)

Krugman eventually comes down to class warfare as his argument, and bases his prescriptions on an economic myth, [opining](#) that "the turn away from fiscal and monetary stimulus can be interpreted, if you like, as giving creditors priority over workers. Inflation and low interest rates are bad for creditors even if they promote job creation; slashing government deficits in the face of mass unemployment may deepen a depression, but it increases the certainty of bondholders that they'll be repaid in full." Of course, the key falsehood that the class warfare rests upon is the idea that low interest rates and monetary stimulus create jobs. In fact, both kill jobs by discouraging savings and running up government debt, which are by far the two strongest factors in economic growth. This is perhaps why, in the end, class warfare is all that is left to Krugman. There are no facts he can cling to for his demand for ever-greater deficit spending. All that is left to him is propaganda.



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