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Real Austerity

MARK THORNTON

Austerity has been hotly debated as either an elixir or a poison for tough economic times. But what is austerity? Real austerity means that the government and its employees have less money

at their disposal. For the economists at the International Monetary Fund, “austerity” may mean spending cuts, but it also means increasing taxes on the beleaguered public in order to, at all costs, repay the government’s corrupt creditors. Keynesian economists reject all forms of austerity. They promote the “borrow and spend” approach that is supposedly scientific and is gentle on the people: paycheck insurance for the unemployed, bailouts for failing businesses, and stimulus packages for everyone else.

Austrian School economists reject both the Keynesian stimulus approach and the IMF-style high-tax, pro-bankster “Austrian” approach. Although “Austrians” are often lumped in with “Austerians,” Austrian School economists support *real* austerity. This involves cutting government budgets, salaries, employee benefits, retirement benefits, *and* taxes. It also involves selling government assets and even repudiating government debt.

Despite all the hoopla in countries like Greece, there is no real austerity except in the countries of eastern Europe.



Mark Thornton is Book Review Editor of *The Quarterly Journal of Austrian Economics* and is Senior Fellow at the Ludwig von Mises Institute. He is the author of *The Economics of Prohibition* and co-author (with Robert B. Ekelund, Jr.) of *Tariffs, Blockades, and Inflation: The Economics of the Civil War*, and editor of *The Quotable Mises*.

For example, Latvia is Europe’s most austere country and also has its fastest growing economy. Estonia implemented an austerity policy that depended largely on cuts in government salaries. There simply is no austerity in most of western Europe or the U.S. As Professor Philipp Bagus explains, “the problem of Europe (and the United States) is not too much but too little austerity—or its complete absence.”

Most of Europe and the U.S. continue to have massive budget deficits and growing national debts relative to GDP. The Keynesians’ magical multipliers have once again failed to materialize. Given that most of these economies have not achieved growth from stimulus, they should give the idea of true austerity a fresh look.

Austerity for individuals, means living a highly restricted lifestyle. The best example is the monk who lives on a subsistence diet, wears simple clothing, possesses a few basic pieces of furniture, and uses only necessary utensils. His days consist of long hours of work and prayer with no leisure activities and he may not even enjoy indoor heating and plumbing.

Austerity applied to whole countries, is not necessarily so harsh or ascetic. It simply means that the government has to live within its means.

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standing armies and nuclear weapons), with Mayberry’s Andy and Barney protecting the peace. The national debt would be wholly repudiated. This would involve certain short-run hardships, although much greater long-run prosperity.

In contrast, the *typical* austerity policy is difficult, but not severe. The government workforce and beneficiaries would have to make adjustments. Some people and businesses might go bankrupt, but soon businesses would reopen and people would go back to work.

Real austerity involves cutbacks in government wages and benefits. Austerity policies typically occur during economic crises when everyone is facing cutbacks and hardships. Given that government employees are typically compensated with roughly twice the income, benefits, and job security compared to similar employees in the private sector; it is not unreasonable to expect them to bear most of the burden of an austerity policy.

One particularly promising area for cutbacks is government regulation. Regulation is a burden on taxpayers, discourages entrepreneurship, and makes us less safe. One recent empirical study found that regulation was extremely costly and that “eliminating the job of a single regulator grows the American economy by \$6.2 million and nearly 100 private sector jobs annually.”

What austerity does not mean is that government cutbacks become a form of extortion. The cutbacks should not be in the form of eliminating garbage collection, the police force, and the fire department (unless private competition in these areas are allowed) while leaving the military, the education bureaucracy, and the dozen or so spy bureaucracies’ budgets untouched.

Real austerity is not adding more difficulties on the productive sector of the economy in the form of higher taxes. The private sector produces, the public sector consumes. The IMF’s idea of raising taxes on individuals to pay off international banksters is bad economics and is not real austerity.

In hard times, government policies should be guided by the idea of increasing production, not of making production more burdensome by higher taxes. Our ascetic monk does not force his duties and burdens on ordinary citizens.

It has even been suggested that “austerity” should involve extending existing taxes onto charities and non-profits. Others have suggested taking away the tax-exempted status of charities and non-profits, which is a backdoor tax increase. These are some of the dumbest suggestions for economic crises and are not real austerity.

Real austerity actually works best with tax *cuts*. To help austerity create growth it needs to be understood that certain taxes are *highly* discouraging to production. Tax cuts on investment and capital actually stimulate economic activity. There is no doubt about this, it is even noted in the mainstream economics literature.

One historical example of austerity legislation is the Economy Act of 1933. This legislation, submitted by Franklin Roosevelt six days after his inauguration, slashed government spending, wages, and benefits, including cuts of 50 percent to veterans’ benefits, which at the time constituted a quarter of the federal budget.

The Act helped jump-start the economy. Combined with the repeal of Prohibition it helped reduce unemployment from 25 percent to almost 15 percent. These two pieces of legislation were the real reason for FDR’s

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Ludwig von Mises Institute, 518 West Magnolia Avenue, Auburn, Alabama 36832-4501 Phone: 334.321.2100; Fax: 334.321.2119; Email: info@mises.org; Web: Mises.org

popularity. Unfortunately Congress acted on less than half of Roosevelt's requested cuts and increases in government spending greatly diminished the beneficial impact of FDR's austerity legislation.

Worse still, FDR quickly adopted Hoover's "New Deal" programs, expanded some, and added new ones. With respect to the Great Depression, Murray Rothbard's thesis was that Hoover's and Roosevelt's "New Deal" prevented the economy from recovering. In an attempt to keep prices and wages high, they both continuously intervened with one program after another. More spending, more regulation, and more resources were withdrawn from the economy, yet nothing worked. Today, mainstream economists Harold Cole and Lee Ohanian have verified the soundness of Rothbard's thesis.

The 1940s are considered by many to be the glory years for the anti-austerity/Keynesian stimulus approach. The massive government spending and deficits during World War II were long thought to have gotten us out of the Great Depression. The truth is quite the opposite. Conscripting one-fifth of the workforce to labor at difficult and dangerous military activities is not good economics. Robert Higgs has demonstrated that even on the home front, real consumption per capita stayed at or below Great Depression levels.

The proof for real austerity, however, came after World War II ended. All the Keynesian economists warned of a return of the Great Depression. In sharp contrast, the American Austrian School economist Benjamin Anderson predicted that the economy would recover, in a very short period, despite multi-billion dollar budget cuts and millions of government jobs being slashed.¹ What was the verdict on this debate? There was no real Depression of 1946, as the economy recovered very quickly despite the fact that the government was running large budget surpluses.

The Austrian austerity solution works, and the Keynesian stimulus solution fails. As Jim Rogers has noted, the Austrian approach worked for Sweden in the 1990s, while the Keynesian approach failed for Japan. In the 1980s the austerity approach worked in Chile, but the lenient-bail-out approach failed in Mexico.²

1 *Financing American Prosperity: A Symposium of Economists*, edited by Paul T. Homan and Fritz Machlup, 1945.

2 Professor Robert Higgs has shown us how statistics can be misleading, especially in the current context.

It should be clear that austerity policy, properly understood, works to revive the economy and restore economic growth. In contrast, the approach of using bailouts and stimulus is bound to fail. Keynesian economists may be good at telling scary stories of death spirals and black holes, but the lessons of history clearly point us in the direction of austerity and away from stimulus.

As Jason E. Taylor and Richard K. Vedder have written:

"Just as history tells us that stimulus packages are ineffective in bringing about recovery, so it also tells us that 'de-stimulus'—moving in the direction of monetary and fiscal contraction—likewise need not have severe adverse effects on employment, income, stock prices, and other macroeconomic variables."

The two significant times that an all-out stimulus approach was adopted occurred in the U.S. from 1929 to 1945, and in Japan from 1989 to the present. Our crisis is now almost 6 years old. The recently passed fiscal-cliff legislation that increased our taxes suggests that the U.S. government is adding the failed IMF approach of higher taxes to the failed Keynesian approach of higher spending.

What the ailing economies of the world need is a heavy, ongoing dose of real austerity, Austrian-style. ■

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March 21–23, 2013

AUSTRIAN ECONOMICS RESEARCH CONFERENCE
(formerly Austrian Scholars Conference)
Mises Institute, Auburn, Alabama

June 10–14, 2013

ROTHBARD GRADUATE SEMINAR
Mises Institute, Auburn, Alabama

July 21–27, 2013

MISES UNIVERSITY
Mises Institute, Auburn, Alabama

Register online at Mises.org or by phone at 800.636.4737.

The Austrian Economics Research Conference (formerly ASC) is the foremost international, interdisciplinary meeting of the Austrian School, bringing together leading scholars doing research in this intellectual tradition. The conference is hosted at the Ludwig von Mises Institute campus in Auburn, Alabama.

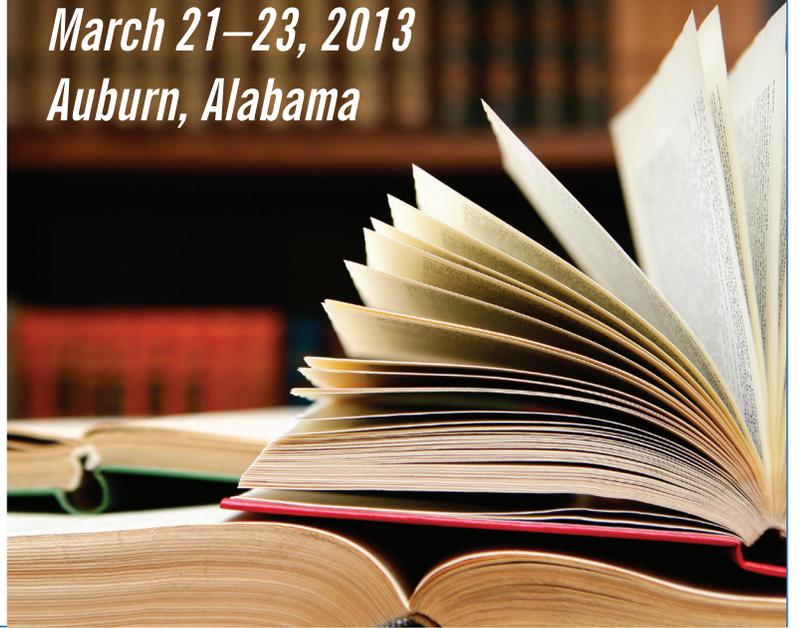
To recognize the increasing importance of Austrian economics research, not only within the university but also in research institutes and among business professionals, the Mises Institute has renamed its annual academic conference the Austrian Economics Research Conference. The aim is to focus more closely on the research tradition of Menger, Böhm-Bawerk, Mises, Hayek, and Rothbard in economic theory, economic history, and political economy.

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Austrian Economics Research Conference

March 21–23, 2013

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by Mark Thornton

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Ludwig von Mises Institute
518 West Magnolia Avenue
Auburn, Alabama 36832-4501

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