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## Beyond Austerity

William Mitchell | March 16, 2011

When President Obama announced in December 2009 that “We don’t have enough public dollars to fill the hole of private dollars that was created as a consequence of the crisis,” the leader of the largest economy in the world told us that, despite having caused the worst economic crisis in eighty years, neoliberalism was still firmly in charge. The global economic crisis might suggest that the neoliberal promise—that markets can self-regulate and deliver sustained prosperity for all—was a lie. But that doesn’t seem to have registered with governments, which have, without exception, built their responses to the crisis on a series of myths—the same myths that caused the crisis. Despite millions remaining jobless and poverty rates rising, governments have claimed that there is no alternative but to impose austerity by cutting budget deficits. In the United States and among most parties in Europe—whether in government or opposition—the unquestioned dominance of neoliberal ideology has reduced economic debate to questions of nuance. So conservatives eschew tax increases and want larger spending cuts, whereas progressives favor a combination of spending cuts and tax increases. This homogenization of the political debate has not only stifled progressive voices; it is also obscuring the only credible route to recovery.

What began as a problem of unsustainable private debt growth, driven by an out-of-control financial sector aided and abetted by government deregulation, has mysteriously morphed into an alleged sovereign debt crisis. As private spending collapsed in 2007–08, budget deficits (public spending minus taxes) rose to bridge the gap. Now conservatives, some of whom were direct beneficiaries of bailout packages in the early days of the crisis, tell us that our governments are bankrupt, that our grandchildren are being enslaved by rising public debt burdens and that hyperinflation is imminent. Governments are being pressured to cut deficits despite strong evidence that public stimulus has been the major source of economic growth during the crisis and that private spending remains subdued.

Austerity will worsen the crisis, because it is built on a lie. Public deficits do not cause inflation, nor do they impose crippling debt burdens on our children and grandchildren.

Deficits do not cause interest rates to rise, choking private spending. Governments cannot run out of money. The greatest lie—endlessly repeated by neoliberal economists and uncritically echoed by the mainstream media—is the claim that if governments cut their spending, the private sector will “crowd in” to fill the gap. British Prime Minister David Cameron’s austerity campaign and President Obama’s foreshadowed budget cuts are built around these lies.

The neoliberal narrative has run into some inconvenient facts. Interest rates remain low, and governments—even those of deeply troubled Greece and Ireland—have not defaulted on their debts. In most of the developed world inflation is falling, and where it is rising, it is due to rising energy and food costs rather than excessive deficits. Further, despite what they might say in public and what they demand of governments, bankers’ private actions show they know better—why else would long-term bond yields remain at historic lows? Yet the public conversation is mired in misinformation, paralyzing policy-makers, while the public interest is being sacrificed and a lost generation of unemployed is emerging.

But isn’t there a sovereign debt crisis in Europe? True, the nations that signed up for the euro did surrender their individual economic sovereignty—they use a currency they do not issue and thus have to borrow to cover deficits, which makes them dependent on bond markets and thus really does put them at risk of insolvency. Events in Greece and Ireland are testimony to that fact. But that problem lies in the flawed design of the euro monetary system, which was a neoliberal ploy to limit the capacity of these governments to borrow and spend. The euro nations are an exception to the rule that modern governments—like the United States and Britain—cannot run out of money and will never default on their public debt.

## **How Did We Get Here?**

The Great Depression taught us that without government intervention, capitalism is inherently unstable and prone to delivering lengthy periods of unemployment. The Hooverian orthodoxy of balanced budgets, tried during the 1930s, failed. Full employment came only with the onset of World War II, as governments used deficit spending to prosecute the war effort. The challenge was how to maintain this full employment during peacetime.

Western governments realized that with deficit spending supplementing private demand, they could ensure that all workers who wanted to work could find jobs. All political persuasions accepted this commitment to full employment as the collective responsibility of society. As a result, very low levels of unemployment in most Western nations persisted until the mid-1970s. While private employment growth was relatively strong during this period, governments maintained a buffer of jobs for the least-skilled workers. These jobs were found in the major utilities, the railways, local public services and major infrastructure

functions of government. By absorbing workers who lost jobs when private investment declined, governments acted as an economic safety valve. In addition, welfare systems provided income support and other public services (such as health and education) to citizens in need. While there were significant differences across nations in the scope of these systems, they all shared the view that the state had a role to play in providing economic security to citizens.

However, conservative resistance to the use of budget deficits grew in the late '60s, particularly in the United States, as inflationary pressures mounted because of spending associated with the Vietnam War. And conservatives believed that trade unions had become too powerful. But the full-employment consensus didn't collapse until the escalating inflation that followed the OPEC oil-price hikes of the '70s. This marked the beginning of the neoliberal era, which has dominated the political debate ever since.

Rather than a failure of the system to create enough jobs, an idea that underpinned the New Deal consensus, mass unemployment was now depicted as an individual problem—poor work attitudes leading to a lack of job-seeking—exacerbated by excessively generous welfare payments. Policy-makers also adopted the neoliberal theory of unemployment, which claimed that Keynesian-style spending could no longer deliver lower unemployment without causing inflation. The only way the government could reduce this “naturally occurring rate of unemployment” was to further free up the labor market. So if governments were unhappy about the level of unemployment, their only alternative was to make it harder for workers to get income support payments and to eliminate other “barriers” to hiring and firing (for example, unfair dismissal regulations). Attacks on trade unions and statutory protections for workers began in earnest.

These same ideas had driven the failed policies that led to the Great Depression. But history is easily forgotten, and with support from business and a co-opted media, a paradigm shift in the academy permeated policy circles. As the neoliberal train gathered pace, the debate became focused on so-called “microeconomic reforms”: cutting expenditures on public sector employment and social programs and dismantling what were claimed to be supply impediments (such as labor regulations, minimum wages, Social Security payments and the like). Privatization and outsourcing accompanied these policy shifts.

Fiscal policy (spending tax revenues to achieve social aims) was actively used during the full-employment era, with monetary policy (the government's power to set interest rates) being considered less effective. The neoliberal assault on the use of fiscal policy began in the '70s, with the rise of monetarism. Politicians seized on the ideas of Milton Friedman to claim that their sole objective should be to control the money supply in order to manage inflation. Although various experiments at controlling the money supply failed dismally in the '80s (remember Reaganomics?), the dominance of monetary policy in mainstream economics was complete. Fiscal policy was demonized as being inflationary and its use eschewed,

depriving liberally inclined governments of the tools to advance a more progressive agenda.

The public justifications were all about creating more jobs and reducing poverty, but the reality was different. Since 1975 most nations have failed to create enough jobs to match their willing labor supply.

The assault on regulation and the attack on workers' rights brought about a growing gap between labor productivity and real wage growth. The result has been a dramatic redistribution of national income toward capital in most countries. For example, in the G7 countries between 1982 and 2005 there was a •  
6 percent drop in the share of national income paid as wages (as opposed to interest or dividends). This was a global trend.

In the past, real wages grew in line with productivity, ensuring that firms could realize their expected profits via sales. With real wages lagging well behind productivity growth, a new way had to be found to keep workers consuming. The trick was found in the rise of "financial engineering," which pushed ever increasing debt onto the household sector. Capitalists found that they could sustain sales and receive an additional bonus in the form of interest payments—while also suppressing real wage growth. Households, enticed by lower interest rates and the relentless marketing strategies of the financial sector, embarked on a credit binge.

The increasing share of real output (income) pocketed by capital became the gambling chips for a rapidly expanding and deregulated financial sector. Governments claimed this would create wealth for all. And for a while, nominal wealth did grow—though its distribution did not become fairer. However, greed got the better of the bankers, as they pushed increasingly riskier debt onto people who were clearly susceptible to default. This was the origin of the subprime housing crisis of 2007–08.

## **The Myth of Austerity**

The conservative agenda to dismantle workers' rights was interrupted by the global financial crisis—which also refocused our attention on the importance of government spending in the form of fiscal stimulus or bailout packages. Before the crisis neoliberal economists and policy-makers claimed that the role of government should be limited to freeing up markets via deregulation. With unemployment seen as an individual problem, neoliberals argued that governments should not try to reduce unemployment by increasing public spending and/or reducing taxes. In fact, neoliberals claimed that whenever misguided governments did try to bring down unemployment in this way, they only made things worse—causing inflation and increasing debt burdens on taxpayers (now and later).

As the worst of the recent crisis abated, neoliberals launched a massive propaganda campaign to reinforce their claim that budget deficits are bad and should be avoided. Austerity is now viewed as inevitable. But is any of this true? The short answer is no, but it needs careful explanation, because the neoliberal arguments against deficits—at least some of them—are seductive.

Neoliberals claim that governments, like households, have to live within their means. They say budget deficits have to be repaid and this requires onerous future tax burdens, which force our children and their children to pay for our profligacy. They argue that government borrowing (to “fund” the deficits) competes with the private sector for scarce available funds and thus drives up interest rates, which reduces private investment—the “crowding out” hypothesis. And because governments are not subject to market discipline, neoliberals claim, public use of scarce resources is wasteful. Finally, they assert that deficits require printing money, which is inflationary.

But they go further than this. They claim that quite apart from these alleged negative impacts, deficits are not required to achieve the aims of the Keynesians. It used to be considered noncontroversial that government deficits could stimulate production by increasing overall spending when households and firms were reluctant to spend. In a bizarre reversal of logic, neoliberals talk about an “expansionary fiscal contraction”—that is, by cutting public spending, more private spending will occur. This assertion comes with the fancy name of “Ricardian Equivalence,” but the idea is simple: consumers and firms are allegedly so terrified of higher future tax burdens (needed, the argument goes, to pay off those massive deficits) that they increase saving now so they can meet their future tax obligations. Increased government spending is therefore met by reductions in private spending—stalemate. But, neoliberals argue, if governments announce austerity measures, private spending will increase because of the collective relief that future tax obligations will be lower and economic growth will return.

Economic policy is now clearly being driven by this idea that austerity is good. The only problem is that none of the propositions that support austerity are true.

It is difficult to expose the underlying myths because the assertions are framed in an opaque jargon. Further, the language of austerity has become ingrained in public debate by decades of miseducation and daily onslaughts from Fox News and its ilk. Those networks feature conservative politicians and denigrate those who challenge their views. Anyone who dares advocate larger deficits is shunned as being incompetent and/or a dangerous socialist. However, constantly shouting that government deficits are bad doesn’t make them so.

When British Prime Minister David Cameron said that the government deficit is just like credit-card debt and that Britain was facing bankruptcy, he was invoking the false neoliberal analogy between national budgets and household budgets. This analogy resonates strongly

with voters because it attempts to relate the more amorphous finances of a government with our daily household finances. We know that we cannot run up our household debt forever and that we have to tighten our belts when our credit cards are maxed out. We can borrow to enhance current spending, but eventually we have to sacrifice spending to pay the debts back. We intuitively understand that we cannot indefinitely live beyond our means. Neoliberals draw an analogy between the two, because they know we will judge government deficits as reckless. But the government is not a big household. It can consistently spend more than its revenue because it creates the currency. Whereas households have to save (spend less than they earn) to spend more in the future, governments can purchase whatever they like whenever there are goods and services for sale in the currency they issue. Budget surpluses provide no greater capacity to governments to meet future needs, nor do budget deficits erode that capacity. Governments always have the capacity to spend in their own currencies.

Why? Because they are the issuers of their own currencies, governments like Britain, the United States, Japan and Australia can never run out of money. President Obama was wrong to suggest otherwise. Most people are unaware that a major historical event occurred in 1971 when President Nixon abandoned what had been called the gold standard (or US-dollar standard). Under that monetary system, which had endured for eighty-odd years (with breaks for war), currencies were convertible into gold, exchange rates were fixed and governments could expand their spending only by increasing taxes or borrowing from the private sector. After 1971 governments issued their own currencies, which were not convertible into anything of value and were floated and traded freely in foreign currency markets. Most nations have operated "fiat monetary systems" ever since, and as a result national governments no longer have to "fund" their spending. The level of liquidity in the system is not limited by gold stocks, or anything else.

Why, then, do governments borrow? Under the gold standard governments had to borrow to spend more than their tax revenue. But since 1971 that necessity has lapsed. Now governments issue debt to match their deficits only as a result of pressure placed on them by neoliberals to restrict their spending. Conservatives know that rising public debt can be politically manipulated and demonized, and they do this to put a brake on government spending. *But there is no*

*operational necessity to issue debt in a fiat monetary system.*

Interestingly, conservatives are schizoid on the question of public debt: public borrowing provides corporate welfare in the form of risk-free income flows to the rich because it allows them to safely park funds in bonds during uncertain times and provides a risk-free benchmark on which to price other, riskier financial products. The fact that bond yields have remained low throughout the latest economic crisis (reflecting strong demand for public debt) tells you that the parasitic bond markets do not buy the neoliberal rhetoric. They know that national governments (outside the Eurozone) have no solvency risk.

*Zimbabwe!*

Yes, a Bob Marley song. But it has also become the one-word response conservatives use to scare us into believing that deficits cause hyperinflation (the cry used to be Weimar!). The reality is this: if the economy is operating at full capacity—which means it cannot produce any more new products—then attempts by the government to expand spending will cause inflation. But up to that point, governments can run deficits forever without causing inflation. By supporting spending in an economy not at capacity, deficits induce more production rather than higher prices, since companies will be happy to supply the growing demand.

*Deficits will drive up interest rates!*

That's funny, since deficits have risen sharply in recent years but interest rates have remained close to zero. Japan has been running large deficits since its property market collapsed in the early 1990s and has maintained zero interest rates and low inflation ever since. The neoliberal lie forgets to mention that the central bank sets interest rates, not the market. What neoliberals don't tell you is that when government deficits stimulate growth, savings also grow as a result of higher incomes. So the claim that private and public borrowers compete for a finite pool of savings is a lie. Far from taking funds away from private investors, deficits expand the pool of available savings. Neoliberals also lie about the way banks work. Any credit-worthy private borrower can get credit from banks. Bank loans create deposits, which can be drawn down when banks make loans to borrowers. Yes, banks need reserves to back their loans, but they also know that the central bank will always supply those reserves should the banks fail to attract the necessary funds from other sources. So private borrowing is not constrained by existing savings. Borrowing typically increases income, which increases savings.

What about the central claim the British government is advancing to justify austerity—that private sector spending will increase if deficits are cut? All the evidence shows that firms are currently very pessimistic and will not expand employment and production until they see stronger growth in demand for their products. Consumers are also pessimistic because they worry about losing their jobs. They are also heavily in debt and are trying to save to reduce risks should they become unemployed. Cutting public spending will only deepen this pessimism. The greatest neoliberal lie denies human psychology. The early indicators from Britain—poor growth figures and surveys indicating growing pessimism among private firms and consumers—are already undermining the substance of the coalition government's austerity strategy. The only way economies grow is if companies expand in response to increasing demand for their products. When private demand is subdued, the only way to increase growth is for government to spend, via deficits. Austerity will just withdraw the lifeline that has been keeping our economies growing in the past year or so.

Finally, the size of the deficit should never be the concern of policy. Fiscal sustainability is being defined by the austerity myth in terms of some arbitrary financial ratio (public debt to

GDP, etc.). But actually deficits should be whatever is required to maintain overall spending at the level consistent with full employment. No more, no less. Fiscal sustainability is about fulfilling the government's responsibility to maintain an inclusive society in which everyone who wants to work can.

## **The Continuing Conservative Dominance**

Neoliberal economists and their supporters failed to predict the recent crisis and offered no effective solution once it arose. Organizations such as the IMF and the OECD advocated policies that contributed to the crisis. So why do neoliberal myths still dominate? And how has the British government been able to impose austerity when the indications are that it will severely damage the economy?

If you step outside the mythical neoliberal world, it is easy to see how the crisis occurred. It is easy to understand why there has been persistently high unemployment and rising inequality and why the distribution of income has moved dramatically in favor of capital. It is also easy to understand the rising dominance of the financial sector and the proliferation of financial products that ultimately exploded when banks abandoned any reasonable notions of risk in search of ever-increasing surpluses for their already wealthy owners. The fault lies with government—its failure to regulate properly and to use its fiscal capacity to ensure that there are enough jobs. The nearly religious belief in self-regulating markets led to policies that have allowed the destructive inner logic of capitalism to explode. Governments abandoned their stabilizing role as intermediaries between labor and capital. Instead, as captives of the financial sector, they supported dangerous and at times dishonest banking practices.

Blinded by our willingness to binge on consumption, courtesy of the increasing levels of credit pushed onto us by greedy banks, we never noticed that our political representatives were sacrificing our longer-term interests by advancing the short-term interests of capital. We also fell for the oldest political con: divide and rule. The poor were portrayed as the lazy detritus of this new entrepreneurial age. The unemployed were easily vilified as failures—which suggested that the rest of us were successes—even if success was measured in terms of the size of the houses and accompanying paraphernalia we could ill afford.

This madness was given a sense of legitimacy by a constant media chorus, sustained by a well-funded conservative lobby operating through high-profile think tanks harmonizing with endorsements from academic economists. Money bought national media access, while progressive voices struggled to be heard. Such is the power of this lobby and its mouthpieces that even though their approach has been thoroughly discredited since the crisis, neoliberals remain in control of the policy agenda and have turned what was clearly a private debt crisis into an alleged sovereign debt crisis.

In part, the neoliberals have retained their dominance because the opposition has been weak and fragmented. Progressives have generally been unwilling to contest the mainstream lies about budget deficits and public debt driving the push for austerity. There is a fear among progressives that they will be represented as spendthrifts if they advocate higher deficits. They too often try to appear “reasonable” by saying they will run fairer budget surpluses without realizing that striving for surpluses is the problem. In the buildup to the crisis, economic growth was driven largely by a private credit binge. The accompanying rise in private indebtedness really was unsustainable. Typically, capitalist economies require continuous public deficits to support growth and allow private debt levels to be sustainable. We lost that balance in the period leading up to the crisis. That point has to become a central tenet of the progressive fight back.

Instead, progressives continually propose all sorts of financial offsets—such as “making the rich pay”—which sound fair but do not get to the heart of the problem. Changing the mix of public spending and taxation may be sensible on equity grounds, but if there is an overall deficiency of spending and the private sector is reluctant to increase spending, then the overriding macroeconomic problems of entrenched unemployment and accompanying poverty will not be solved without increasing budget deficits.

With some well-known exceptions (for example, Joseph Stiglitz, Paul Krugman and William Greider), progressives think that advocating fiscal constraint makes them appear responsible. What they fail to see is that their economic stance largely undermines their capacity to pursue enlightened social and environmental policies.

## **What Is to Be Done?**

Austerity is not the only alternative. The major economies are suffering from a collapse of private spending and a massive overhang of private debt. Consumers won't spend if they fear unemployment; firms won't hire and produce if sales are flat. Persistently high unemployment means that our economies are forgoing massive production and income-earning opportunities. Unemployment also causes other problems, such as family breakdown, increased alcohol and substance abuse, increased crime rates and community dislocation. An economy with high unemployment is unhealthy. Austerity will worsen unemployment. It beggars belief that a government entrusted with advancing the well-being of its citizens would deliberately introduce policies that force people into joblessness.

As long as private spending is subdued, the greatest need is to expand budget deficits. That's the only way the advanced economies will drive growth fast enough to absorb the huge pool of unemployed. Inflation is low, and there is considerable slack in the economy, which can be brought back into productive use by further government stimulus. The current obsession with inflation control and austerity (using unemployment to discipline wage

demands) is very costly.

In advocating further fiscal stimulus, I would use the increased public spending to directly target job creation. I would introduce an open-ended public employment program—a Job Guarantee—that offers a job at a living (minimum) wage to anyone who wants to work but cannot find employment. These jobs would “hire off the bottom,” in the sense that minimum wages are not in competition with the market-sector wage structure. By not competing with the private market, the Job Guarantee would avoid the inflationary tendencies of old-fashioned Keynesianism, which attempted to maintain full capacity utilization by “hiring off the top” (making purchases at market prices and competing for resources with all other demand elements). Job Guarantee workers would enjoy stable incomes, and their increased spending would boost confidence throughout the economy and underpin a private-spending recovery. There is no reason the government could not afford this program. The labor is available for work, and the government can easily supply the jobs. There were no questions asked when the government, in the early days of the crisis, instantly provided billions for the banks. Let me repeat: the government has no financial constraint on its spending and should immediately allocate funds to a massive job-creation program.

Sustainable growth requires that the private sector save overall and avoid ever-increasing levels of indebtedness. It is possible that strong net exports could allow high levels of domestic activity with both private saving and the government’s budget in surplus. But that situation cannot hold for all countries. Normally, budget deficits will be required. Progressives should stop apologizing for them.

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