

Governing Challenges

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Day 1 Agenda

09.00-10.00 Introduction(s) and Overview

10.00-11.00 The idea of Austerity

11.00-12.30 Austerity Channels.

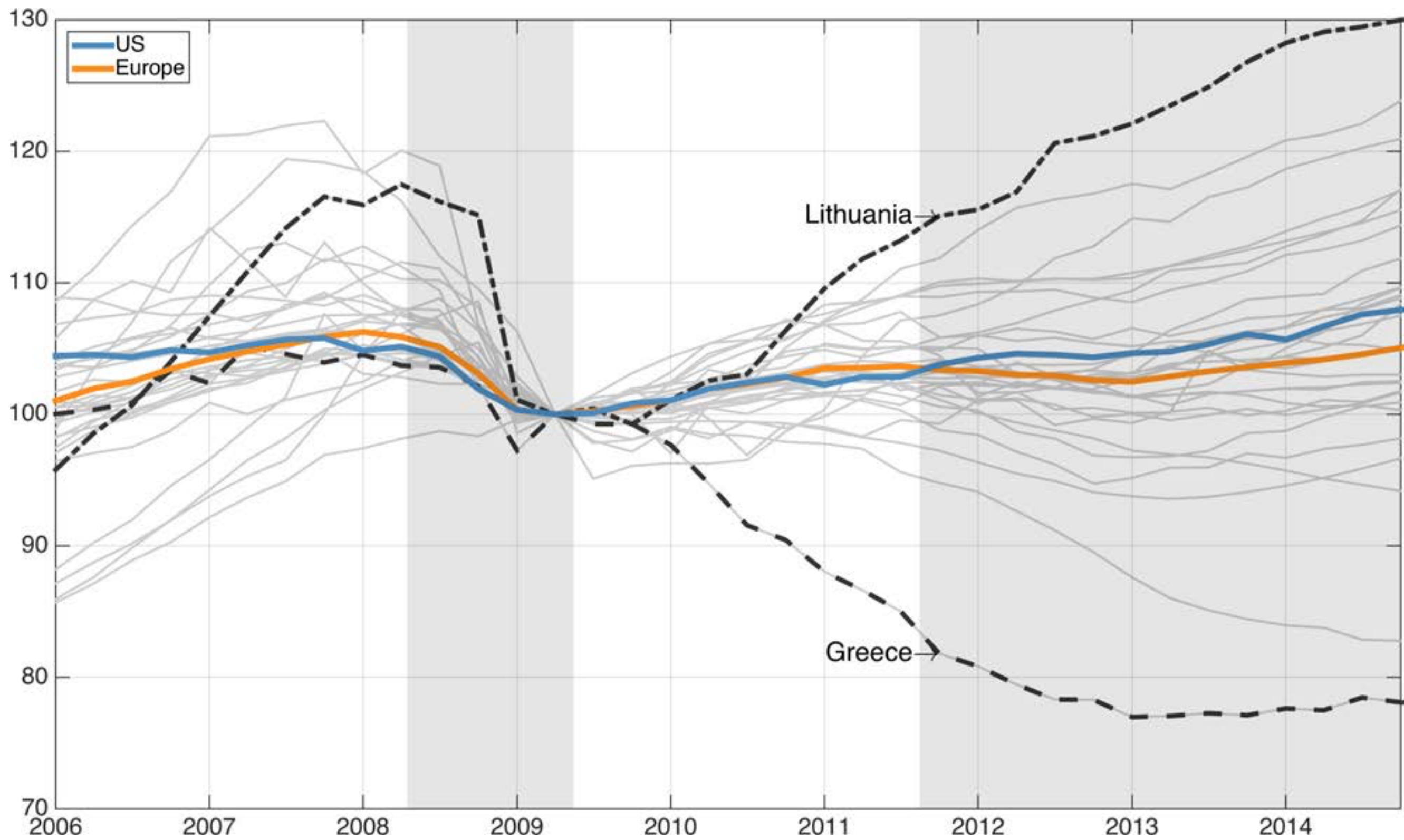
12.30-13.30 Lunch

13.30-15.30 Comparing Experiences of Austerity: Case studies

15.30-16.00 Coffee/Tea

16.00-17.00 Discussion & Notes for Tuesday

Introduction(s) & Overview

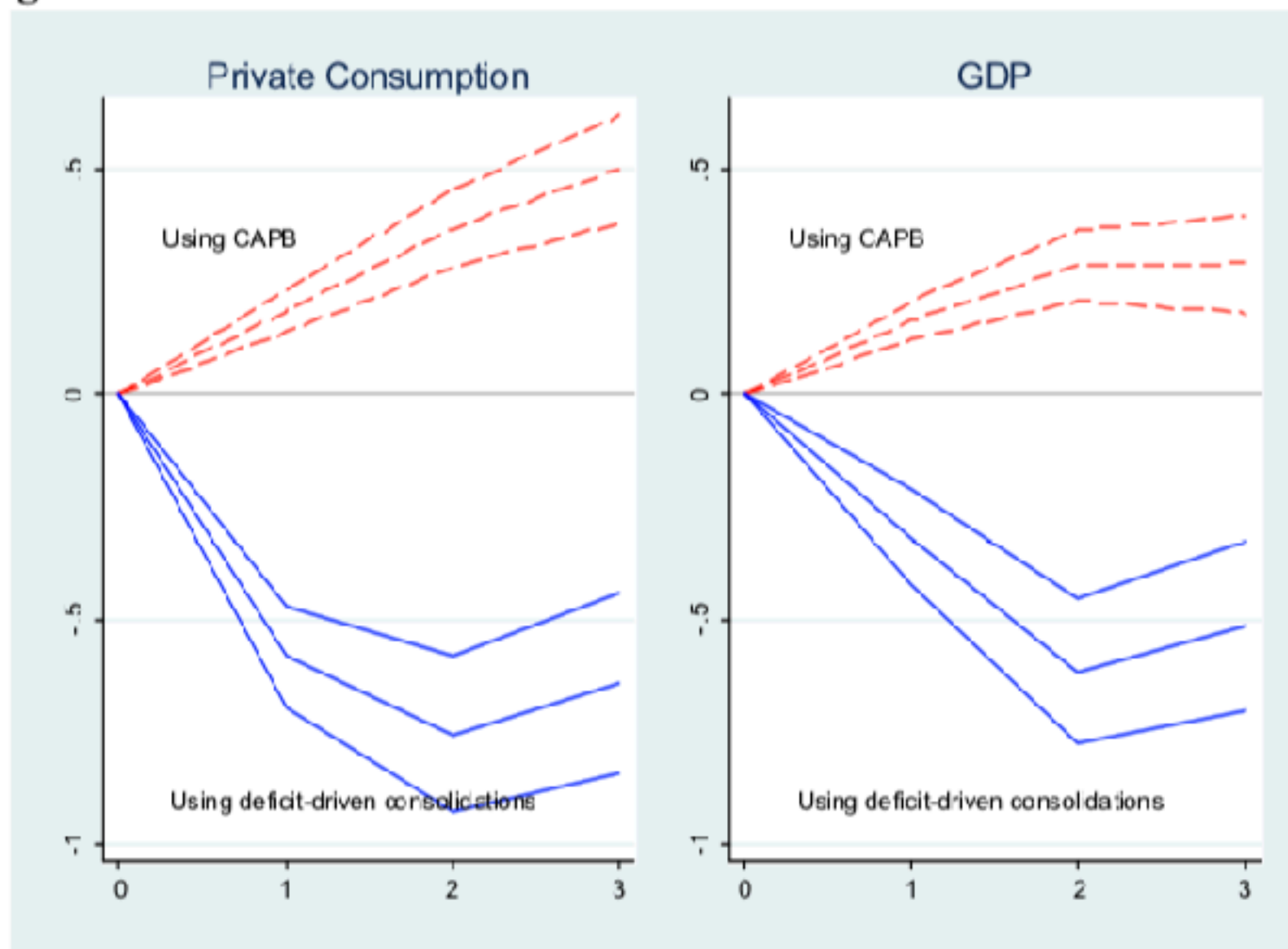


Defining Austerity

- Austerity is *not* simply fiscal consolidation.
- It is fiscal consolidation to impress bond markets and international creditor agencies through distributional changes, thus creating better investment expectations & lowering future tax burdens.

2 Stories: Measuring austerity

Figure 2. Estimated Effect of a 1 Percent of GDP Fiscal Consolidation



Note: Figure reports point estimates and one standard error bands in percent. $t=1$ denotes the year of fiscal consolidation.

Government deficit / surplus as a percentage of GDP

General government financial balance, surplus (+), deficit (-)

	2008	2009	2010	2011	2012	2013	2014	2015
Australia	-0.6	-4.7	-5.1	-3.6	-2.9	-1.4	-2.5	-1.4
Austria	-1.0	-4.1	-4.5	-2.4	-2.6	-1.5	-2.8	-1.3
Belgium	-1.1	-5.6	-4.0	-4.0	-4.1	-2.7	-2.1	-1.2
Canada	-0.3	-4.5	-4.9	-3.7	-3.4	-3.0	-2.1	-1.2
Czech Republic	-2.2	-5.8	-4.7	-3.2	-4.2	-1.5	-2.1	-2.6
Denmark	3.3	-2.8	-2.7	-2.0	-3.9	-0.9	-1.5	-3.0
Estonia	-3.0	-2.0	0.2	1.1	-0.2	-0.2	-0.2	-0.1
Finland	4.3	-2.7	-2.8	-1.0	-2.2	-2.5	-2.2	-0.9
France	-3.3	-7.5	-7.0	-5.2	-4.9	-4.3	-3.8	-3.1
Germany	-0.1	-3.1	-4.2	-0.8	0.1	0.0	-0.2	0.2
Greece	-9.9	-15.6	-11.0	-9.6	-8.9	-12.7	-2.5	-1.4
Hungary	-3.7	-4.5	-4.4	4.2	-2.2	-2.3	-2.9	-2.9
Iceland	-13.5	-9.9	-10.1	-5.6	-3.8	-2.1	-2.0	-2.1
Ireland	-7.4	-13.7	-30.6	-13.0	-8.1	-7.0	-4.7	-3.1
Israel ¹	-3.3	-8.2	-4.6	-3.9	-5.1	-4.3	-3.9	-3.6
Italy	-2.7	-5.4	-4.4	-3.6	-2.9	-2.8	-2.7	-2.1
Japan	-1.9	-8.8	-8.3	-8.8	-8.7	-9.3	-8.4	-6.7
Korea	2.9	-1.0	1.0	1.0	1.0	-0.4	0.1	0.5
Luxembourg	3.2	-0.7	-0.8	0.2	0.0	0.1	0.3	-0.9
Netherlands	0.5	-5.6	-5.0	-4.3	-4.0	-2.4	-2.7	-2.0
New Zealand	0.4	-2.7	-7.4	-4.4	-2.1	-0.3	0.1	0.7
Norway	18.8	10.5	11.1	13.6	13.9	11.1	10.7	10.2
Poland	-3.7	-7.5	-7.8	-5.1	-3.9	-4.3	5.6	-2.9
Portugal	-3.7	-10.2	-9.9	-4.3	-6.5	-5.0	-4.0	-2.4
Slovak Republic	-2.1	-8.0	-7.5	-4.8	-4.5	-2.8	-2.7	-2.6
Slovenia	-1.9	-6.3	-5.9	-6.4	-4.0	-14.7	-4.1	-2.6
Spain	-4.5	-11.1	-9.6	-9.6	-10.6	-7.1	-5.5	-4.5
Sweden	2.2	-1.0	0.0	0.0	-0.7	-1.3	-1.5	-0.8
Switzerland	2.0	0.8	0.3	0.7	-0.2	0.1	0.1	0.3
United Kingdom	-5.1	-11.2	-10.0	-7.9	-6.3	-5.9	-5.3	-4.1
United States	-7.2	-12.8	-12.2	-10.7	-9.3	-6.4	-5.8	-4.6
Euro area (15 countries)	-2.1	-6.3	-6.2	-4.1	-3.7	-3.0	-2.5	-1.8

Table 3: Average composition of plans (1981-2014)

<i>Type of plan</i>	N	Average composition (% of GDP)						
		Total Plan	Tax		Consumption		Transfer	
		% GDP	% GDP	% Plan	% GDP	% Plan	% GDP	% Plan
Tax Based	74	1.56 (1.52)	1.01 (0.81)	0.65	0.25 (0.45)	0.16	0.17 (0.36)	0.11
Consumption Based	46	1.45 (1.62)	0.23 (0.66)	0.16	0.83 (0.72)	0.58	0.22 (0.33)	0.15
Transfer Based	61	1.69 (1.41)	0.41 (0.64)	0.24	0.33 (0.35)	0.20	0.71 (0.63)	0.42

Note. Mean values computed in each category. Columns denoted by GDP report the measure as a ratio with respect to the GDP in the previous year. Column denoted by Plan show the average with respect to the total plan size. Average shocks of fiscal components do not sum to the total plan because of residual measures not classified under any of the three categories.

Standard Deviation in parenthesis.

Not all recessions are crises. Example: USA

Financial crisis 1873, 1884, 1893, 1907, 1929, 1984, 2007

1873	1875	1882	1887	1889	1892	1895	1901	1906
1909	1913	1916	1918	1926	1929	1937	1944	1948
1953	1957	1969	1973	1979	1981	1990	2000	2007

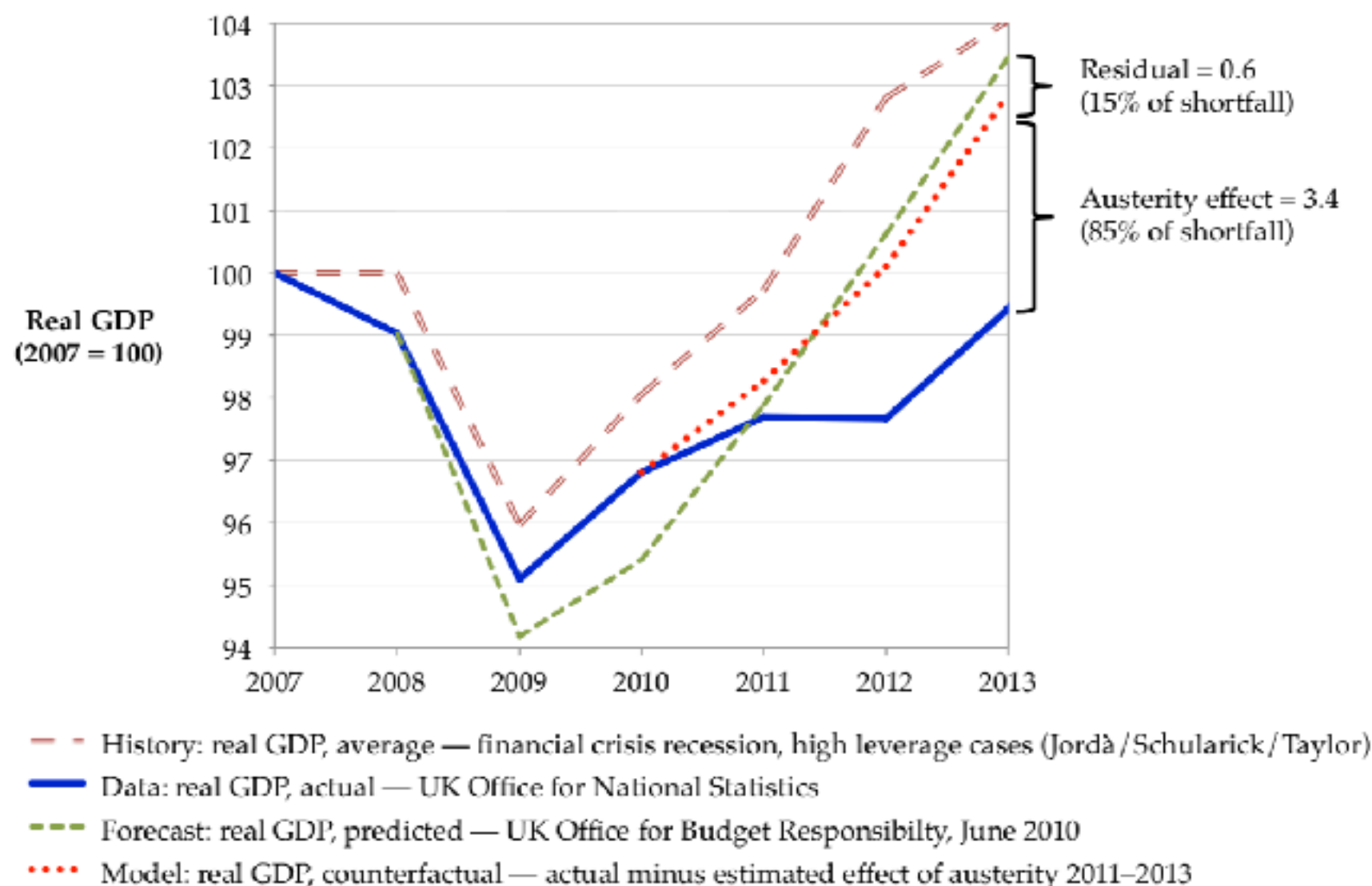
Financial recession

Normal recession

Macro disaster

Austerity as natural experiment

Figure 4: *U.K. austerity: forecast, actual, and counterfactual paths for real GDP, 2007–13*



Notes: Units are percent of 2007 real GDP, the last peak. OBR forecast is from http://budgetresponsibility.independent.gov.uk/wordpress/docs/pre_budget_forecast_140610.pdf. The Jordà, Schularick, and Taylor (2013) path is for real GDP per capita, extended to a 6-year horizon, adjusted by +0.65% per year given the U.K. rate of population growth. Actual data from ONS in March 2014. Model counterfactuals subtract estimated AIPW responses in the slump bin, suitably scaled. See text.

The idea of austerity

- Fundamental question about the relationship of the state to the market.
- Hume/Locke/Smith
- JS Mill: State as engine of social progress
- Early 20th C: Liquidationists & Treasury View, beaten by Keynes.
- Late 20th C: Bocconi boys and the Ordoliberal turn

Paradoxes & Austerity

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Post-Keynesian economics

Table 1.4 Holism: some post-Keynesian macro-paradoxes

Paradox of thrift (Keynes, 1936)	Higher saving rates lead to reduced output
Paradox of costs (Kalecki, 1969; Rowthorn, 1981)	Higher real wages lead to higher profit rates
Paradox of public deficits (Kalecki, 1971)	Government deficits raise private profits
Paradox of debt (Fisher, 1933; Steindl, 1952)	Efforts to de-leverage might lead to higher leverage ratios
Paradox of tranquillity (Minsky, 1975)	Stability is destabilizing
Paradox of liquidity (Dow, 1987; Nesvetailova, 2007)	New ways to create liquidity end up transforming liquid assets into illiquid ones
Paradox of risk (Wojnilower, 1980)	The availability of individual risk cover leads to more risk overall
Paradox of profit-led demand (Blecker, 1989)	Generalized wage restrictions lead to a slowdown in growth even when all economies seem to be profit-led

In any economy total income (Y) is the sum of consumption (C), government expenditure (G), private investment (I), Exports (X), and imports (M). The ‘fundamental accounting identity’ is

$$Y = C + I + G + X - M.$$

Another perspective on the national income accounting is to note that households can use total income (Y) in only three ways. It can save (S), consume (C), or pay taxes (T).

$$Y = C + S + T.$$

You then then bring the two perspectives together (because they are both just “views” of Y, one on income, the other on spending) to write:

$$C + S + T = Y = C + I + G + (X - M)$$

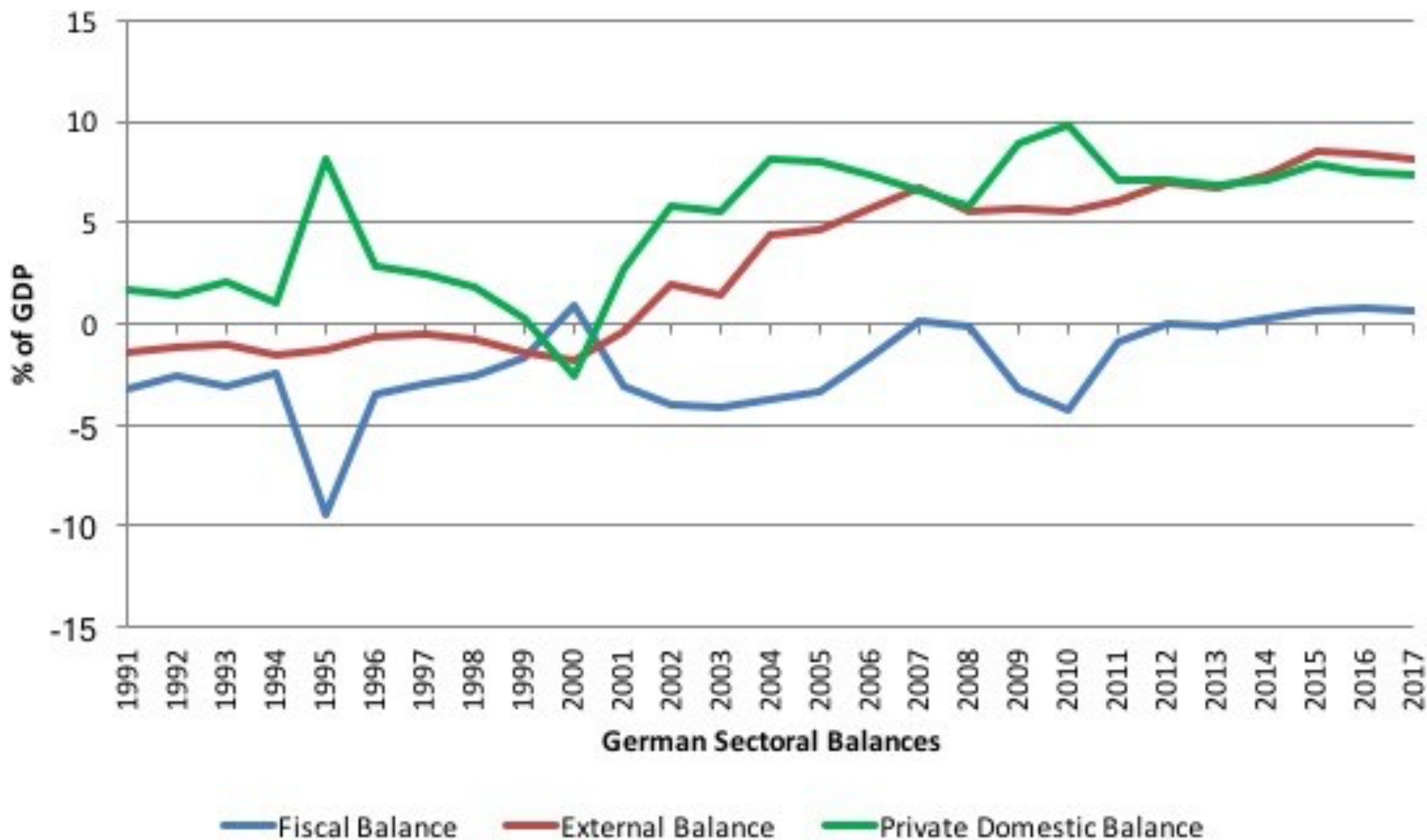
You can then drop the C (common on both sides) and you get:

$$S + T = I + G + (X - M)$$

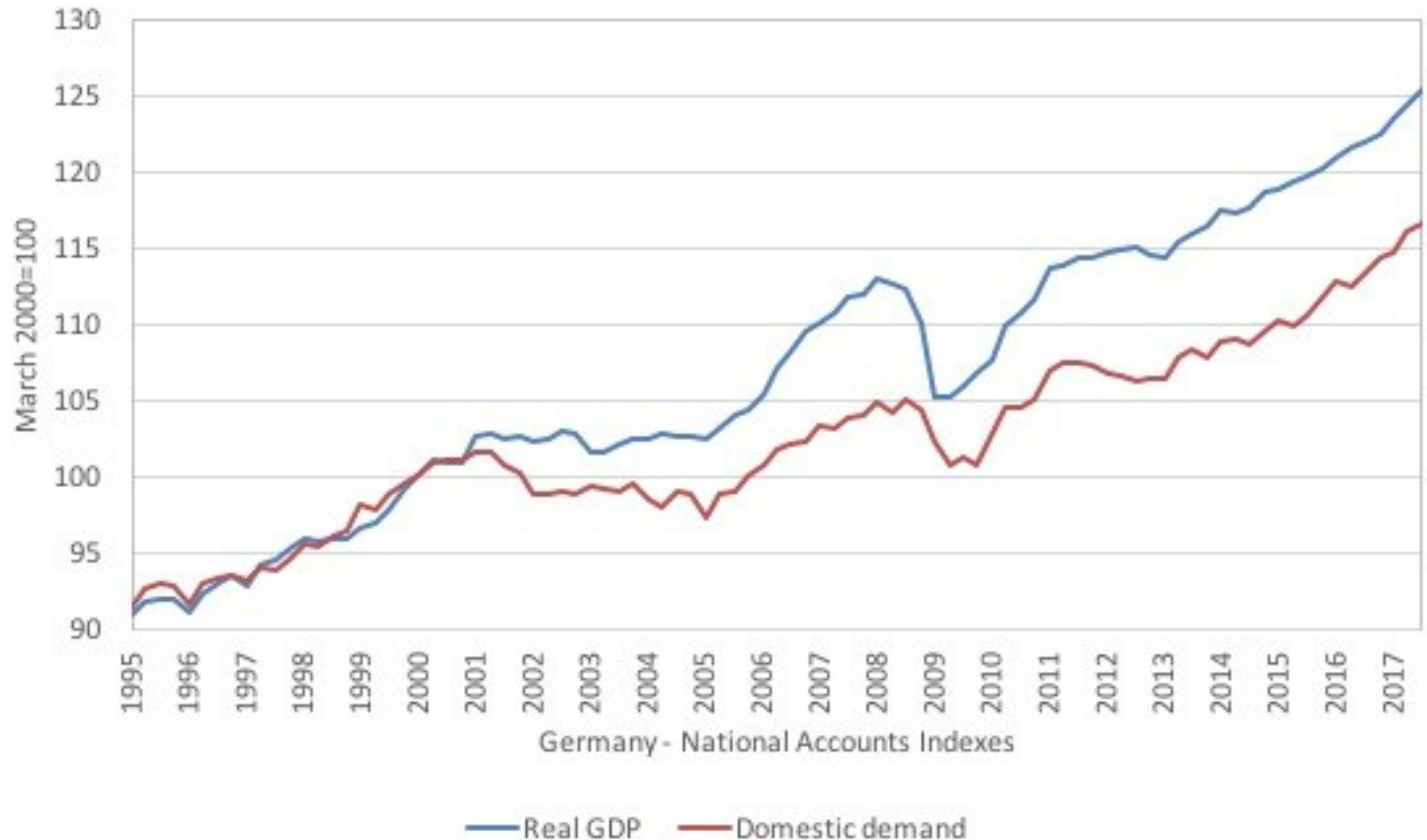
Rearrange to get the accounting identity for the three sectoral balances – private domestic, government budget and external:

$$(S - I) = (G - T) + (X - M)$$

Germany's sectoral balances



Ordoliberalism implies wage repression



**How big of a problem
is austerity?**

Country	Years
Australia	1987
Austria	1997
Belgium	1982, 1987, 2006
Canada	1981, 1987, 1996, 1997
Spain	1994
Finland	1976, 2000
United Kingdom	1996, 1997
Greece	2005, 2006
Ireland	1984, 1987
Italy	1976, 1982, 1990, 1991, 1992, 1997
Japan	1984, 1999, 2006
Netherlands	1973, 1983, 1988, 1993
Norway	1979, 1983, 1989, 2000, 2004
New Zealand	1987, 1989
Portugal	1982, 1983, 1992, 2002
Sweden	1981, 1986, 1987, 1994, 1997
Total Cases	48

Austerity is a global problem

Table 1: Number of Countries Contracting Public Expenditures (%GDP) and Population Affected, 2008-15

	2008	2009	2010	2011	2012	2013	2014	2015
Number of countries contracting, year on year, % of GDP	55	37	106	111	68	119	131	132
Number of persons affected (billions)	1.1	1.2	5.4	4.1	1.7	5.8	6.2	6.3
World population affected (%)	15.7	17.1	75.8	57.4	24.5	81.4	87.3	89.0

Source: Authors' calculations based on the IMF's *World Economic Outlook* (October 2012) and United Nation's *World Population Prospects: The 2010 Revision* (2011).

Austerity *often* coincides with financial crises

Australia	1893	1989						
Austria	<i>1873</i>	1924	<i>1929</i>	2008				
Belgium	<i>1870</i>	1885	1925	<i>1931</i>	<i>1939*</i>	2008		
Canada	1907	<i>1923</i>						
Denmark	1877	<i>1885</i>	1908	<i>1921</i>	1931	1987	2008	
Finland	1878	1900	<i>1921</i>	1931	1991			
France	1882	<i>1889</i>	1907	1930	2008			
Germany	<i>1873</i>	1891	<i>1901</i>	1907	1931	2008		
Greece	1931	1991	2008					
Ireland	2008							
Italy	1873	<i>1887</i>	<i>1893</i>	1907	<i>1921</i>	<i>1935*</i>	1990	2008
Japan	1882	1900	<i>1904*</i>	<i>1907</i>	<i>1913</i>	1927	1992	
Netherlands	1893	1907	<i>1921</i>	<i>1939*</i>	2008			
Norway	1899	<i>1922</i>	1931	1988				
Portugal	1890	<i>1920</i>	<i>1923*</i>	1931	2008			
Spain	1883	<i>1890</i>	<i>1913</i>	<i>1920</i>	<i>1924*</i>	<i>1931</i>	1978	2008
Sweden	1878	1907	<i>1922</i>	1931	1991	2008		
Switzerland	<i>1870</i>	<i>1910</i>	1931	1991	2008			
United Kingdom	1890	1974	<i>1984</i>	1991	2007			
United States	<i>1873</i>	1884	<i>1893</i>	1907	1929	1984	2007	

Notes: Financial crisis events from Bordo et al. (2001), Reinhart and Rogoff (2009b), Laeven and Valencia (2008; 2012), and Jordà, Schularick, and Taylor (2013). The table shows all financial crisis events in the 20 countries in our sample since 1870. * = crises removed from the OLS regression. Italics = crises removed from the descriptive analysis.

In open economies the external sector is often the risky channel

AEA PAPERS AND PROCEEDINGS

MAY 2010

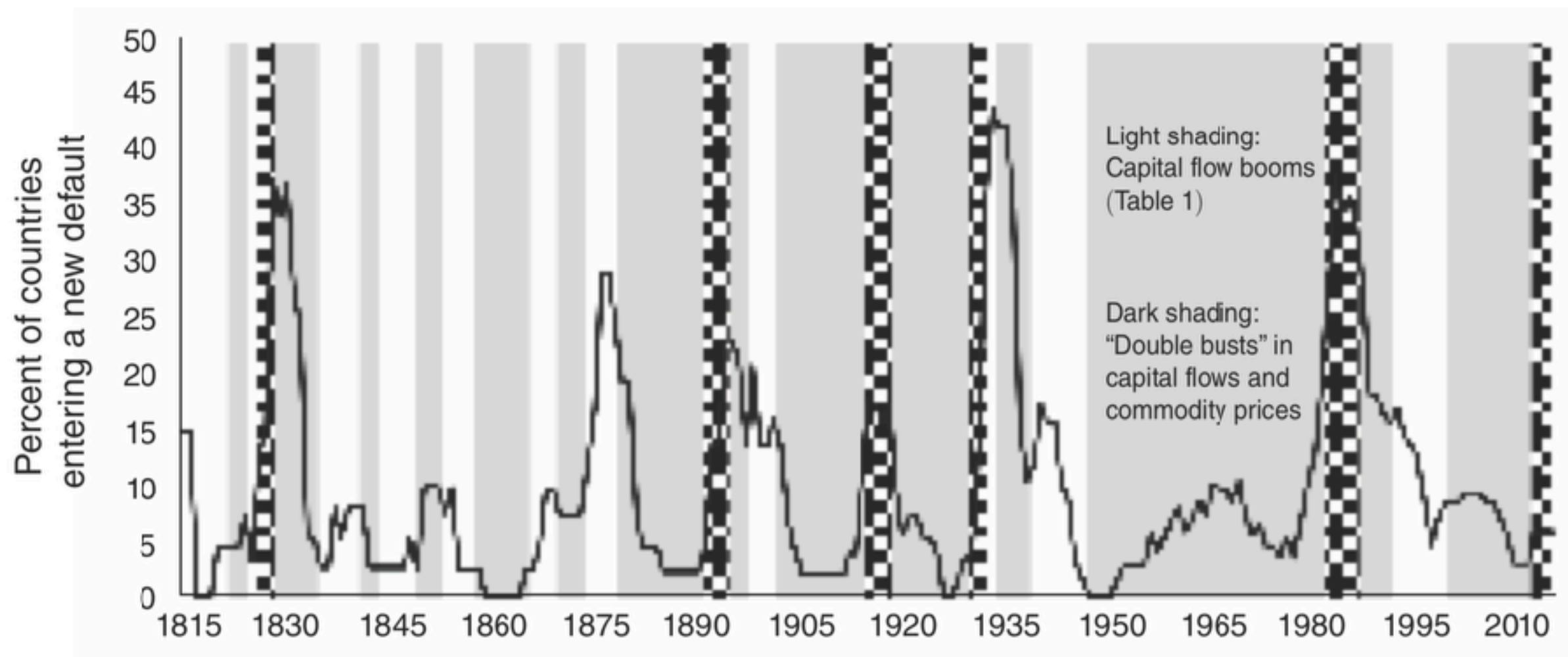
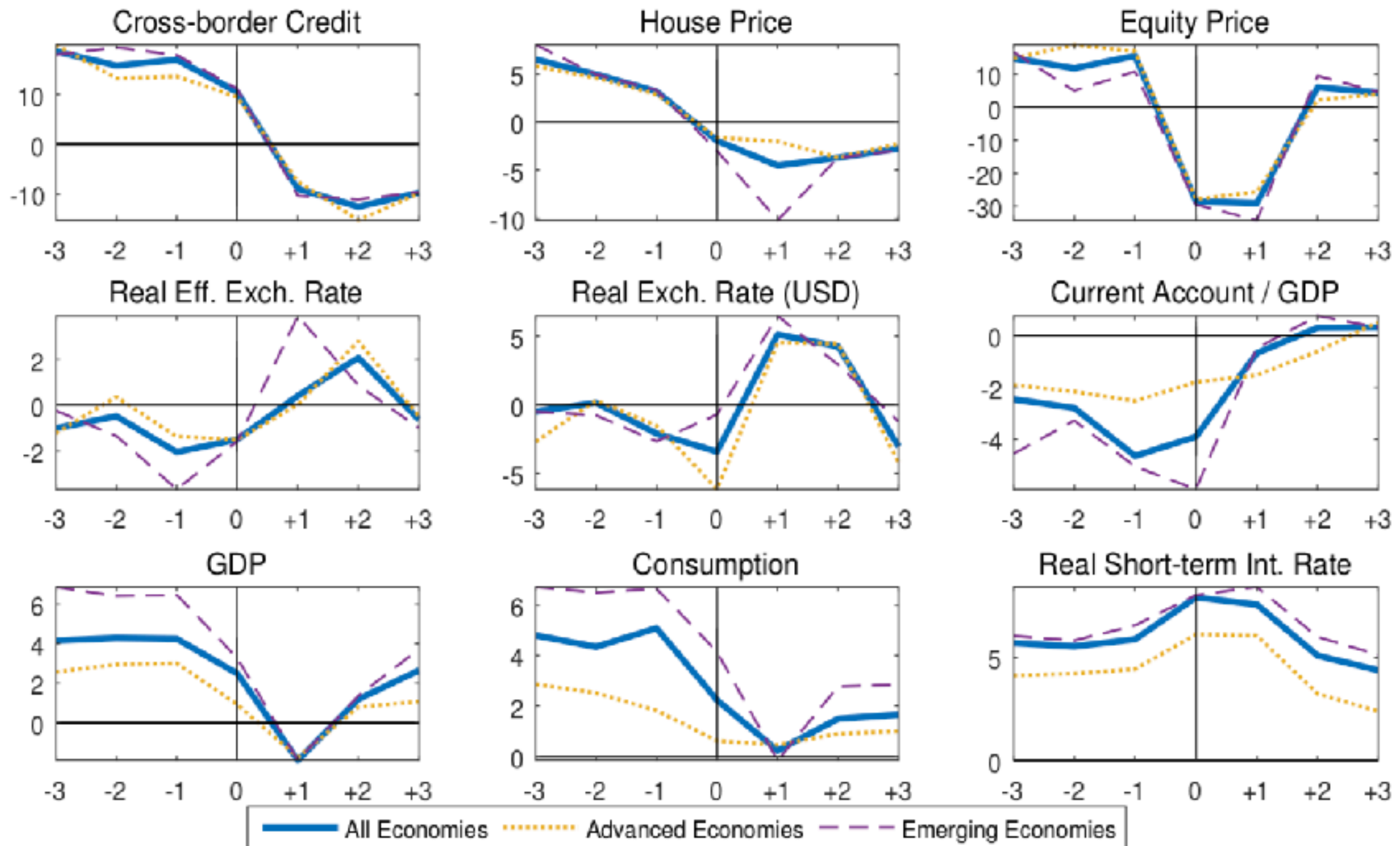
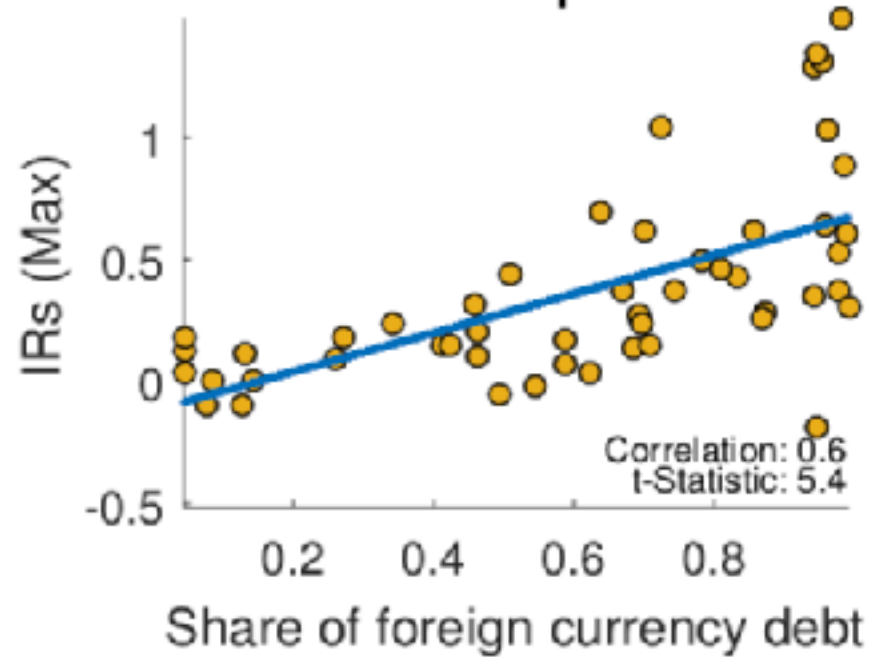


FIGURE 3. CAPITAL FLOW BOOMS, DOUBLE BUSTS, AND NEW SOVEREIGN DEFAULTS, 1815–2015

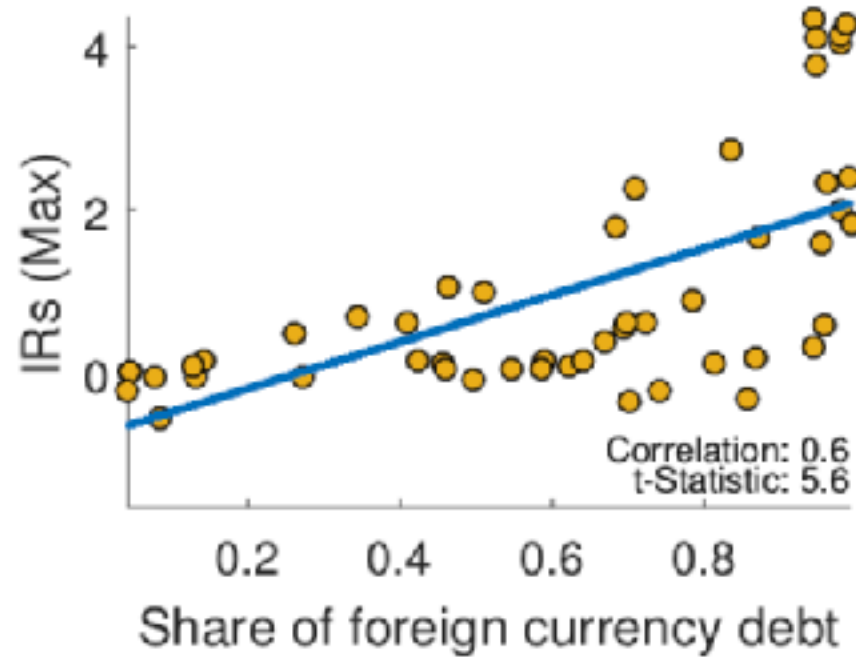
Austerity is not a developed economy problem



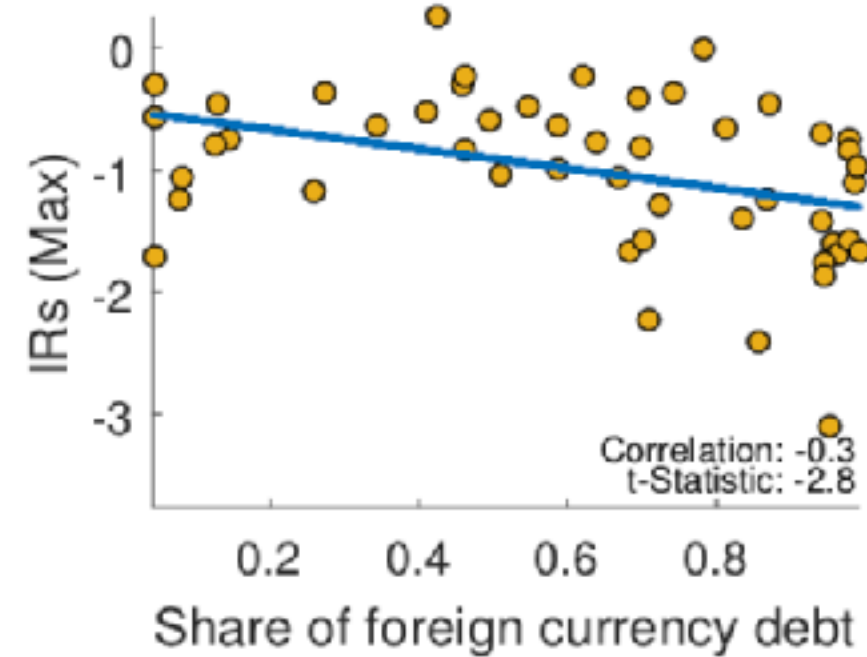
Consumption



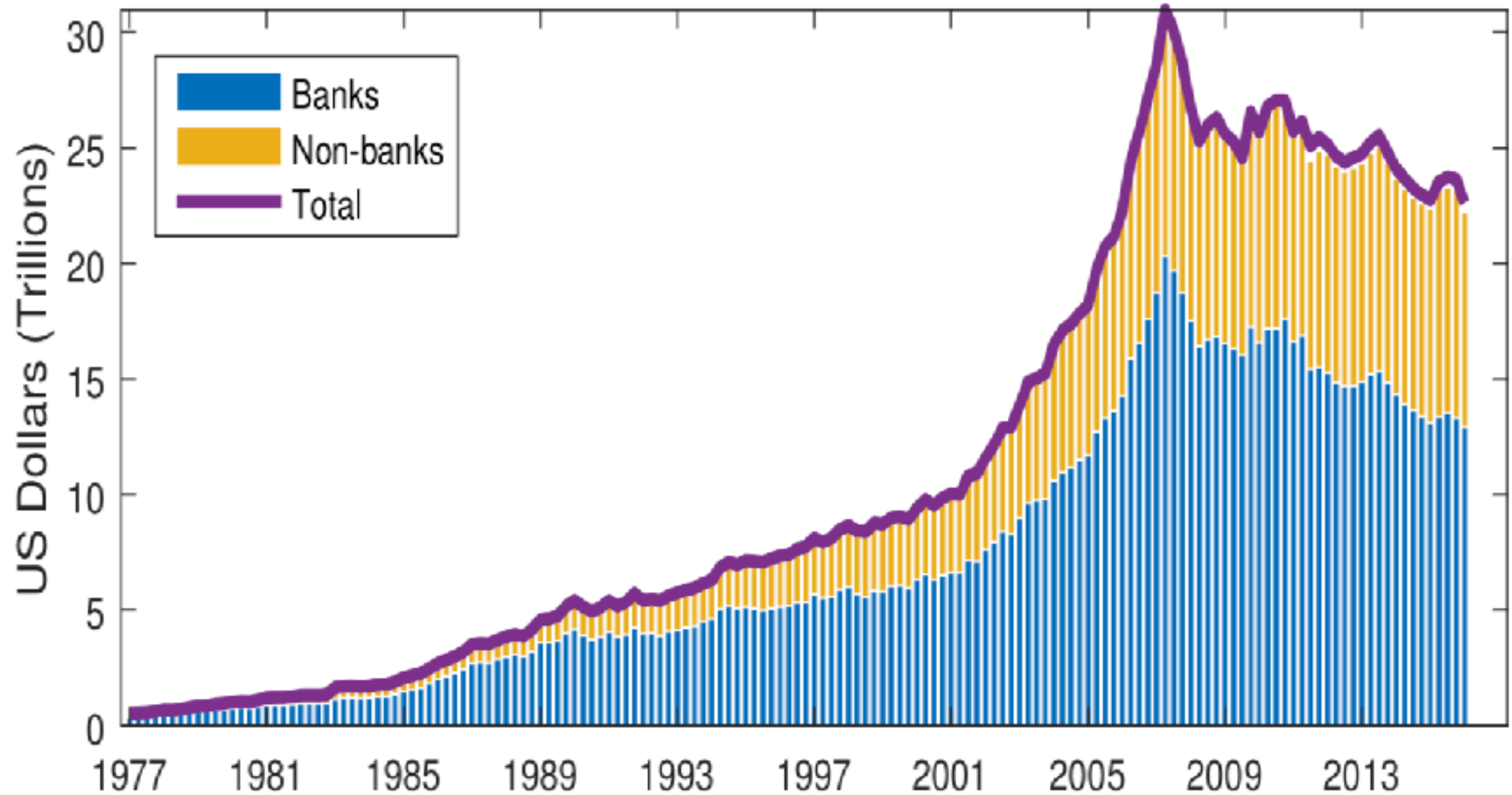
House Price



Real Exch. Rate

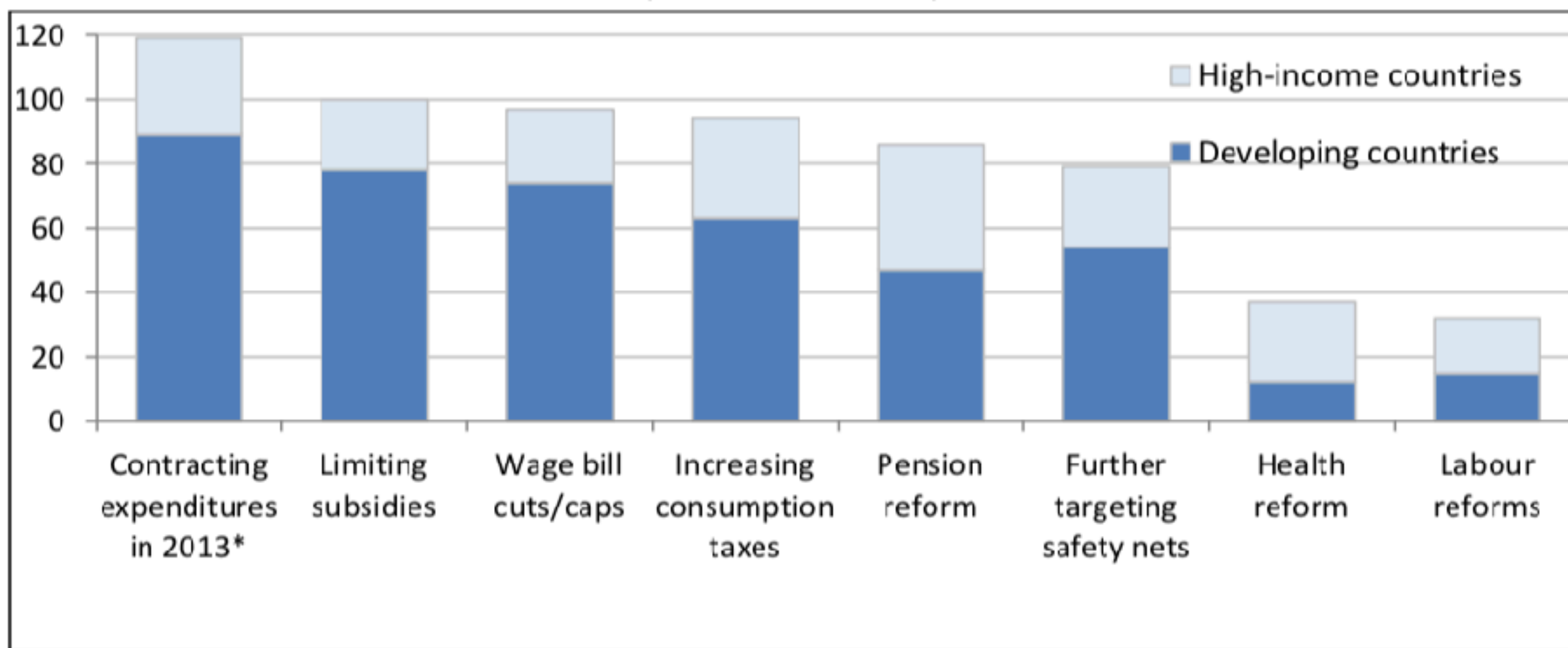


Banks are often the risk channel too



Austerity measures

Figure 5: Incidence of Austerity Measures in 174 Countries, 2010-13
(number of countries)



Source: Authors' analysis of 314 IMF country reports published from January 2010 to February 2013

* Authors' calculations based on IMF's *World Economic Outlook* (October 2012); Contractions are based on changes in total expenditure as a percent of GDP, and the sample covers 181 countries

Elements of ‘adjustment’

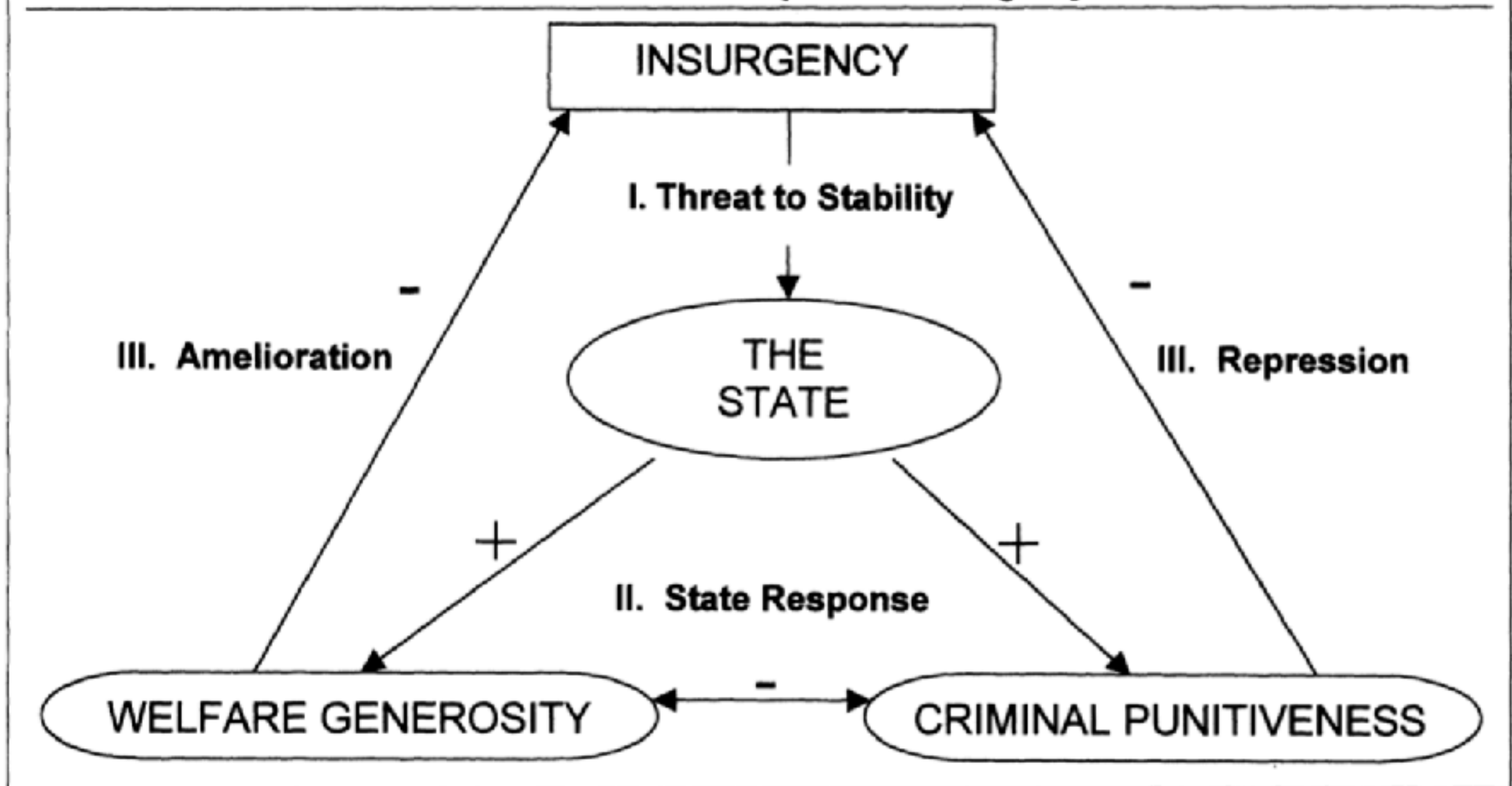
Table 13: Adjustment Measures in East Asia and the Pacific, 2010-13

Country	Limiting Subsidies	Wage bill cuts/caps	Increasing consumption taxes	Pension reform	Rationalizing and targeting safety nets	Health reform	Labor reform
Cambodia		X	X		X		
China							
Fiji	X	X	X	X	X		X
Indonesia	X				X		
Lao PDR							
Malaysia	X		X		X		
Marshall Islands	X	X		X	X		
Micronesia	X	X	X	X			
Mongolia		X			X		
Myanmar							
Palau	X	X		X	X		X
Papua New Guinea	X	X					
Philippines	X				X		
Samoa		X					
Solomon Islands		X					
Thailand	X		X				
Timor-Leste	X	X			X		
Tonga	X	X					
Tuvalu	X	X	X				
Vanuatu		X	X				
Vietnam			X				
Total	12	13	8	4	9	0	2

Source: Authors' analysis of 314 IMF country reports published from January 2010 to February 2013

Models of state response

FIGURE 1. The Social Control Model of State Response to Insurgency



Austerity fuels political instability, helps right more than left.

Figures

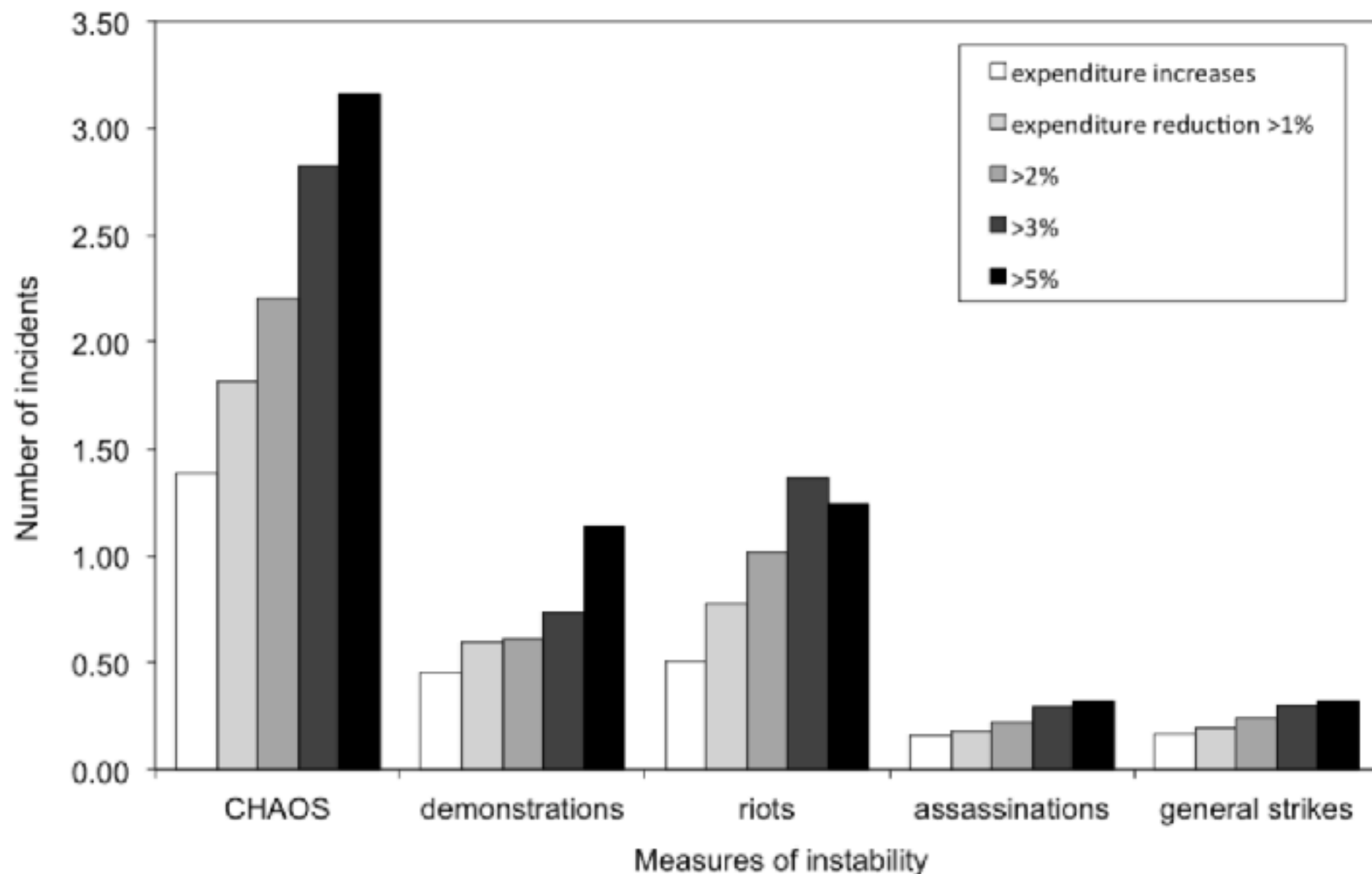


Figure 1 Frequency of incidents and the scale of expenditure cuts