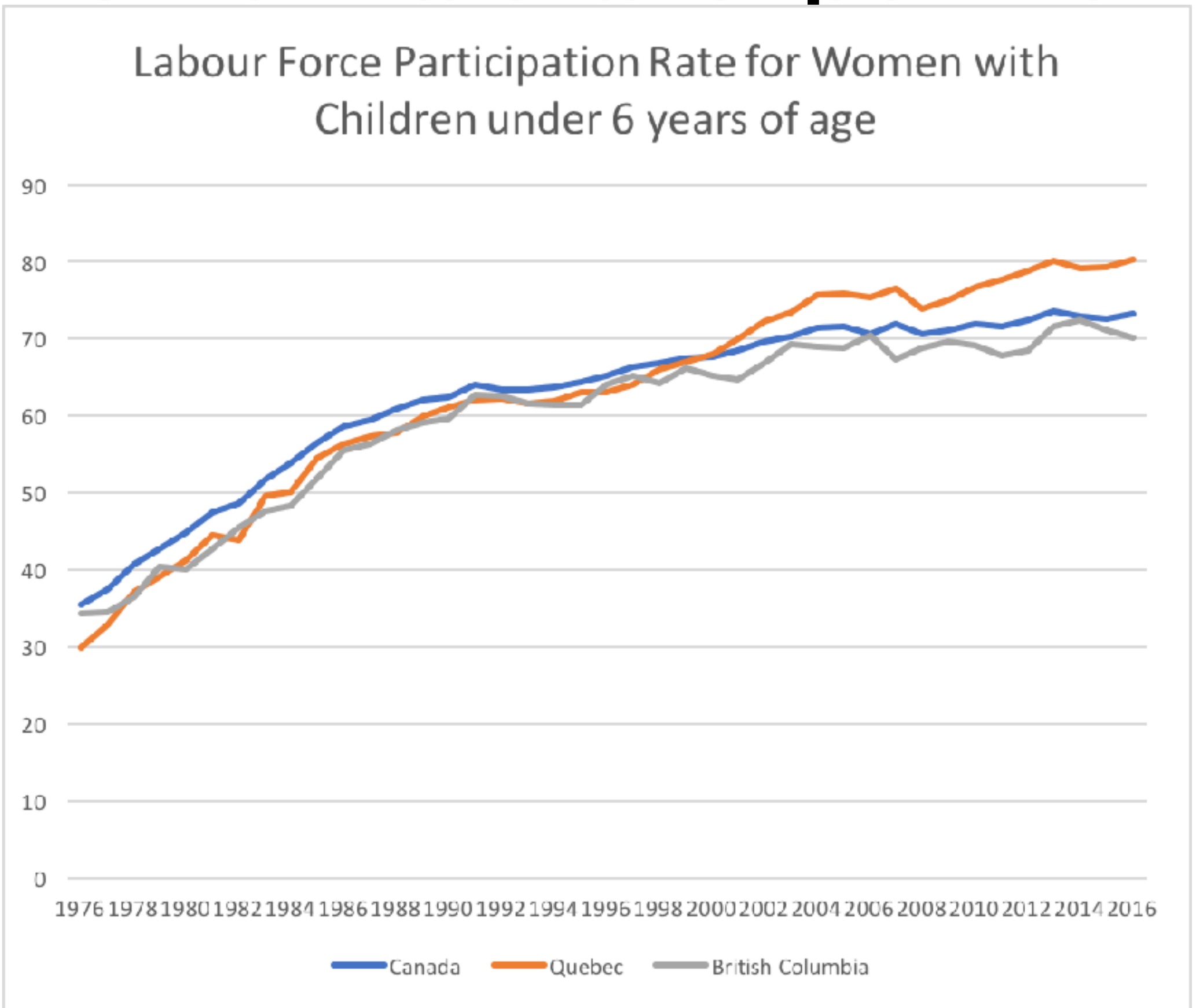
Day 2 Agenda

- 0900-10.30 Recap and further observations from Day 1.
- 10.30-1100 Coffee
- 11.00-12.30 Distributional effects, Group Exercise on imposing austerity.
- 12.30-13.30 Lunch
- 13.30-15.30 Sectoral, Social, and Political effects of austerity. Group exercise on political fallout from austerity.
- 15.30-16.00 Coffee
- 16.00-17.00 Discussion & assessment preparation

Recall the general definition of austerity (Blyth, 2013: 866–67)

- “cutting the state’s budget to stabilise public finances, restore competitiveness through wage cuts, and create better investment expectations by lowering future tax burdens”

Another natural experiment

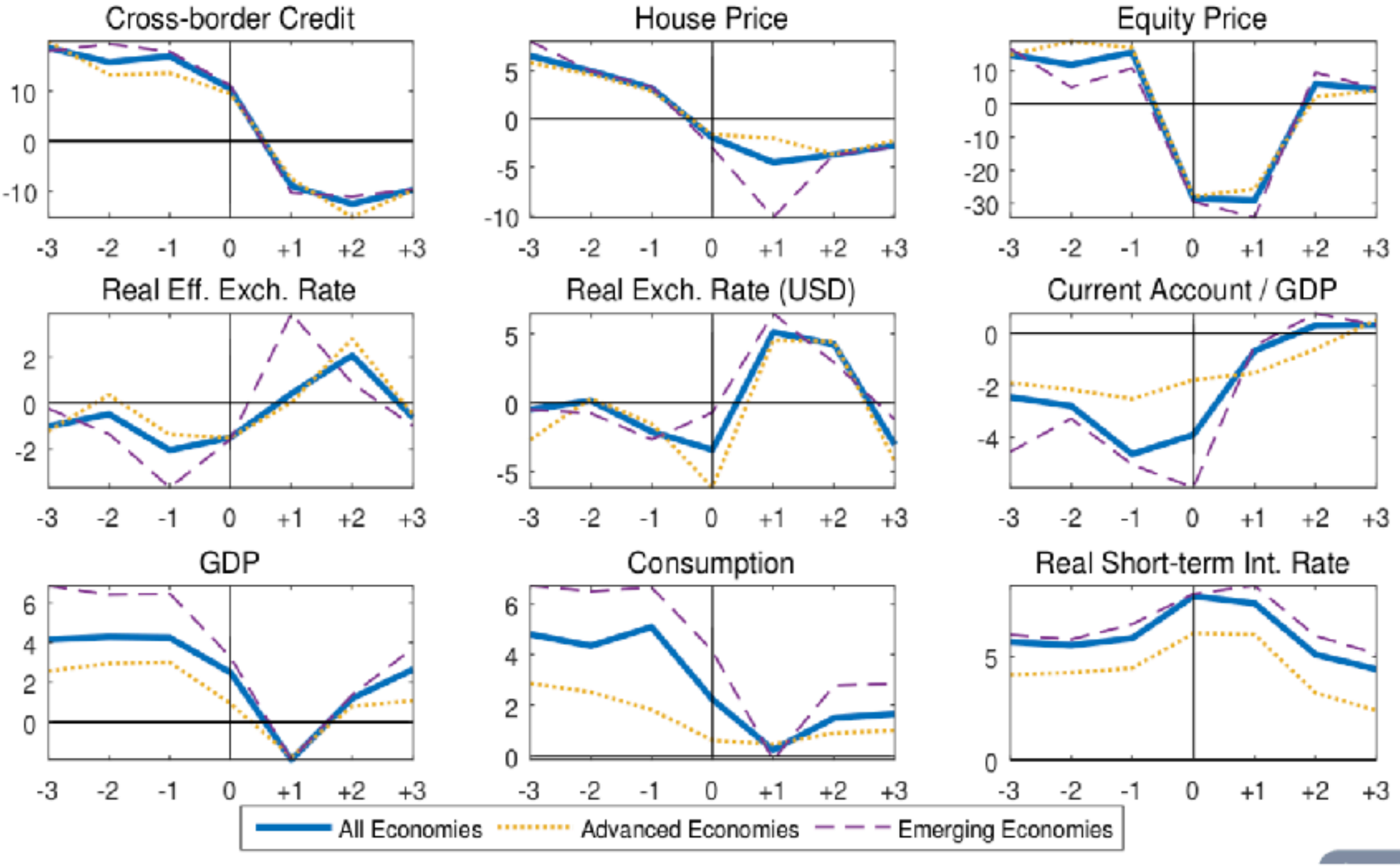


Austerity *often* coincides with financial crises

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

Austerity is more often than not a developing economy problem



In open economies the external sector is often the risky channel

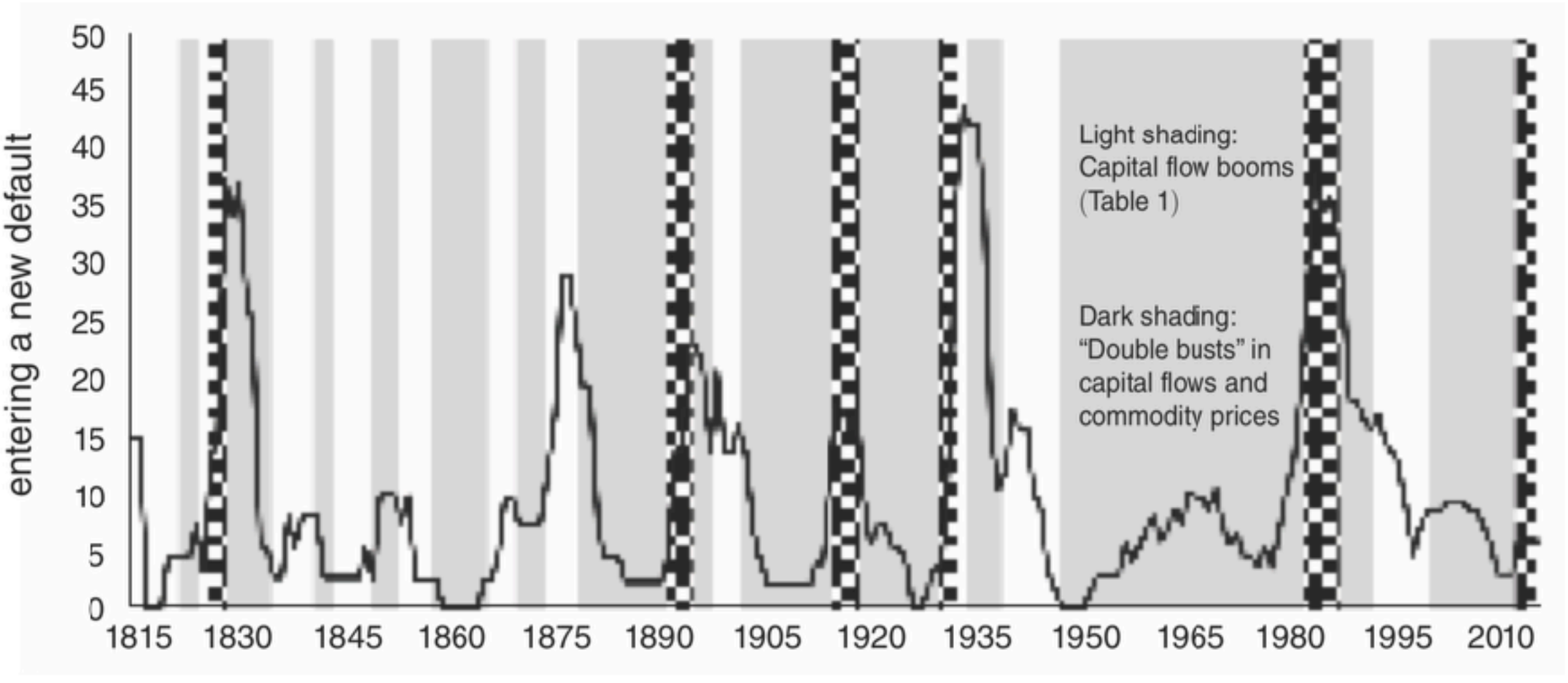
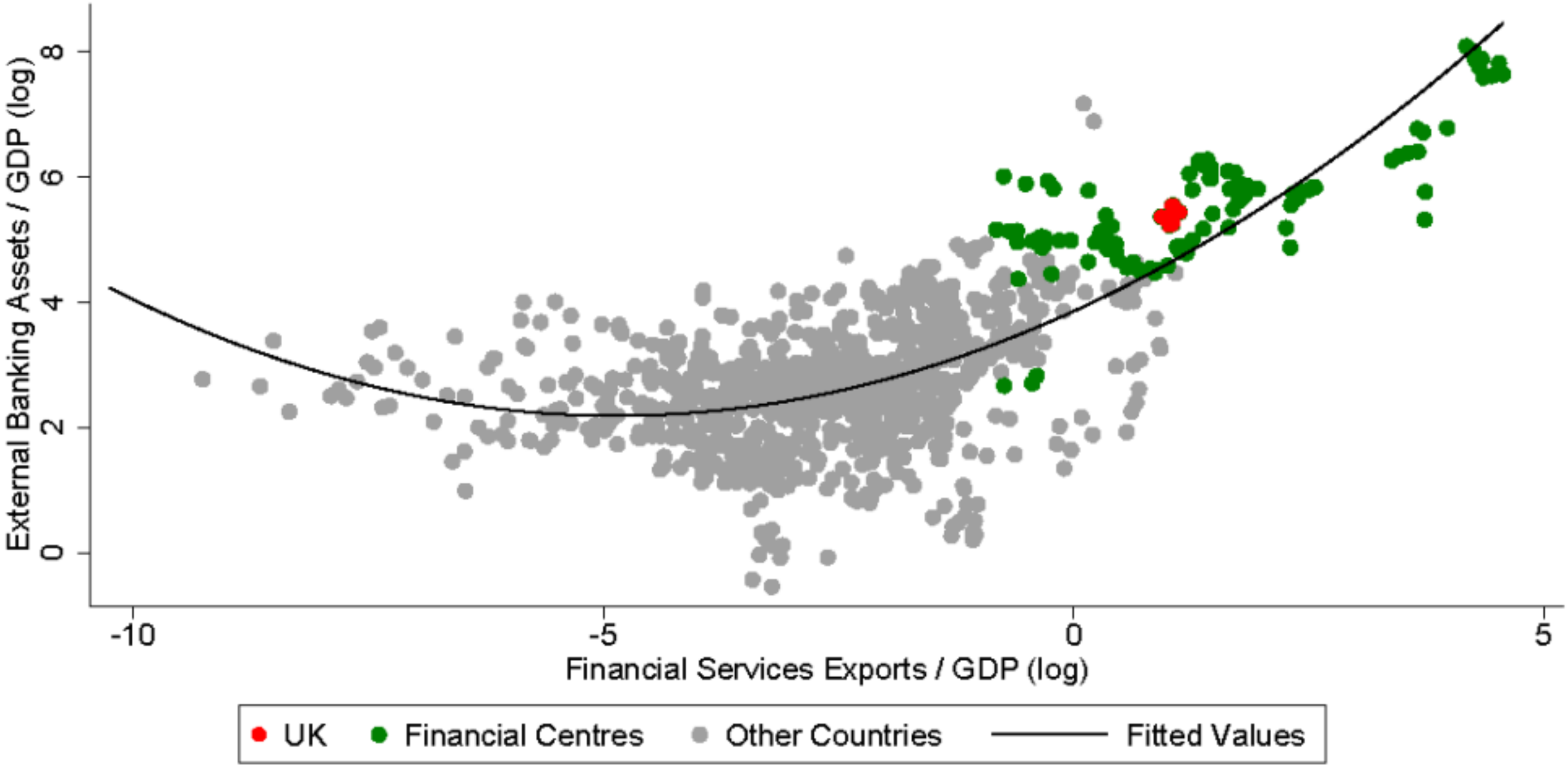


FIGURE 3. CAPITAL FLOW BOOMS, DOUBLE BUSTS, AND NEW SOVEREIGN DEFAULTS, 1815–2015

Financial Openness and Financial Services Exports, 2007-2016



Paradoxes & Austerity

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

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

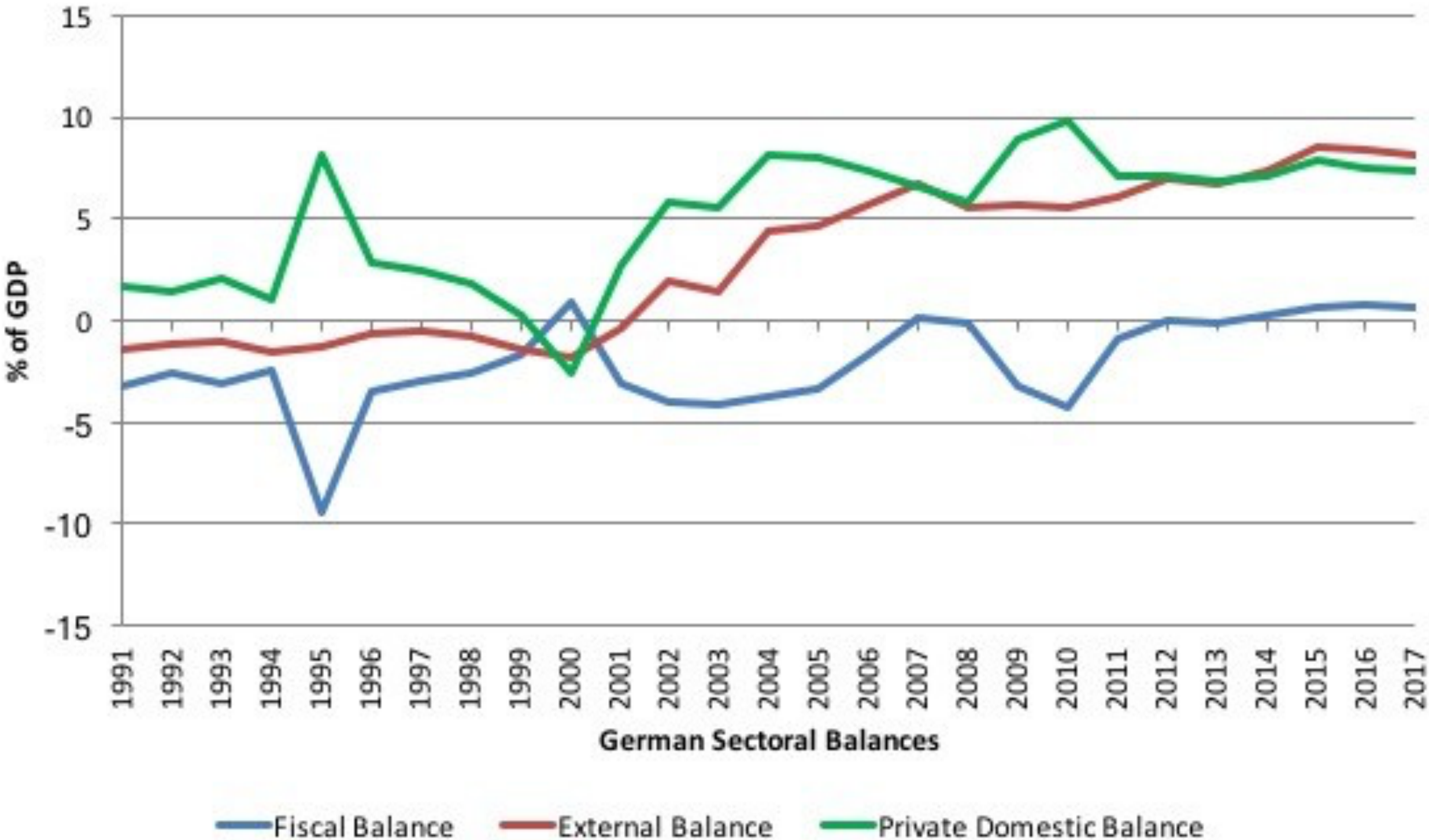
You can then drop the C (common on both sides) and you get:

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

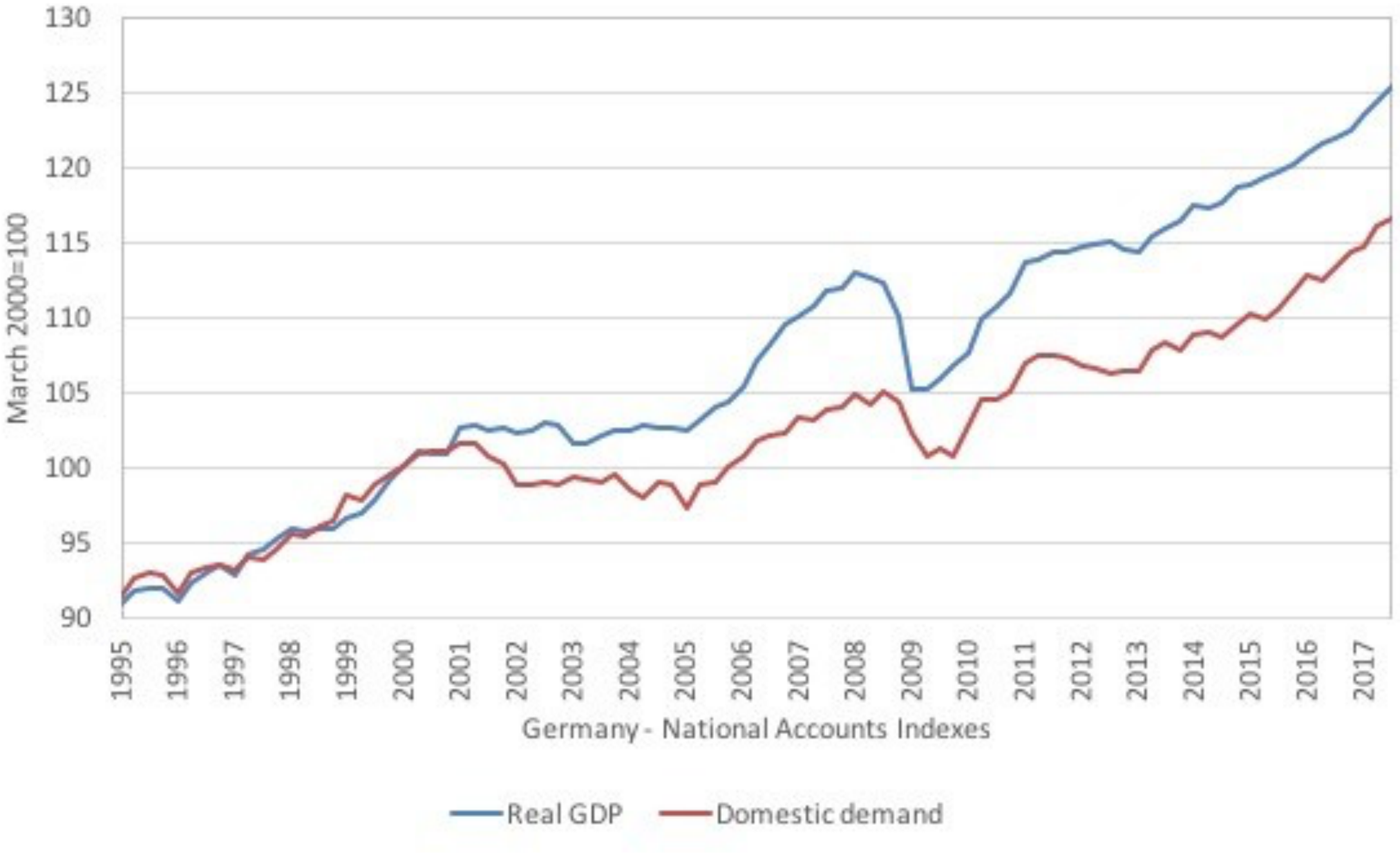
Rearrange to get the accounting identity for the three sectoral balances – private domestic, government budget and external:

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

Germany's sectoral balances



Ordoliberalism implies wage repression



Austerity is a global problem: you need a global IPE to understand it

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).

Sen and Walter (2013)

- 2 Questions of IPE:

- The first concerns how politics constrains economic choices by actors and social groups.

- The second concerns how economic forces enable and constrain political choices, such as individuals' voting behaviour, or firms' lobbying, or internal and and edternaml policies.

- Importantly, economic outcomes have political implications because they change the distribution of power.

- This is where binding constraints matter most.

Ban (2016)

- Ban (2016) discusses the development of the adoption of austerity between Romania and Spain.

- He shows conclusively that the transmission of ideas—via PhD studies in the US—was a crucial difference in the adoption of austerity policies in each state.

- The degree to which ideas matter over rational policy/ median voter theorem arguments is obviously contextually dependent, but it is clear ideas matter.

Distributional effects of Austerity: inequality

Ball et al, 2013

In particular, they find fiscal consolidations in their data set:

1. *increased inequality* by 0.1 percentage point (about 0.4 percent) in the very short term, and by 0.9 percentage point (about 3.4 percent) over the medium term;

2. led to a significant and long-lasting *fall in the wage income share* of about 0.8 percentage point of GDP; and

3. *raised long-term unemployment* by about 0.5 percent over the medium term.

Figure 1. Cumulative Change in the Gini Coefficient before and after Consolidation Measures

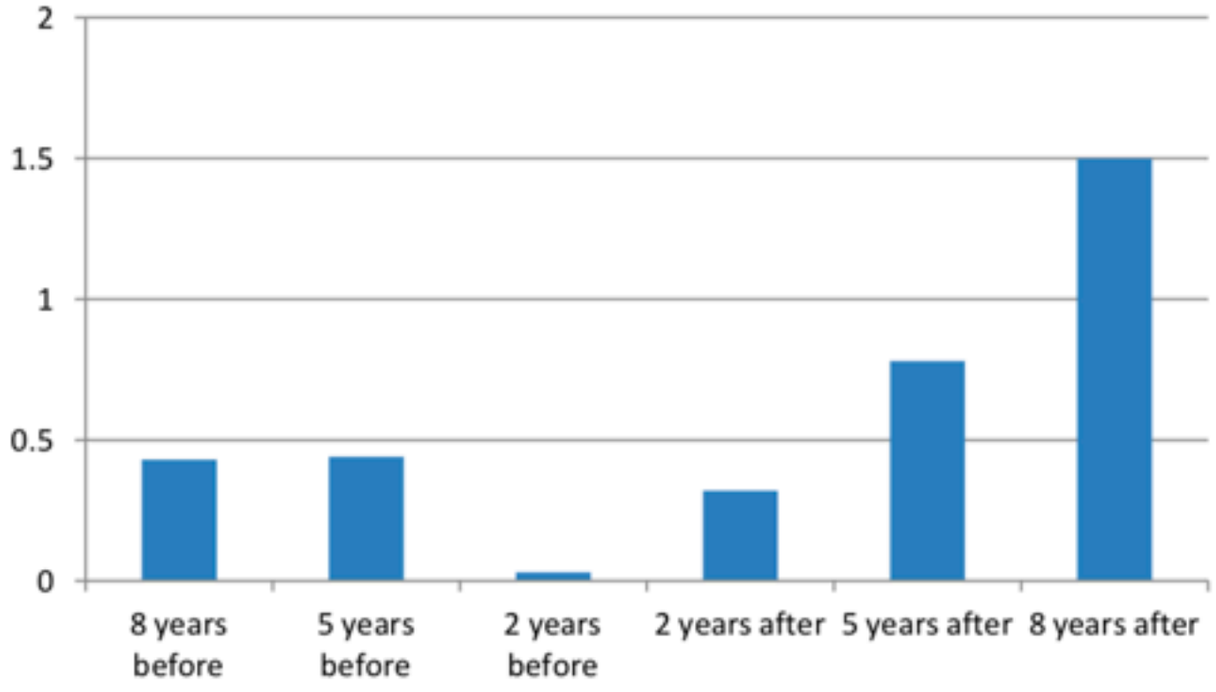
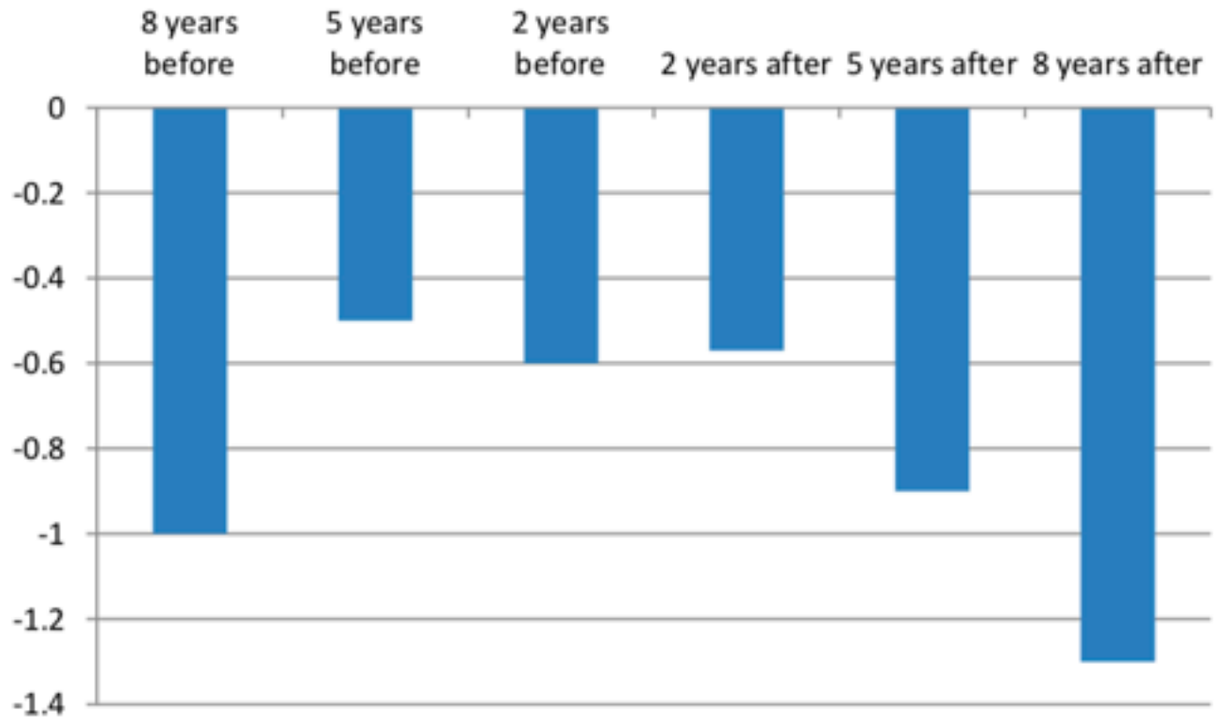


Figure 2. Cumulative Change in the Share of Wage Income in GDP before and after Consolidation Measures (% of GDP)



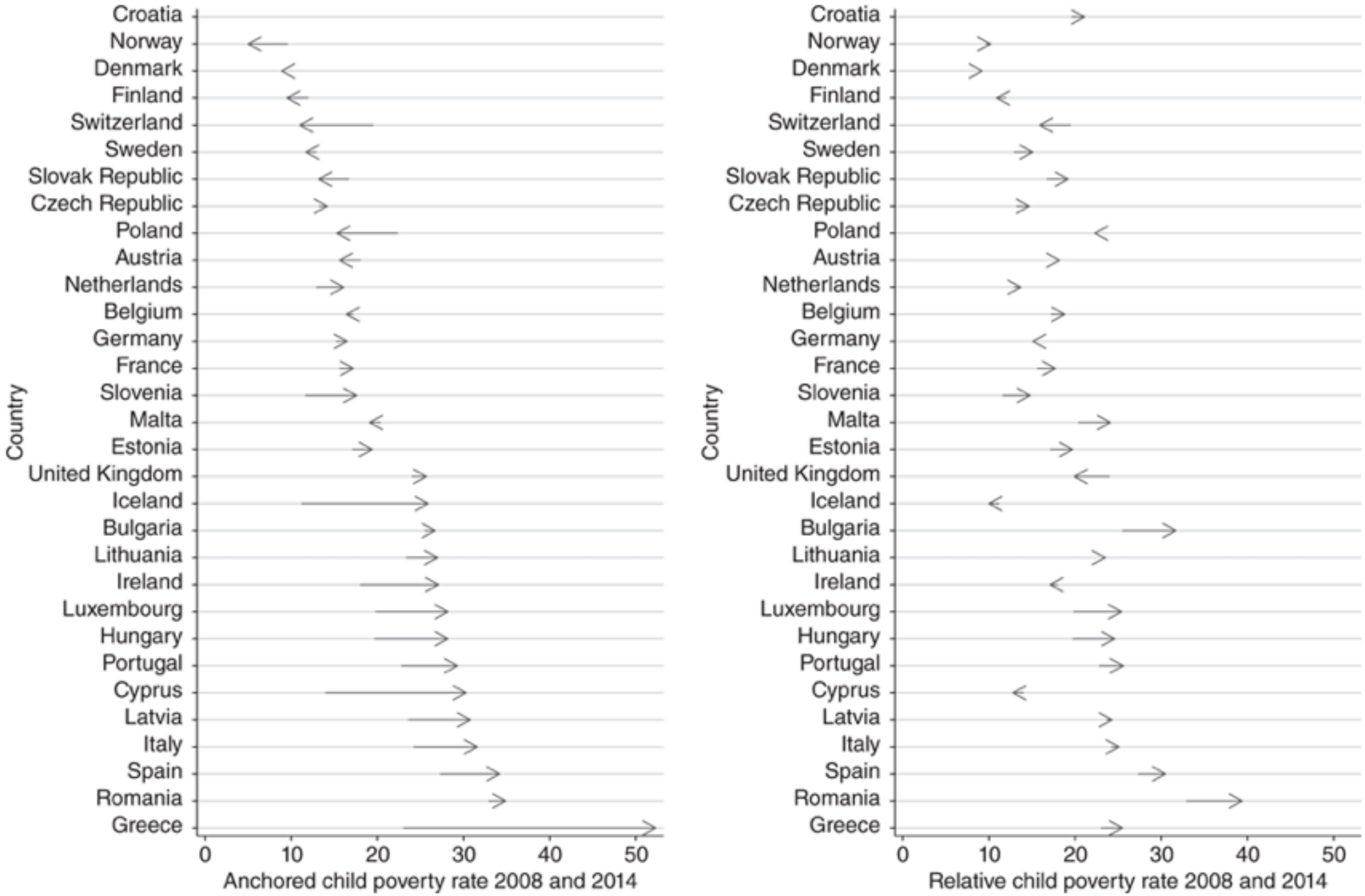


Figure 2.5. Child poverty rates (2008–2014) in 31 European countries

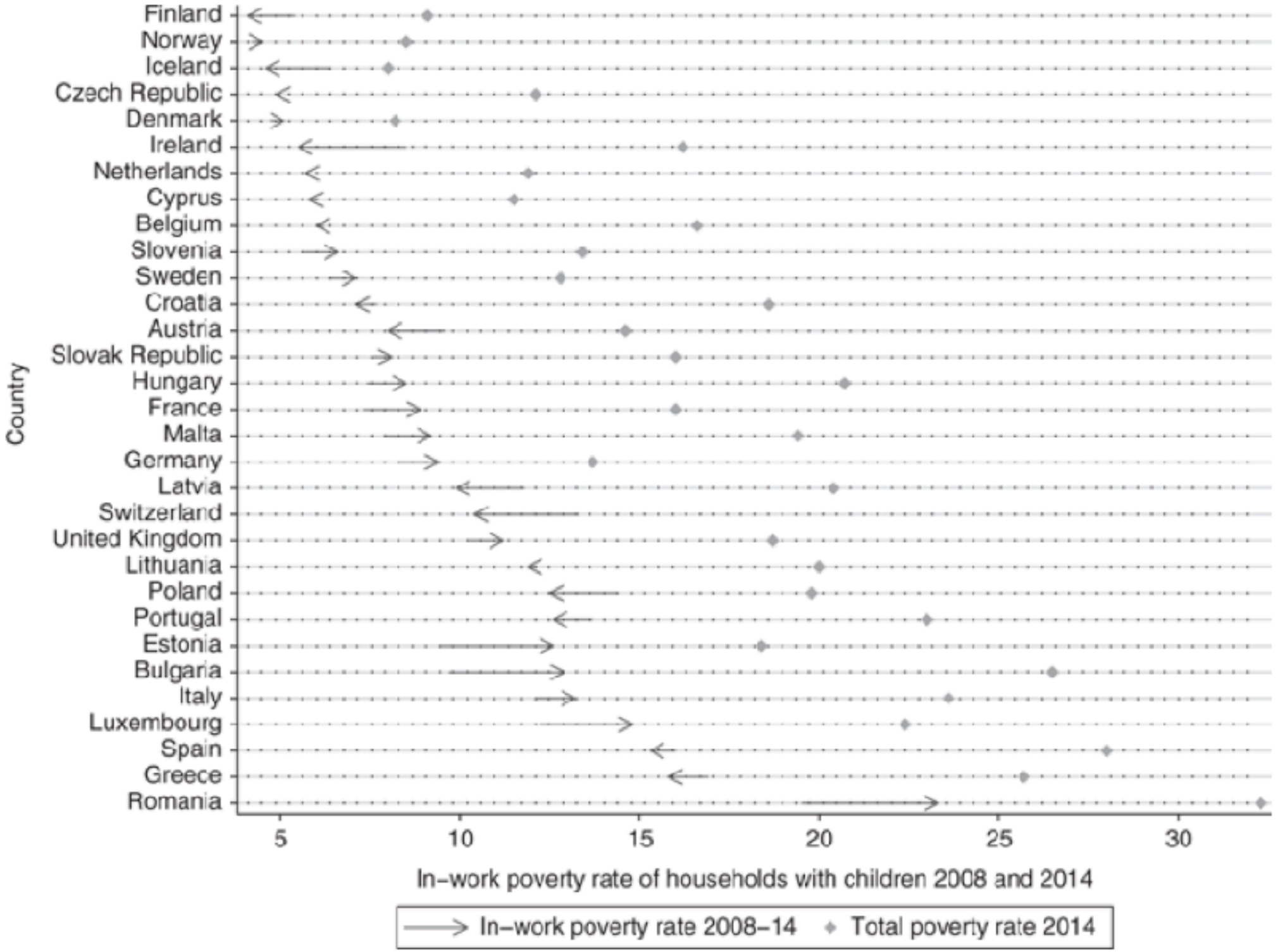


Figure 2.6. In-work poverty rates among households with children (2008–2014) in 31

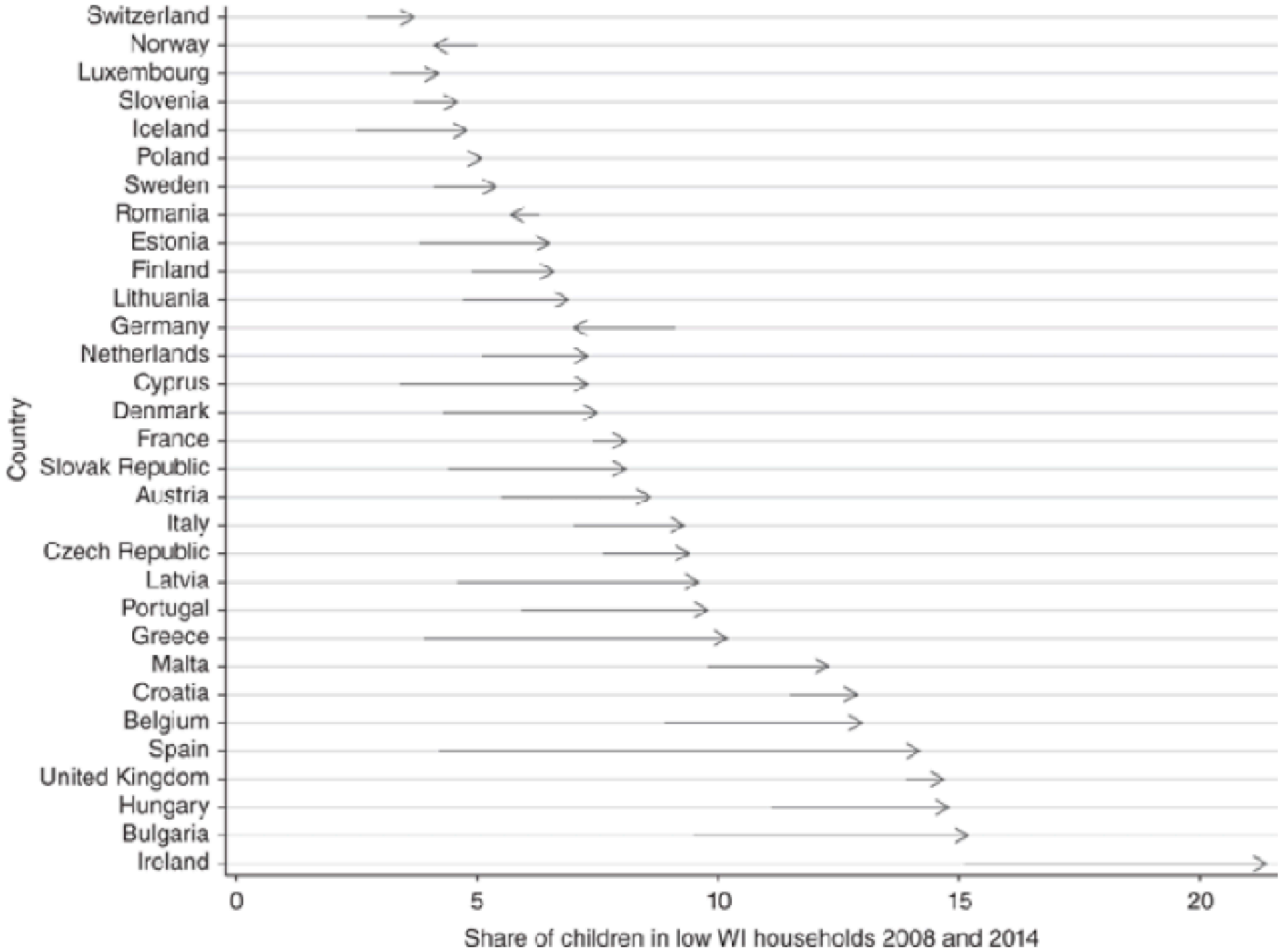
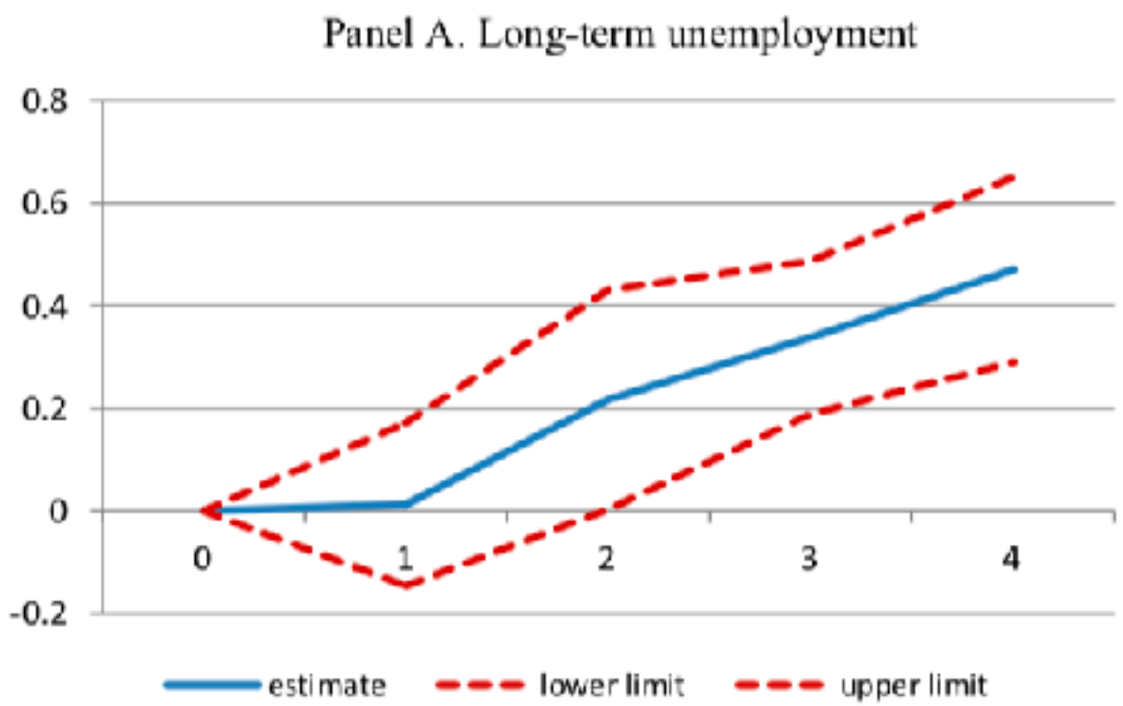
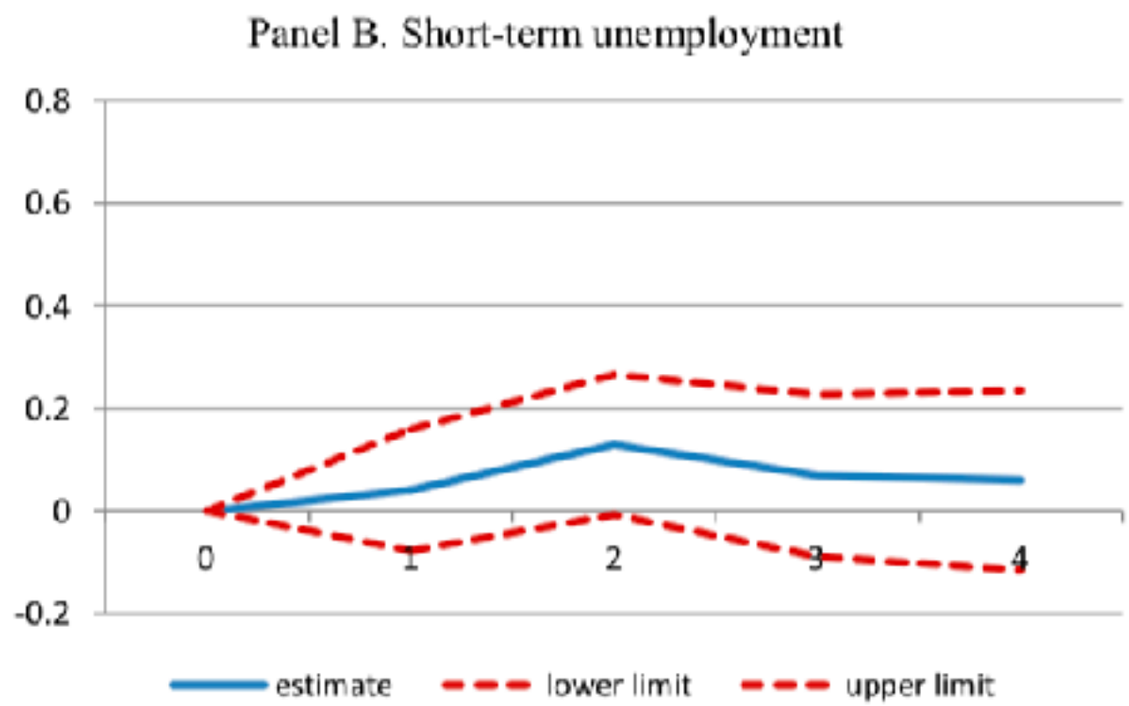


Figure 2.7. Proportion of children living in low work intensity households (2008–2014) in 31 European countries

Figure 10. The Effects of Fiscal Consolidation on Short and Long-term Unemployment

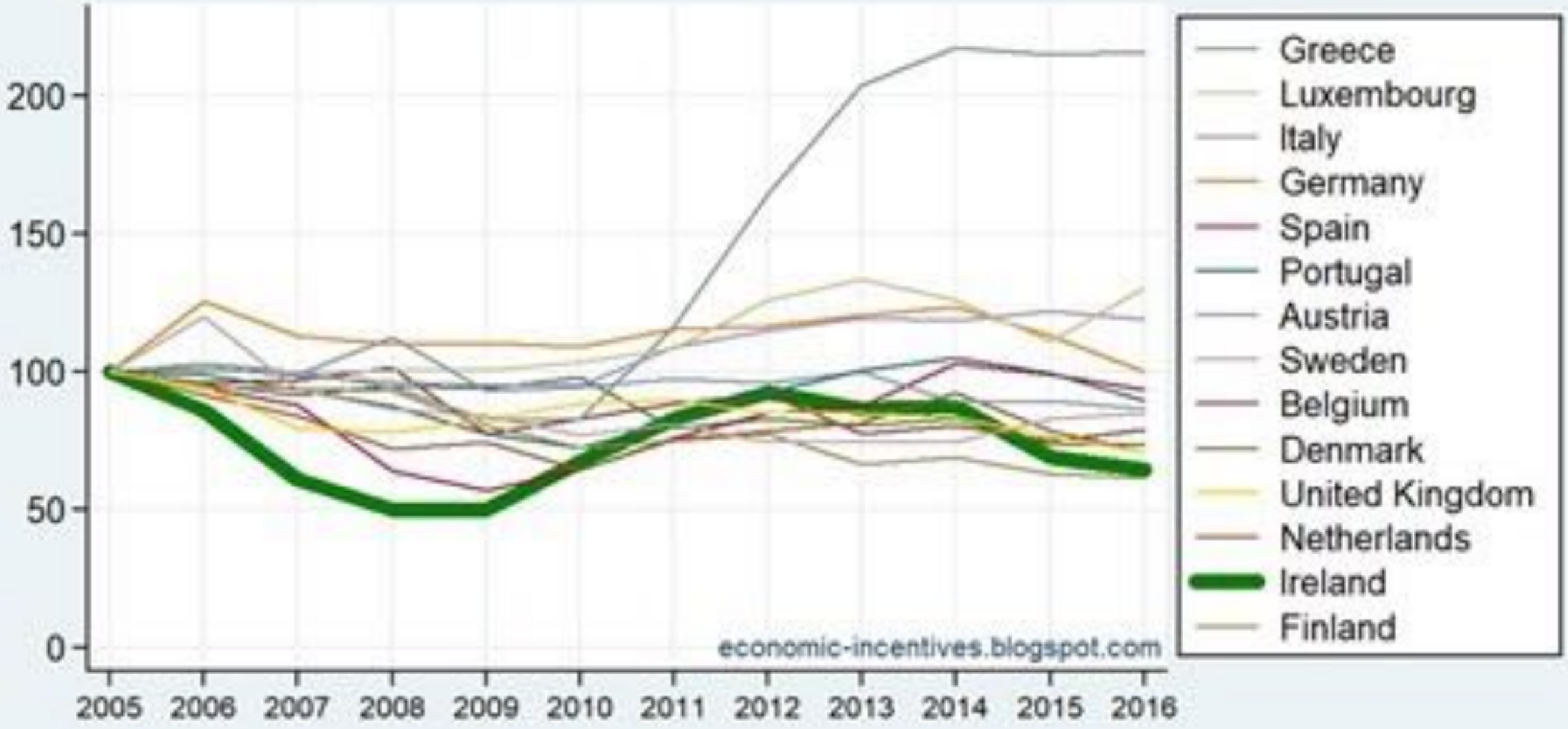




Note: dotted lines equal one standard error bands.

At-Risk-Of-Poverty with threshold anchored at fixed point (2005)

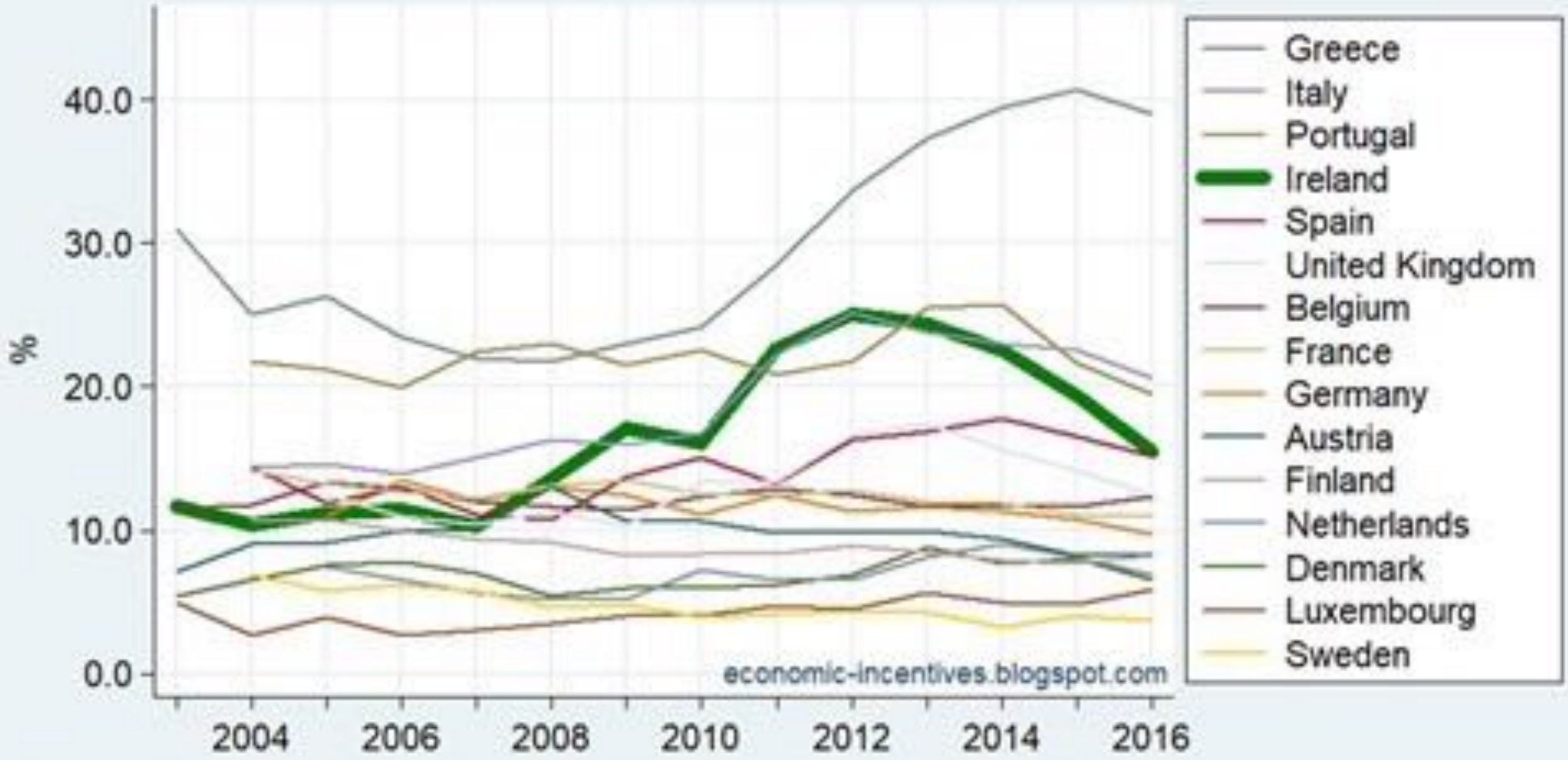
Relative change in at-risk-of-poverty rate (2005 = 100) using anchored threshold of 60% of 2005 median equivalised disposable income adjusted for inflation in subsequent years



Source: Eurostat

Material Deprivation

Percentage of population with an enforced lack of at least 3 of 9 material deprivation items



Source: Eurostat

	Year on Year Change in the percentage of the population experiencing each type of deprivation						
	2010	2011	2012	2013	2014	2015	2016
Without heating at some stage in the last year	44	16	6	22	0	-13	-32
Unable to afford a morning, afternoon or evening out in the last fortnight	30	9	10	8	-12	-16	-17
Unable to afford two pairs of strong shoes	38	7	58	6	-2	0	-43
Unable to afford a roast once a week	62	22	13	7	-6	-11	-18
Unable to afford a meal with meat, chicken or fish every second day	43	-7	39	8	-17	-23	-15
Unable to afford new (not second-hand) clothes	69	-4	42	2	0	-3	-9
Unable to afford a warm waterproof coat	82	10	68	5	-5	-27	-30
Unable to afford to keep the home adequately warm	66	0	25	18	-12	2	-36
Unable to afford to replace any worn out furniture	25	7	13	5	-1	-4	-14
Unable to afford to have family or friends for a drink or meal once a month	53	3	9	16	3	-13	-17
Unable to afford to buy presents for family or friends at least once a year	50	14	3	20	-11	-16	-19

Peck 2014

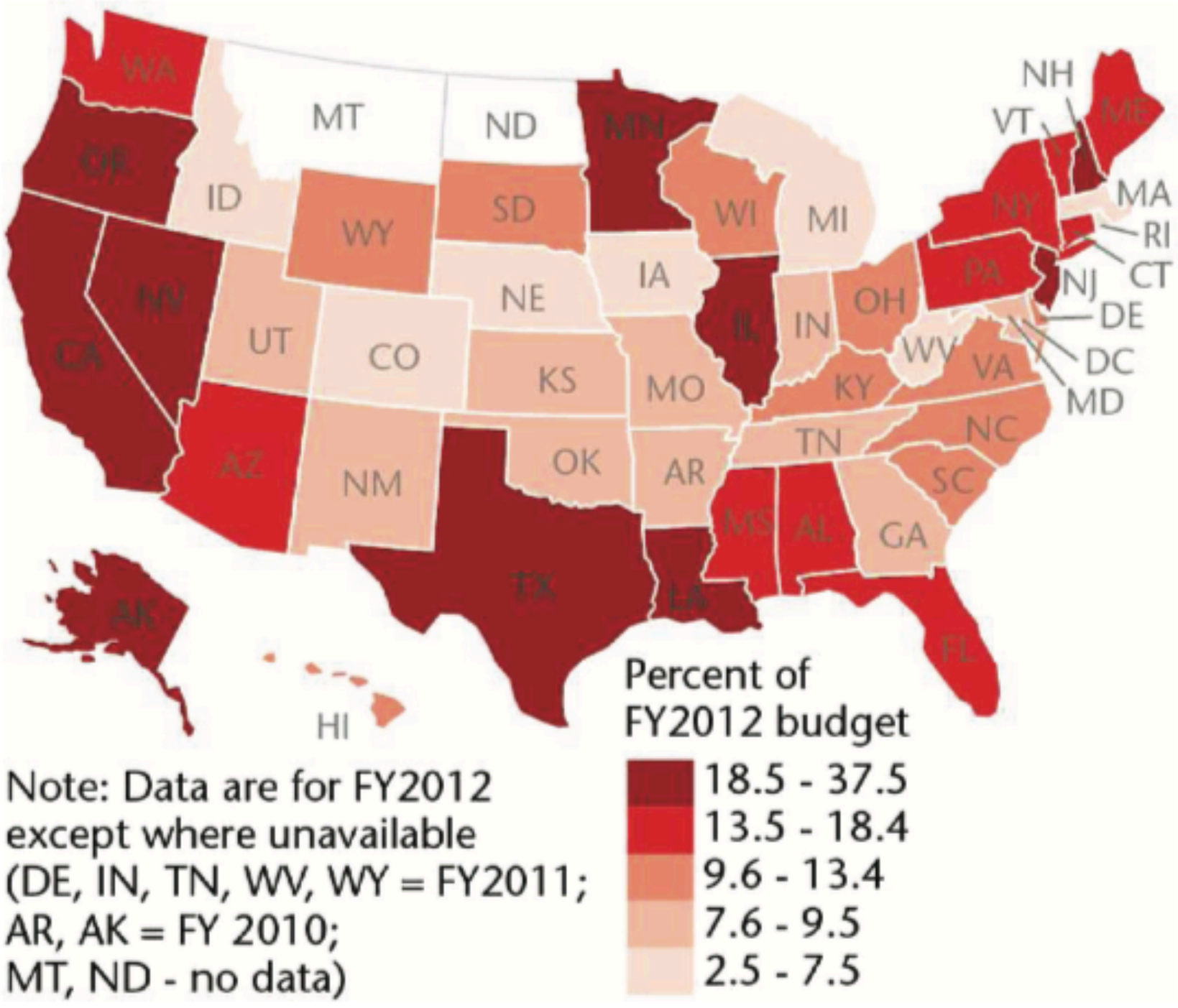
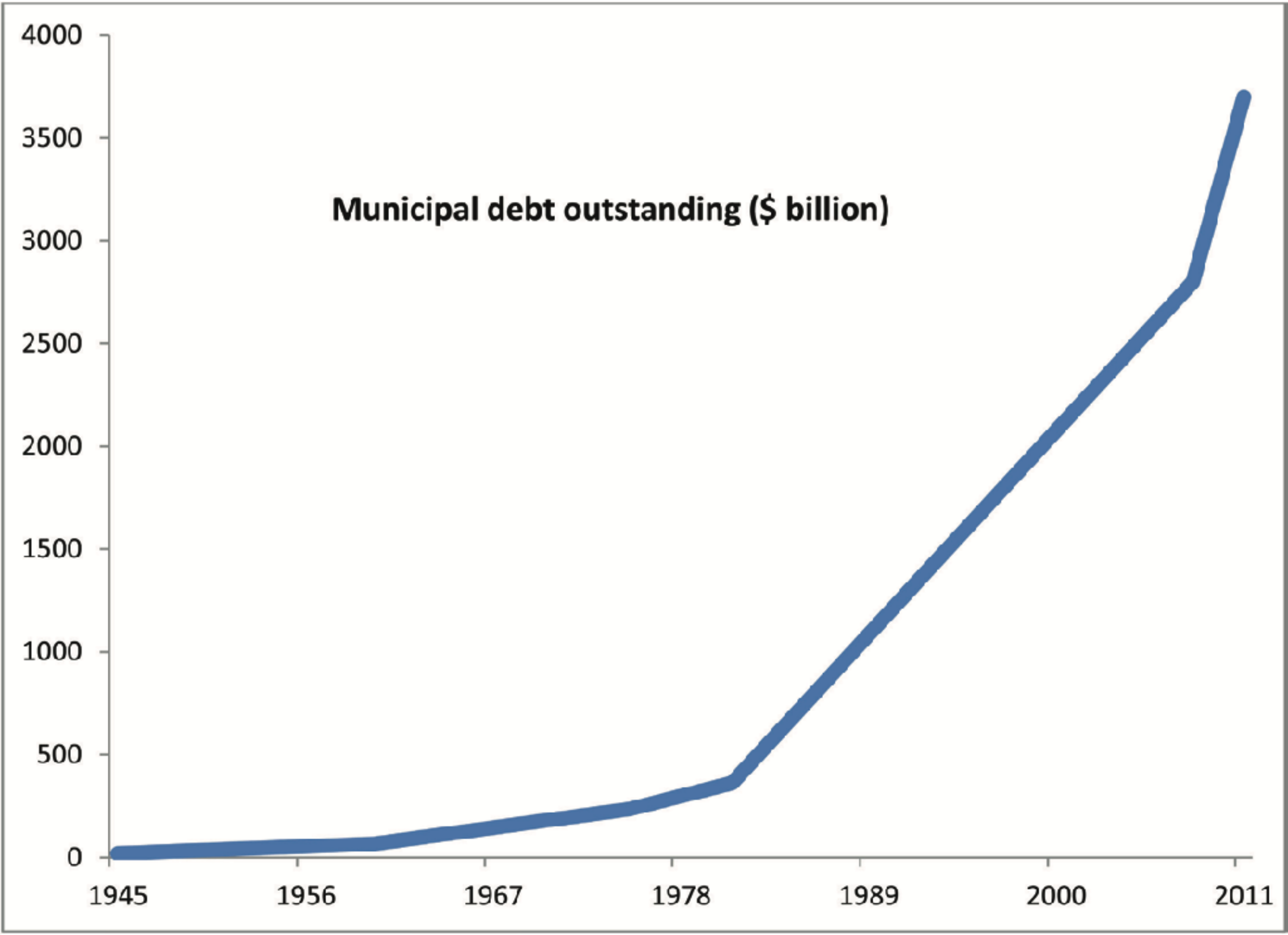


Figure 1. *State budget gaps: annual shortfall as a share of total state budget.*
Source: Center on Budget and Policy Priorities; Oliff *et al* (2012).


Municipal debt outstanding ($ billion)
4000
3500
3000
2500
2000
1500
1000
500
0
1945
1956
1967
1978
1989
2000
2011

Municipal bankruptcies under chapter 9 by year of filing

Orange County, CA (1994)

Harrisburg, PA (2011)

Jefferson County, AL (2011)

San Bernardino, CA (2012)

Vallejo, CA (2008)

18
16
14
12
10
8
6
4
2
0

1981
1991
2001
2011

Exercise

- In groups of 2, you are to construct an argument *for* an austerity policy and present this argument to the class.
  - 10 mins: brainstorm & write presentation.
  - 5 mins: presentation
  - 5-10 mins: discussion

Sectoral, Social & Political Effects

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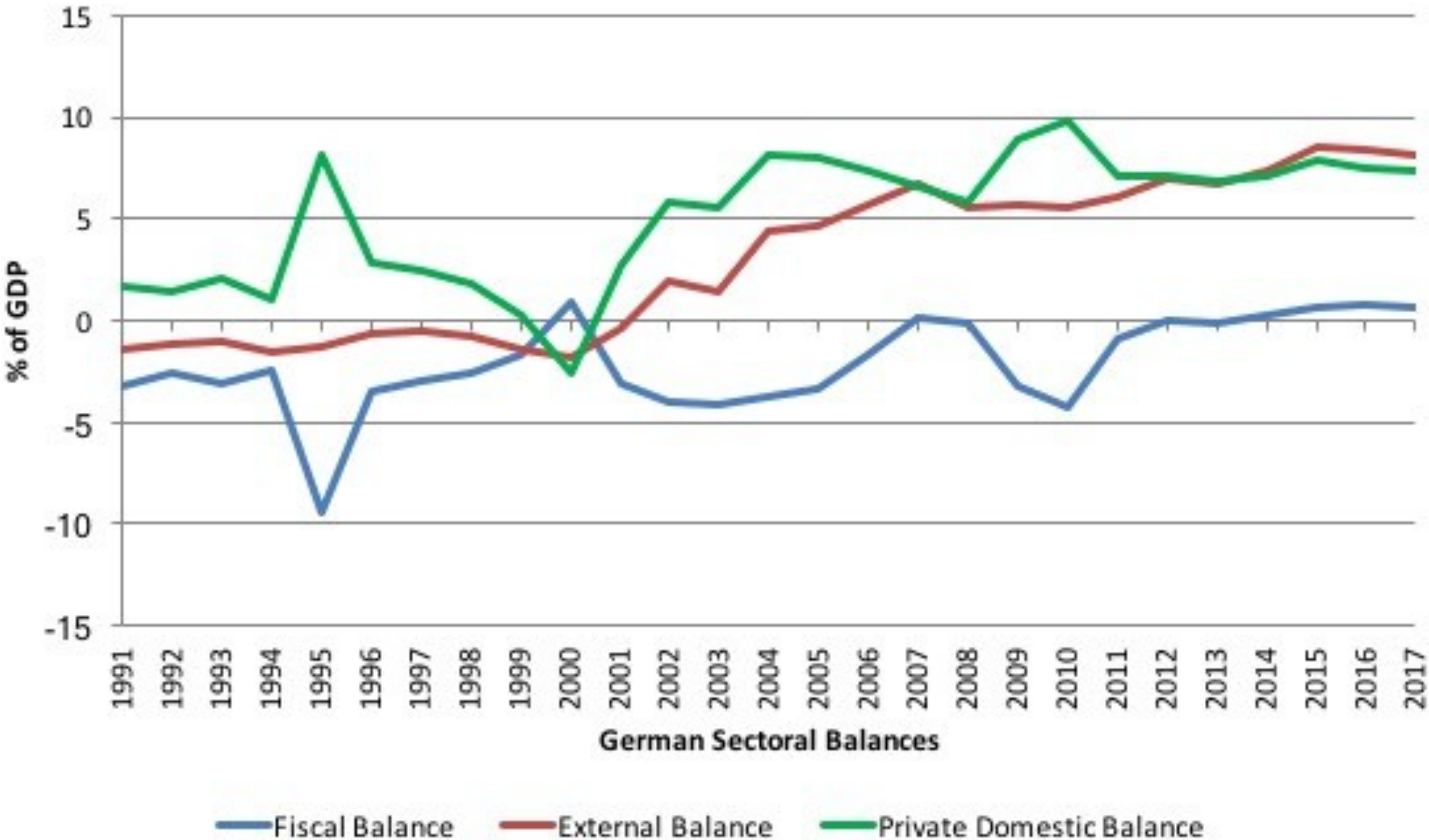
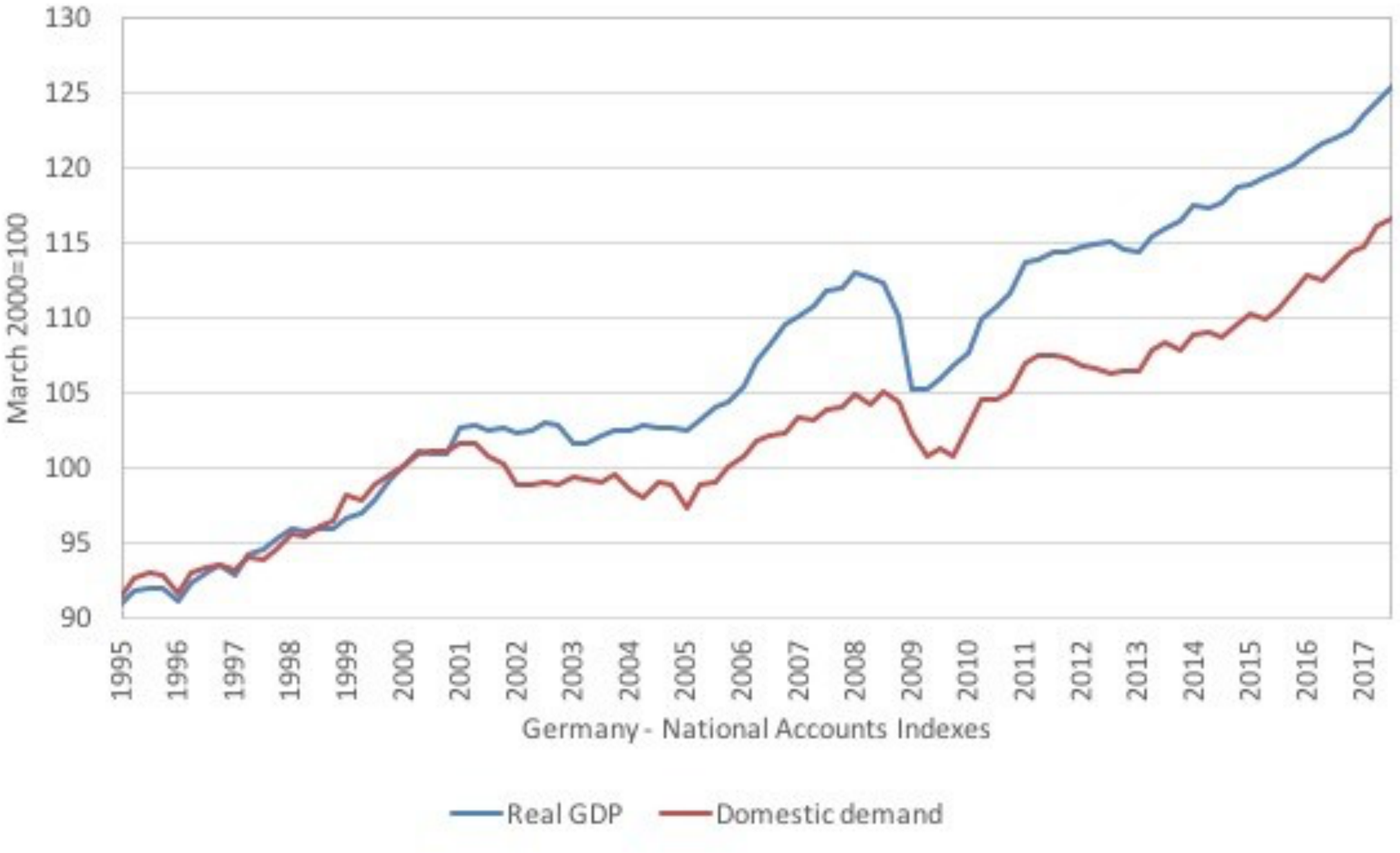
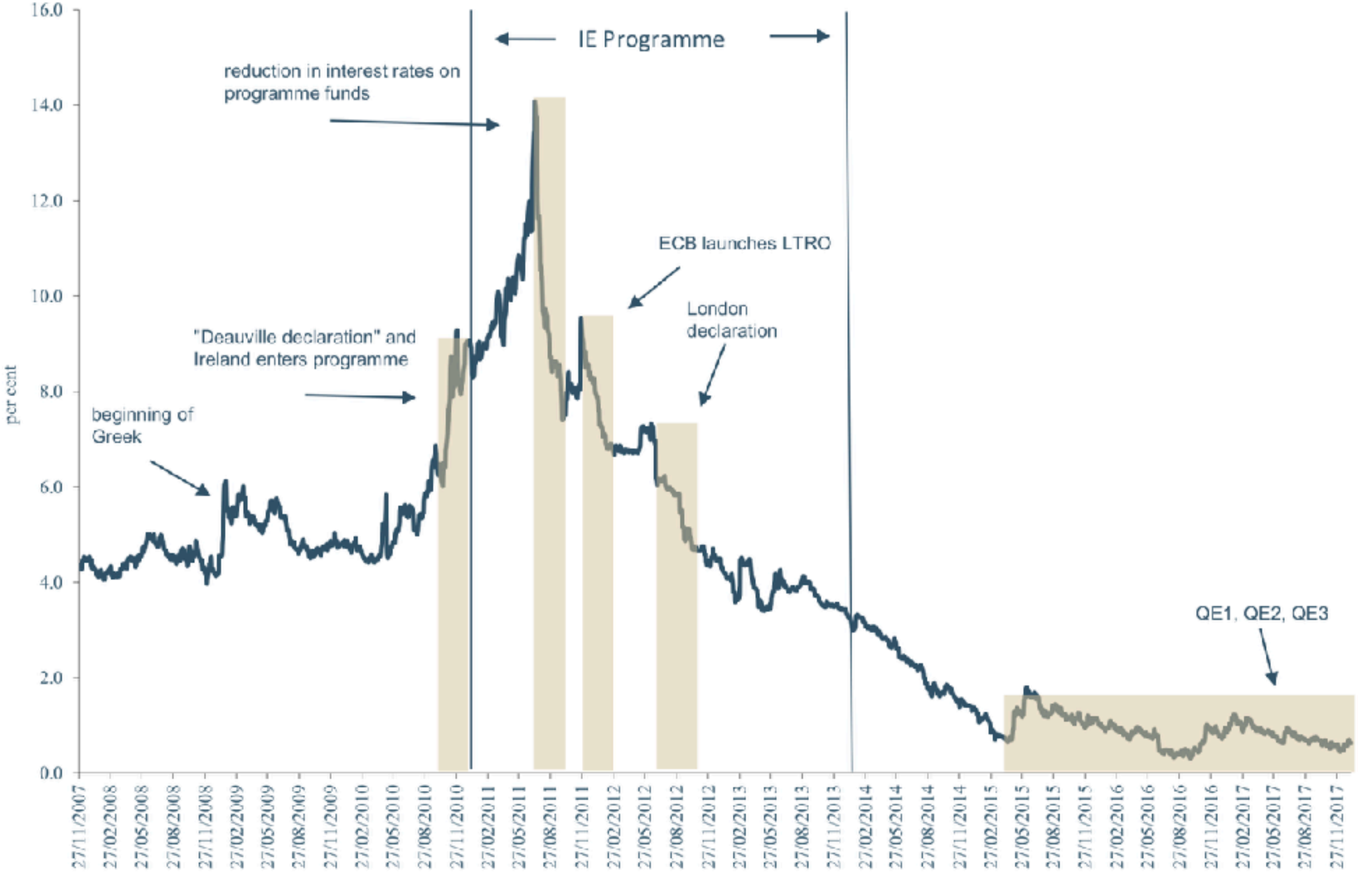
Germany's sectoral balances



Ordoliberalism implies wage repression

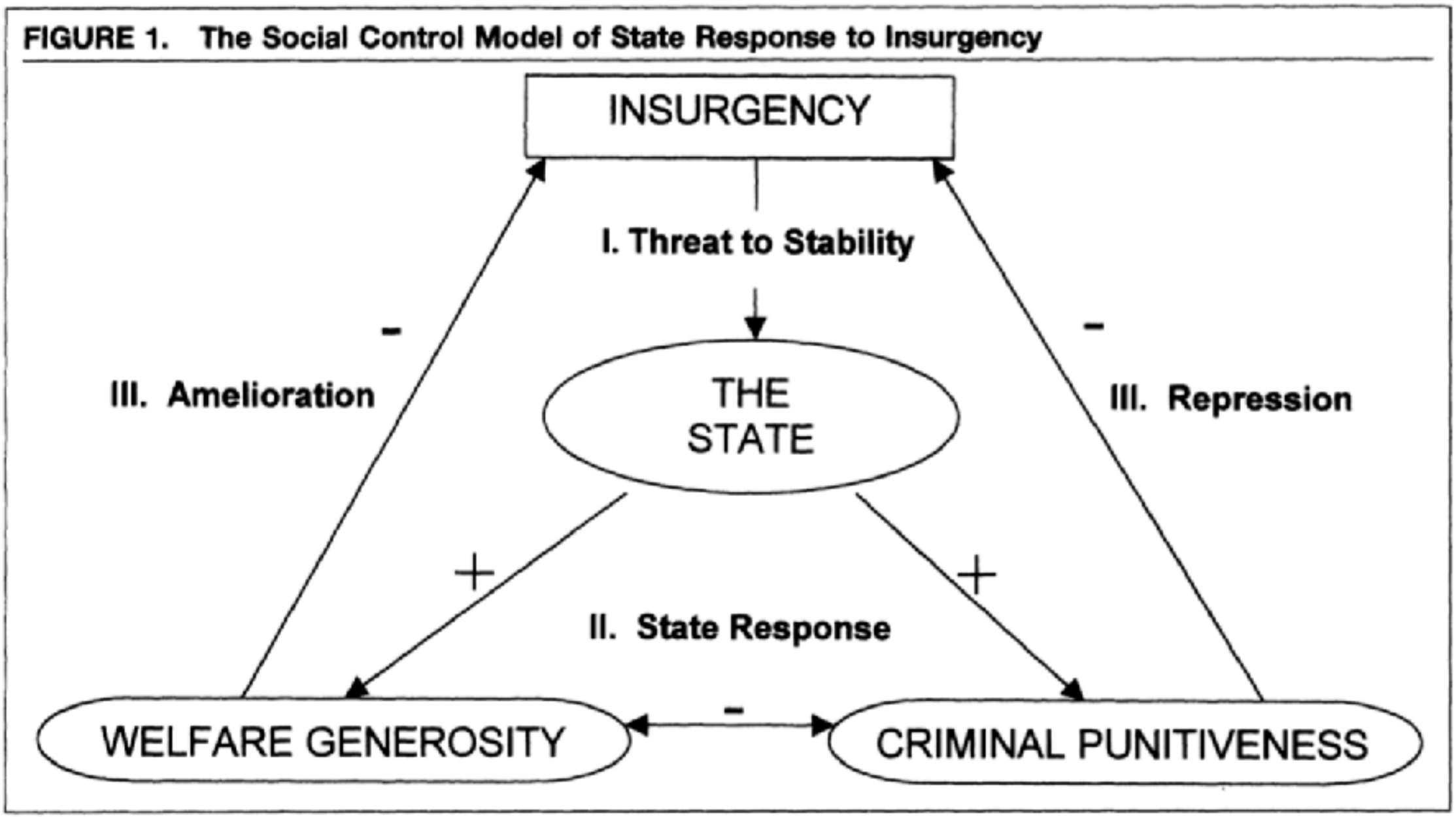


Yields on Irish government debt…



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

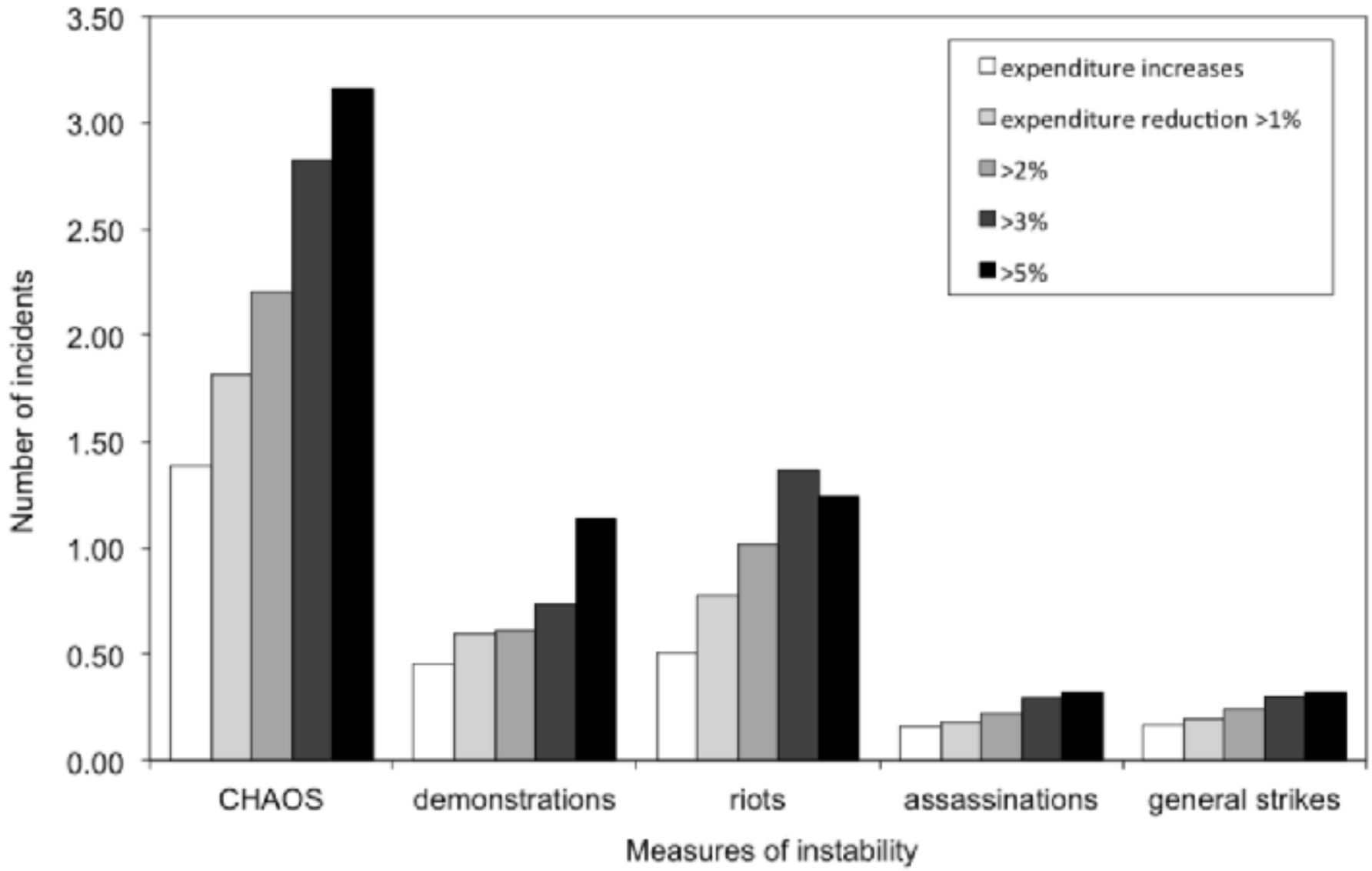
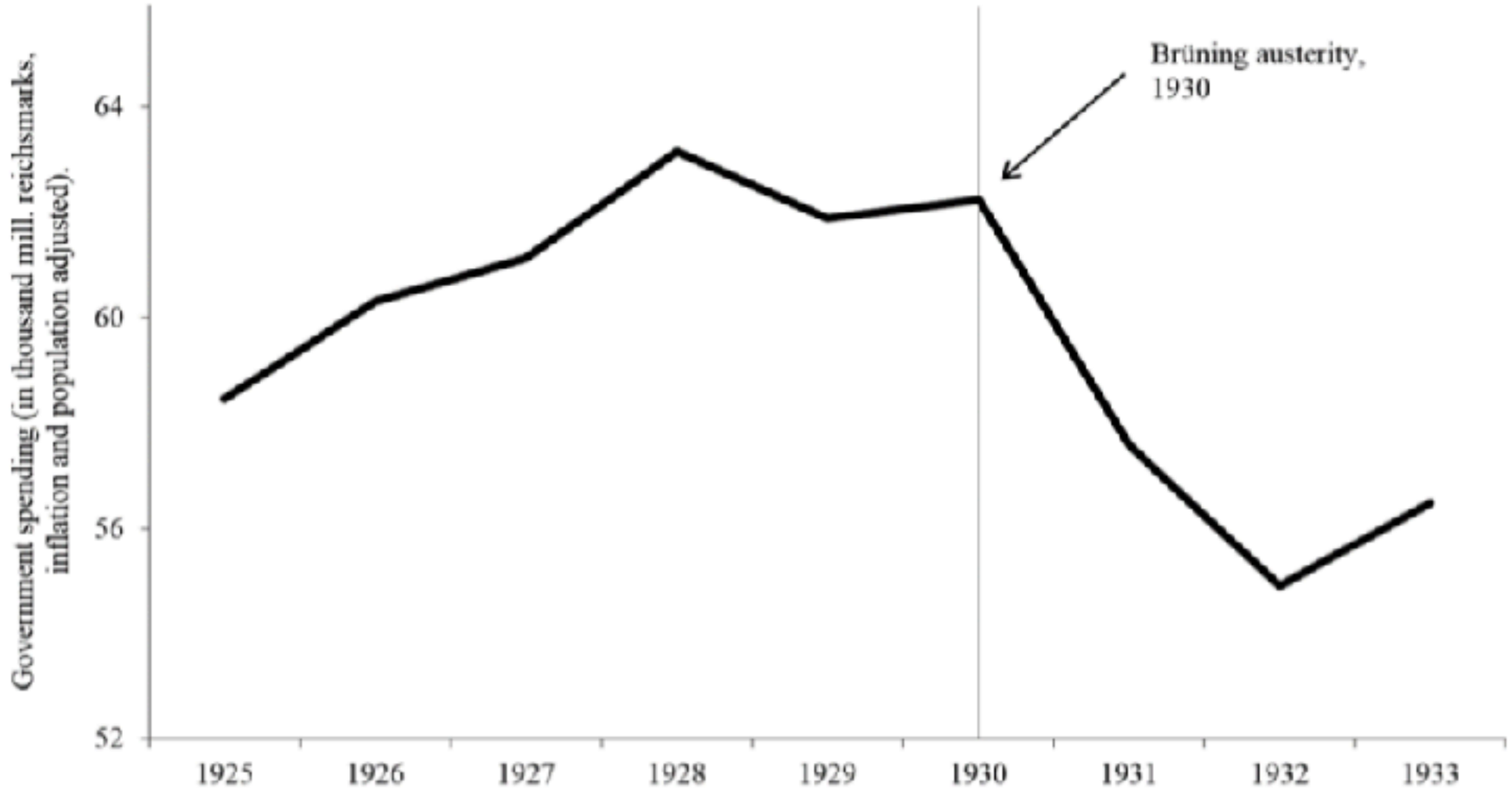


Figure 1 Frequency of incidents and the scale of expenditure cuts

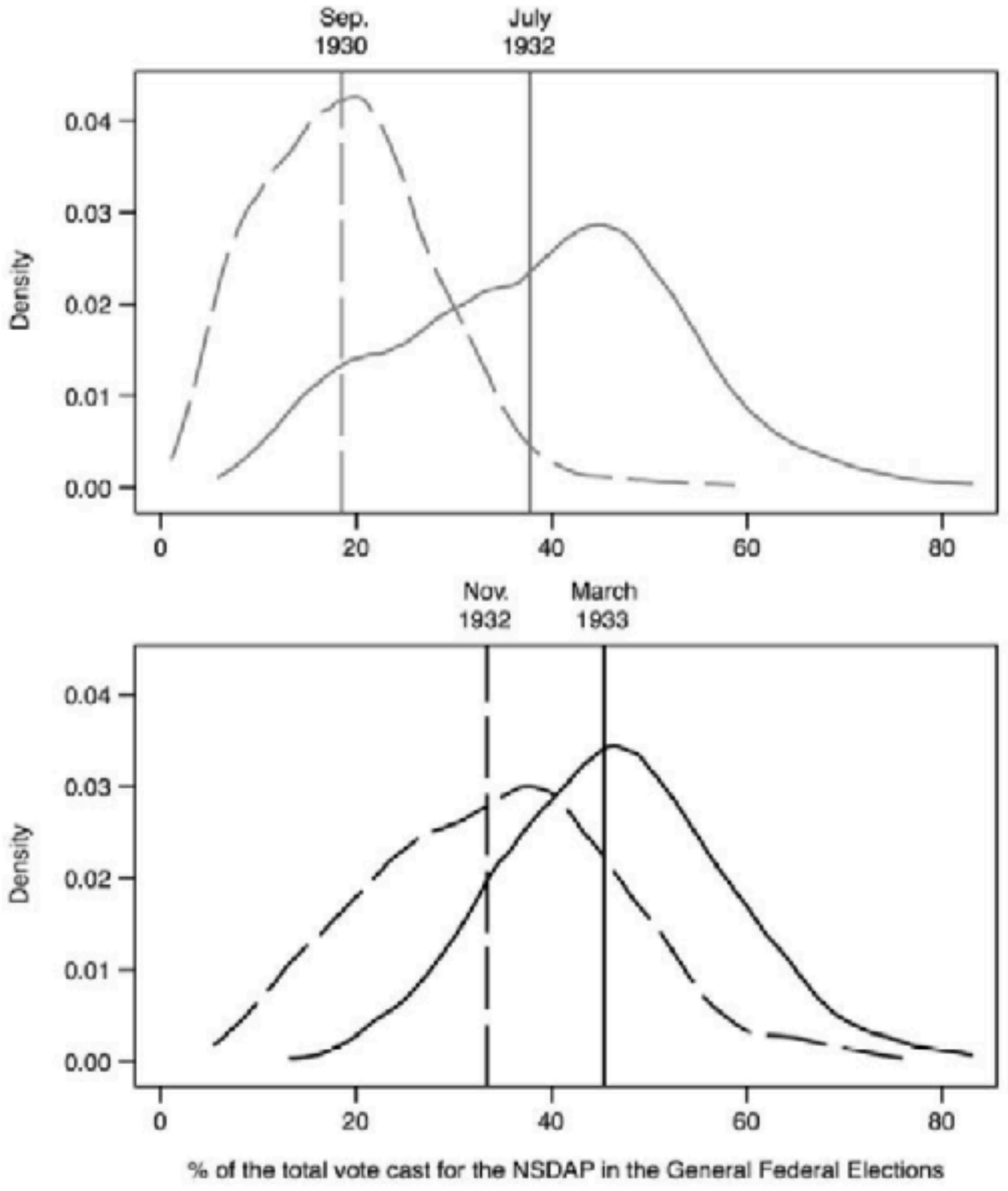
Historical precedent: the rise of the Nazis

Figure 2: Development of total government spending in the different *states*, 1925-1933



Sources: See text. **Notes**: The figure has been adjusted for inflation using the price index (1950=100) from Piketty and Zucman (2013, Table DE15a, available at **http**://piketty.pse.ens.fr/en/) and for population using also the data from Piketty and Zucman (2013, Table DE1, available at **http**://piketty.pse.ens.fr/en/). For the data on the government spending see text. The same overall figure is available in Ferguson (1996, 646, Fig. 2) and Ritschl (2013b, 126, Table 4.4).

Figure 1: Percentage of total vote share for the Nazi party in the different federal elections between 1930 and 1933.



Sources: See text. **Notes**: Vertical dashed lines show the mean value of the total vote share for the Nazi party in the different elections across districts (in percentage points). These averages are very close to the overall vote shares which totalled 18.47% (September 1930), 37.79% (July 1932), 33.6% (November 1932), 44.6% (March 1933). The figure does not include the election results for May 1928 as the vote share for the Nazi party was very low (2.6%).

A global political story now

Matthjis and Blyth (2017)

Table 1. The macroeconomic regimes of the 1970s and today compared.

Macro-Regime I: Institutional configuration	Macro-Regime II: Institutional configuration
Policy target:	**Policy target:**
Full employment (or low unemployment)	*Price stability* (or low inflation)
Policy outcomes:	**Policy outcomes:**
Positive inflation	Secular disinflation
Labor's share of GDP at historic highs	Capital's share of GDP at historic highs
Corporate profits low or stagnant	Wages low or stagnant
Inequality low	Inequality high
Markets mostly national	Markets globalized
Trade unions strong	Trade unions weak
Finance weak and immobile	Finance strong and highly mobile
Central banks weak and politicized	Central banks strong and independent
Legislatures strong	Legislatures weak

Source: Authors (adapted from Blyth (2016a, p. 220) and Matthijs (2016b, pp. 405–408)).

Table 2. The political consequences of Regime II post-2008.

Losers	Winners
Creditors/owners of capital:	**Debtors/workers (owners of labor):**
Bailouts politically toxic. Real value of debt goes up but ability to collect goes down.	Revolt against double squeeze of austerity. No longer able and willing to pay, but will vote.
Center left and center right parties:	**Populist and nationalist parties and movements of both the left and the right:**
Overall vote share collapsing with attendant 'crisis of democratic legitimacy'	Anti-austerity, anti-elite/creditor, [anti-immigrant*], and anti-globalization coalitions. Common narrative: 'taking back control'
De-legitimization of neoliberal policies (e.g. 'centrist' social democratic, liberal, and Christian democratic parties across Europe, establishment Democrats and Republicans in the United States)	(e.g. Brexit, Farage, Le Pen, Wilders, Corbyn, AfD, Orbán, Kaczyński, Trump, Sanders, M5S, Syriza, Podemos, Scottish SNP, etc.)

Source: Authors (adapted from Blyth (2015a, Table 3, p. 219)).

*Anti-immigration platforms are not a common characteristic of left-wing populist parties and movements. Corbyn, Sanders, Podemos, Syriza, and the SNP all share broadly pro-immigration platforms, in contrast with right-wing populists. This is the distinguishing feature of left-populism.

Fatas & Summers (2017)
Permanent effects of austerity

Table 7. Permanent Effects of Fiscal Consolidation.

	Forecast Error Potential GDP			
	Europe		Euro	
VARIABLES	2014	2019	2014	2019
Fiscal Consolidation	-0.999*	-1.868***	-1.365**	-2.247***
	(0.534)	(0.505)	(0.524)	(0.528)
Constant	-2.872***	-5.309***	-2.343***	-5.789***
	(0.690)	(1.093)	(0.689)	(1.422)
Observations	21	21	14	14
R-squared	0.225	0.325	0.422	0.431

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1