

Austerity for the piigs: easing the pain while increasing competitiveness

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The flood of commentary on the financial/economic crisis in journals, media and blogs undoubtedly contains much useful information and thinking. However, really novel and incisive ideas seem to be rare. In the following I present what I believe to be such an idea and I attempted to do this without materially adding to the flood!

As a result of popular opposition to the austerity measures imposed by the international community on the PIIGS states there were changes of government in all of them, either through resignation or electoral defeat. All of the new governments are committed to carrying out the expenditure reductions and associated reforms that were demanded, but their chances of success, though different from country to country, are generally in doubt. The austerity measures further depress the economies, thereby reducing government revenue and thus at least partially negating the intended effects. The populations, experiencing the measures as excessive and unjust engage in extensive protest activities including mass demonstrations and strikes. These contribute even further to the depression and the erosion of government revenue.

Economic stress is an ideal breeding ground for right wing populist parties. Such parties have appeared throughout Europe and they have already scored considerable successes. If the reform governments fail, these parties will be the likely successors--a sad end to the project of European integration.

I believe that the austerity programs as they are currently conceived have a defective design and that elimination of this defect would both ease the pain of the populations and at the same time improve the competitiveness of these economies. The central feature of all austerity programs is to reduce government expenditures by reducing the number of government employees, by reducing the salaries of those that are retained and by reducing transfer payments for pensions and various social services. The people whose incomes are thus reduced still face the same fixed costs as before. Their rents, their utilities, payments on their mortgages and on other contracts all continue as before. Nor is competitiveness improved. The government is cutting its own costs, but the costs of private businesses remain essentially unchanged.

A better policy would be for the government to legislate a cut not only in the contracts to which it is a party, but in all private domestic contracts as well. It may be questioned if such a massive intervention in private contracts is even legally possible. But the governments are already breaking many implicit and explicit contracts that they entered in the past. It can also be argued that the foundation of income expectations, on the basis of which private contracts were entered, has broken away. Many contracts will be broken anyway, simply because of inability to pay.

A principal problem of the PIIGS, as many economists have pointed out, is that lacking an own currency they cannot devalue externally. A domestic deflation left to market forces generally takes a very long time and requires a depressed economy. My proposal would cause the domestic deflation that is required to restore international competitiveness to proceed more quickly. It would also spread the pain more evenly through the society. The

exclusive concentration on the public sector is a faulty design that should be corrected; otherwise it may cause the entire project to fail.

Should such a policy ever be seriously considered, many details of the implementation would have to be resolved, but I don't believe that these would be more difficult than with any other policy implementation.

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