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The review is written under the
auspices of the project 179052
supported by the Ministry of Education,
Science and Technological
Development, Government of the
Republic of Serbia.

Austerity: The History of a Dangerous Idea

by **Mark Blyth**

Oxford University Press, 2013.

Mark Blyth's book is important intervention with respect to understanding of the unceasing economic crisis. On the one hand, the author gives a review of different theoretical approaches, and on the other hand, he argues about economic and political consequences. So, the reader who is immersed in the interpretation of *Austerity: The History of a Dangerous Idea* gets the opportunity to view the whole with respect to the economic constellation which is dominant today. Finally, this book was written from a critical perspective; the author criticizes the existing economic practices as well as mainstream economic theory.

I will emphasize the points that I believe are the most important for understanding of this book:

- Economic ideas matter and the current crisis prove how they matter. The crisis cannot be understood if we do not take into consideration the fact that both economic theoreticians and the subjects of economic crisis have accepted certain economic concepts which represents their orientation;
- Austerity represents an idea, which is dangerous;
- Economic policy based on austerity was never effective, that is, it failed;
- Austerity is a political problem of distribution and not an economic problem of "accountancy";
- The idea of austerity has remained in spite of the examples from history, which have proved that austerity does not work and that it gives negative results; undoubtedly, this situation can be understood as a puzzle since the negative consequences of an idea do not necessarily question the idea itself (when quoting John Quiggin, Blyth often speaks about "zombie idea");
- The idea of austerity has survived because of "misrepresentation of facts";
- The idea of austerity must be criticized because it represents a "fallacy of compositions";
- The logics of austerity will still be present as a determining economic idea, so this is not the case of a phenomena rising from market conditions;
- The logic behind austerity proved to be damaging even during the thirties of the 20th century, but it is not a coincidence that lessons from history are forgotten.

The mistakes made eighty years ago are the same as these from present financial crisis;

- Special attention is given to the financial sphere, banks in particular. These financial institutions are treated from the viewpoint that the existing banks are “too big to fail”;
- Financial ideas have strong political power;
- The crisis is determined by the private sector; this is undoubtedly a “private-sector crisis”. The crisis began in the private sector and continued to the public sector; but the retrospective viewpoint presented public debt as the main reason for the crisis. The causation was inverted. It should be noted that the causation is related to the banking bubbles;
- There is a continuous interference between the state and market. The history of economics proves that states created markets (although the opposite was also witnessed) so a theoretical approach to austerity is possible only with an analysis in relation to the state with respect to the market and austerity.

Let us first consider the obvious signs. What is austerity and how often is it mentioned in the theoretical and political-economic texts? Blyth defines this phenomenon in the following way: “Austerity is a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending in order to restore competitiveness which is (supposedly) best achieved by cutting the state’s budget, debts, and deficits” (p. 12). According to this definition, we can divide austerity into the following constituent parts: (a) voluntary deflation in order to “restore” competitiveness; (b) cutting down the budget and reducing the deficit leads to the rehabilitation of competitiveness.

Mark Blyth, who is writing from the perspective of political economy and who does not want to renounce the merits of the welfare state, believes that the idea of austerity is a dangerous idea because it supports the rising of inequality. Without having second thoughts he refers to the movements (Occupy, for example) from the first and second decades of the 20th century which resulted in putting the question of inequality on the agenda (at one point he is even discussing about “classes”); he is convinced that austerity contributes to political differentiations. If we can say, that is one practical idea, which organizes economy and suppresses its political forms.

Austerity is propagated with the aim of returning the economic stability, especially from the perspective of “business confidence”. It is assumed that the government, that is the spending practice, has always constrained maneuverability of private business (“crowding out”). The idea of austerity is also dangerous because it seems to be a logical idea, which is based on a simple and indestructible logic of economics. It is based on the fact the debt cannot be cleared based on “autoreferentiality of debt”: debt can be cleared by other debt. Blyth never uses the notion of “populism”, but closer consideration of his argumentation brings us exactly to that conclusion that austerity, as a sustainable idea, from an intuitive perspective, has “populist effects”. This means that science would not have to exist if merely intuitive ideas were enough for the discovery of truth. These ideas are tempting but they draw us back from the complexity of reality.

The author of this book frequently emphasizes “fallacy of composition”: as something that determines austerity. Naturally, it is not a coincidence that he turned to this methodology and evoked the criticism, which is based on the “fallacy of composition”. Furthermore, he quoted Keynes who delivered some serious attacks on “classic economy” (as he said) which were provoked by this “mistake” found in the mentioned methodology. What does it, in this case, mean that the inadequate transfer of logic from the part to the whole should be avoided? Of course, there is the message related to Keynes, particularly regarding the “paradox of thrift”: if everyone is motivated to thrift then eventually there will be no consumption, which generates investments. Thus, believing that the problem can be identified in the sphere of “business confidence” is the wrong understanding of economic situation. If everyone is austere at the same time, then crisis tendencies are revealed. As Blyth says: “We cannot all be austere at once. All it does is shrink the economy for everyone” (p. 16). A totalization of the austerity policy is most important; not realizing this impossibility, however, is the blind spot of mainstream political economy and theory. In other words, Blyth argues in favor of how the mainstream in political economy and theory is firmly connected to the question of “fallacy of composition”.

Still, we shall not forget yet another moment: the austerity policy is dangerous because it generates different externalities. The political-economic approach is taken here as well: austerity can be represented here as intersubjective contagion. Those with the greatest wealth claim that we “have been spending too much”, but they have forgotten that by excessive spending we are actually paying to save their assets. It is a mistaken belief that wasteful spending of government proves to be a cause of the crisis: banks, as the determining subjects, promised never-ending progress but they always socialized their costs and burdened the state. Blyth even thinks that, in the present crisis, we are witnessing the unconceivable acts of shifting: the crisis that was typically anchored in the rut of private sphere began to be treated as the crisis of public debt or the crisis which was created due to the inherently unproductive public sphere which imposed its debts.

Blyth constantly applies the methodology, which discovers political moments in economic issues. Therefore, he finds it convenient to describe the political context of economic theories. The dominance of austerity-logic could not be imagined without serious transformations of macroeconomic theory in the seventies. Without economic-theoretical arguments, which prove that the market can never make mistakes systematically, austerity as the main idea would have never become dominant. According to Blyth, every economic theory implicitly contains a political frame for distribution processes. Accordingly, every economic theory, as he says, contains the elements of an “instruction sheet” with respect to the orientation of economic subjects. Economic theory is not just a reflection of a previous economic reality; it is endogenous with respect to economic practice and economic language.

Special attention is paid to the European crisis because this crisis can be treated in the light of a permanently practiced policy of austerity. Blyth sees European banks as having the key role in the generation of sovereign debt crisis. In order to explain this, he went back to the twenties; it is in accordance with his methodological approach, which seriously considers the genesis of various economic ideas.

History matters. This is how we could interpret the endeavors of the author of this book. In his approach, he first describes present situation (for instance, cases of different crisis manifestations in different countries), and then, he thematizes the genesis, which includes the historical path that has led to present situation. We might say that this is some kind of retrospective method which goes back in order to remind us of the genealogy of the chosen phenomena. Blyth, who has been exploring the aspects of neoliberalism, finds it suitable here to carefully distinguish between neoliberalism and German *ordo-liberalism*. For him, German orientation is an exception to Anglo-Saxon rule: “market is *a priori* good and state is *a priori* bad”. However, even the remaining of German *ordoliberalism*, which always succeeded in integrating the market into established social order, did not prevent the occurrence of crisis in Europe.

It could be said that the banks in the USA are “too big to fail” (meaning that they are immune to losses and disasters because the state will always throw a life-belt), but in Europe it is different. Namely, the structure of the banking system in Europe is such that it is indeed “too big to fail”: when observed collectively the banks are so big that the sovereign (the state) is not powerful enough to cover the risks incurred from banking practices. The European system cannot project a bailout that is big enough to stop the erosion of system. Thus, in order for the system not to be destroyed the policy of austerity should be followed. Blyth places this European problem in a larger context, which can be explained by generating the sovereign debt problems. This problem was inhibiting the growth via austerity, but it was always alluding to the restoration of competitiveness. And deflation (which was present again and which, according to some economists, indicated great dangers) derogated the entire process leading Europe to a crisis. Blyth sees that the planners of European economic policy made the mistake and in an interesting way he evokes Hayek (whom he sees as the main representative of neoliberalism): European planners also had “epistemological hubris”, overestimation of epistemological possibilities. Although Hayek strongly attacked the postwar Keynesianism, the blade of his criticism was supposed to hurt those who had built and shaped European economic policy. Just by taking into consideration the inflation rate and debts of state it is obvious that they were not able to recognize the most important fact about the banks we mentioned earlier. This contributed to the establishment of a belief among European elites that austerity would open the door to economic progress and this further contributed to another belief that there was no alternative. The problem is that this experiment with austerity is taking place in Europe, but some predictions about its failure could be made. Here, Blyth starts with the mentioned description of genealogy. Genesis is used to show the elements of austerity doctrine development. However, considering the fact that austerity can occur only after the establishment of a modern country, the coherent doctrine of austerity was established in the 20th century. The predecessors were John Locke, David Hume and Adam Smith. The basic elements of doctrine were already introduced by Locke: Blyth used one interesting sentence to describe liberal dilemma which is the basis for austerity-politics: “The state: can’t live with it, can’t live without it, don’t want to pay for it” (p. 74). Blyth repeated this sentence several times and it is obvious that he believes it is an adequate expression of liberal

understanding of economics. Namely, Locke was already thinking in that direction, shaping and limiting the attitude of state when public debt is actually the debt of the king. Hume goes further with his declarative claim that public debt can destroy a nation. He believes that the problem of public debt is insoluble and that there are no limits: costs are more often implicit than explicit and costs can be passed on from generation to generation. Adam Smith, who was a follower of Hume, also confronted the problem of public debt. According to Blyth, Smith formulated one complicated theory about a country in capitalism: he deduced, in a complex way and in the context of public debt, that capitalism could not survive without a country which was prepared for certain sacrifice and it is this fact that abolishes capitalism. It is often forgotten how high Smith's opinion of the saving as an actuator is: the main problem is that the states are not savers. Here, there are no explicit indications to austerity, but we already have a clear image of the way the public debt of a country perverts saving-processes. There is a dominant role of a country in market economy but we should struggle against it. Moralization of debt is the most important; saving is a virtue and spending is vice. Therefore, Blyth does not imply that the doctrine has already been formulated, but moralization of debt prejudices moral tone which can often be heard even in today's indications of austerity.

After the mentioned arguments, Blyth leads us through the 19th century and soon we come to the 20th century and American comprehension of austerity. In this case, he draws particular attention to Hoover-administration (treasury secretary, Andrew Mellon). Here, we should discuss about certain paradigm called "liquidationism". This paradigm can be explained if we link certain tendencies with the thinking of some Austrian economists from the 1930s. The thinking of a great economist Joseph Schumpeter was developed: capitalism is developed in cycles and mistakes are inevitable, which means that they are incorporated in the next cycle. Intervention with the aim of preventing liquidation of certain companies is not effective because it would prevent a necessary phenomenon of liquidation: the consequence of this way of thinking is austerity; we should tend to purify the system and reduce the country's expenditures. There is no alternative, austerity is inevitable and it applies the iron logic of capitalism. Here, we again have the moment of analysis of the dynamics of economics based on "business confidence": the state is sending clear signals to the entrepreneurs by showing persistence regarding the austerity.

There was a British type of austerity policy. Blyth calls it "treasury view" which rearticulated liberal doctrine about austerity. The person who criticized this approach was Keynes who presented a series of anti-austerity arguments. The British economist, as we have already noticed, presented his arguments based on "fallacy of composition" by establishing critical diagnosis of labor and investment markets. Here, Blyth identifies a diametrical contradiction between liberal doctrines of Smith and Hume: despite parsimonious merchants who cared about the mentioned economic thinkers of the 18th century, dynamics of economics is here put into the perspective of consumption, which encourages investments.

It is important to mention German tradition has never allowed the prevalence of liberalism in philosophy of economics. This is the second time that Blyth turns to German ordoliberalism who realized certain synthesis between elements of the men-

tioned German tradition and liberalism between two world wars, although their influence was shown after the World War II. They tried to join the concept of order (“ordo”) with competition. They managed to draw Germany from the influence of Keynes, which was not big. This is interesting because it can easily be proved that ordoliberalism marked the formation of the European Union. Blyth believes that the most important elements of the European structure are marked with the influence of ordoliberalism of the mentioned German economic thinkers. In other words, there is ordoliberalization of Europe. The contribution of Germany to the doctrine of austerity is also evident and the adequate slogan would be: first save and then buy. This can be connected with the theory of Austrian economists who are believed to be the relatives of German ordoliberals: a country should not go back to the long-term evolution of the structure of economics. Therefore, Austrian economists, who became influential in the USA, but not in Europe, became the supporters of the austerity doctrine. By no means could theoretical macroeconomic transformation from the 1970s be identified with Austrian tendencies; however, it should be pointed out that Austrian tendencies contributed to the establishment of the mentioned doctrine. According to Blyth, there is an “Austrian Accent” in the theory of macroeconomics. A person does not have to favor a Keynesian approach to claim that market undergoes changes in its autoreferential development: furthermore, non-Keynesian Irving Fischer, in turbulent 1930s, discussed about debt deflation, which means that depression does not end on its own but it needs an intervention.

First Keynes was overpowered locally in Germany under the management of ordoliberals. Later, Keynes was overpowered globally. This was the period of Milton Friedman’s monetarism with firm indications to inherent pathology of a country. Besides this, new macroeconomics found its opponent in the democracy, and public choice theory recognized the politicians as the carriers of individual interests. Therefore, we should report about the strong relationship between neoliberalism and austerity-policy. Neoliberalism is necessarily brought to the glorification of austerity; this is not just a marginal issue in neoliberalism, it is the most important moment in it.

How can we explain the fact that neoliberalism survives despite the truths which contradict it? How can we explain that “failed idea” still exists even though there are convincing counterarguments? Here, Blyth develops the arguments concerning ideology. Actually, we are facing here one general question: are ideologies immune to the facts? How can ideologies be rejected? Is there a possibility of refuting the ideologies? Is there a possibility of rejecting economic ideologies? Austerity, of course, is not a neutral theoretical indication but it is related to ideological organization of economic dynamics. Blyth takes examples throughout Europe and America to illustrate that austerity does not work, it uses a number of empirical data and theoretical arguments (*pace* Alesina and Ardagna, for example) concerning the fragility of austerity program. This part of the book leads us to the present situation and we can read about different examples (Ireland, Baltic-states, etc.), but the author does not forget the past and provides us with different examples from the 1930s, which were very important for him.

Blyth succeeds in combining theoretical and empirical considerations in a very interesting way: as for the first moment, he emphasizes the extent to which we are tangled in the struggle of different ideas, and regarding the second moment, he proves that the selected facts are always within certain theoretical frame and that facts are always theoretically enframed *ex ante*. Ideology indeed revolves around the idea that “there is no alternative”. Blyth does not present only the fact that there is always an alternative; he also presents the fact that suppression of alternatives is a function of ideology. This is the reason why facts are denied when it comes to ideology and they cannot be mobilized against ideology: this was quite clear to Blyth and his short and clear indications of ideology immunity prove how aware he was of the problem. However, he does not see the light at the end of a tunnel. When parties who have authority are defeated due to austerity, the opposition continues with the same program.

Blyth continues to warn about the danger of conducting austerity-base programs: the Eurozone could erode even more than it already has. The crisis was started in the USA, and the euro system not only transmitted the impulses of the crisis but it deepened it even more by changing European monetary system into something framed by gold standards. This is the reason why lessons about the gold standard problems relating to euro were forgotten: (i) no matter how often it occurs, austerity never works; (ii) the gold standard cannot be affirmed in democracy. Naturally, austerity will not be erased here as an element of instrumentarium of economic policy: it can be accepted as particular element of one unity and never as a replacement for a unity. The austerity is a specific case of the general situation (in terms of Keynes’ opinion on classical economics). However, in the Eurozone, the logic of austerity perpetuates and it becomes the only ideology, which directs everything else.

As we have already seen, austerity is both an idea and political-economic program. It can be raised to the level of ideology but, as Blyth claims, our behavior towards the country regarding its attitude about market economy is rather schizophrenic. At the end of his book, he even suggests that austerity is more than ideology; there is a “desire” to implement it. It is up to us to reveal what it means.