GLOBAL POLITICS IN ACTION . . .

The West in an age of debt and austerity

Events: The dramatic events of September 2008 precipitated the steepest declines in global output since the 1930s. Although the world economy returned to modest growth in 2009, renewed economic problems emerged across much of the western world during 2010, in the form of escalating sovereign debt (sometimes called 'national debt' or 'government debt'). In some cases, this brought the creditworthiness of a country into question, as concerns over its ability to repay its loans pushed up interest rates to unsustainable levels and created the need for external intervention. Sovereign debt crises, often linked to banking crises, were most acute in the eurozone, where bail-outs were negotiated by the EU, the IMF and the European Central Bank for Greece (in 2010 and again in 2012), Ireland (in 2010), Portugal (in 2011), Spain (in 2012) and Cyprus (in 2013). Elsewhere, low growth and rising debt meant that states lost their prized AAA creditworthiness status; this, for instance, happened to the USA in 2011, France in 2012 and the UK in 2013. Either because of conditions attached to bail-outs, or because of wider anxieties about debt, many western states shifted economic policy away from fiscal stimulus (the initial, and orchestrated, response to the September 2008 crisis) to 'fiscal retrenchment' (reduced public spending or increased taxes), helping to initiate an 'age of austerity'.

Significance: The structural weaknesses of many western economies may have been exposed by the Great Recession, but they had deeper causes. These include a tendency, sometimes going back to the 1980s, to bring about growth by ever-higher levels of borrowing (in the form of mortgages, bank loans, credit cards and hire purchase, and so on), made possible by an inflated and under-regulated banking and financial sector. Moreover, some 30 years of growth in the world economy had allowed western governments to become complacent about sovereign debt, confident in the belief that growth would continue. This assumption was brutally destroyed by the Great Recession: as output plummeted, so did tax revenues, throwing the public finances into chaos with a resulting explosion of borrowing.

However, there is major debate about how the blight of debt should be addressed, and especially about the link between debt and austerity. The austerity approach, adopted across much of Europe, is based on the belief that if chronic indebtedness is the problem, the solution must be debt reduction, achieved, in particular, by cutting public spending. A failure to take the 'austerity medicine' risks passing on an escalating debt burden to future generations, and losing altogether the confidence of financial markets, making loans impossible to service. Quite simply, governments and general publics must (once again) get used to living within their means. Austerity, nevertheless, brings with it the problem that spending cuts and/or increased taxes take demand out of the economy, and so threatens to result in a 'lost decade' of economic stagnation and high unemployment. In this scenario, public finances remain in turmoil as low or zero growth results in declining tax revenues and stubbornly high public spending. A solution that makes sense for a family in debt may thus be self-defeating if applied to the economy as a whole, and disastrous (because of its impact on exports) if applied to a range of linked economies. The principal alternative to austerity is a neo-Keynesian strategy that, whilst accepting the long-term goal of a balanced budget, would maintain spending in the short- and perhaps medium-term on the infrastructure programmes in particular. This, broadly, is the approach adopted by the Obama administration in the USA. In such a strategy, the justification for continued or increased borrowing is that it will boost growth and, in due course, tax revenues, allowing the debt problem to be resolved as the economy revives. Critics, on the other hand, argue that neo-Keynesianism simply leaves government 'addicted to debt', unable or unwilling to carry out the 'rebalancing' that western economies have long needed to carry out.