Austerity: the history of a dangerous idea | analysis

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AUTHOR AUSTERITY

THE HISTORY OF A DANGEROUS IDEA

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August 5, 2011 is a typical Friday to each of us regular people. But then, an unthinkable event happened. The United States of America has lost its triple AAA credit ratings when it was downgraded by the ratings agency Standard & Poor's (S&P's). For us typical person, this is a bit of a problem cause we all know that US dollar which is the world's reserve currency. Basically that the dollar is treated as the emergency store value for the rest of the world: practically all tradable commodities are valued in connection to the dollar, and that it serves as a bridge to the world's monetary system. Meanwhile, the counterpart of the US, the European bond market that began in Greece is now threatened to engulf Italy and Spain, undermining the Euro which is the single currency while increasing doubts about the solvency of the entire European banking system. On the other hand, London, which is another great financial center in the world, was hit by riots that spread all over the capital city and then the country. In the previous years, many countries including first world countries experience what we called the Worlds Financial Crisis. So, what or who should be blamed for this financial crisis that is going on..?

Politics has succeeded in spending wastefulness and reckless especially in Europe and in the US which had made the economy worse. In contrary, they have created a policy of cutting the budgets – (austerity) in order to solve the financial crisis that is happening. People are being told that all have lived beyond the means and that there is a need to tighten the budget. In this point of view, not all of us forget where all the debt has came from. It is not from the spending of the government, but as a result of bailing out, adding liquidity to the damage banking system and recapitalizing. As a result of this action, private debt was the same as that of government debt while those people responsible for generating it walked away freely; thereby putting the blame on the state, and thus the burden goes to the tax payer

Now it takes a burden in the form of global turn to austerity, the policy to lessen domestic prices and wages in order to restore the competitiveness and equilibrium of the budget. According to Mark Blyth, a political economist that the problem of which is that austerity is a very dangerous idea in the first place. Austerity in the first place is not working. As the past years and countless historical examples from the last 100 years show, while it makes sense for any state to try and cut its way to economic growth and stability, it simply cannot work when all states try to resemble and try it simultaneously: all that will do is that it will shrink the economy. In the worst case scenario that will happen, austerity policies worsened the Great Depression and created the conditions for seizures of power by the forces responsible for the Second World War: the Nazis and the Japanese military establishment. Rather than expanding growth and opportunity to the economy, the revival of this dead economic idea has almost led to low growth along with increases in wealth and income inequality. Austerity demolishes the conventional wisdom, guiding and marshaling an army of facts to demand that we recognize austerity for what it is, and what it cost us.

It is not really a sovereign debt crisis. The first reason that austerity is a dangerous idea is that it simply does not work. Both the politicians and media are representing the dangerous idea in austerity, as a means of payback for the sovereign crisis, which was supposedly brought on by the state which on the other side spent too much. The US banking system, the origin of the global banking crisis, was deemed by the US government to be " too big to fail" and therefore wasn't allowed to fail when it got into trouble in 2007-2008. The price of not allowing it to fail was to turn the Federal Reserve into a " Bad Bank" meaning lots of bad assets that were swapped for cash to keep lending going, while the federal government blew a hole in its finances as it solves the gaps caused by lost revenues from the crash deficit spending and debt issuance. As what others commonly say, No good deed goes unpunished. This we know that less well known is how part two of this crisis is simply another variant of this story has also been happening simultaneously in Europe.

What actually happened in Europe was that over decade introduction of Euro, very large core-country European banks bought lots of peripheral sovereign debt, this means that bonds issued by a national government in a foreign currency, in order to finance the issuing country's growth and development, which of the moment is worth much less. (Sovereign Debt, 2014). Levered up (reduced their equity and increased their debt to make more profits) far more than their American counterpart. There is no crisis of sovereign debt caused by sovereigns' spending unless you take account of actual spending and continuing liabilities caused by the rupture of national banking systems. What begins as a banking crisis ends with a banking crisis, even if it goes through the states' account. But on this book, politics are making it appear that the state will be blamed for all the faults such that those who made the bust will don't have to pay for what they have done. Austerity is not just the price of saving the banks but also the price that the banks want some else to pay for the price.

The author relates an Oscar-winning documentary INSIDE JOB in relation to what is happening in America. It somehow gives a clear and understandable picture and description of what is happening on the financial crisis undergone by the country. The documentary exposes the conflicts of interest within the economic profession. So what really matters in this situation? I think it is the unconnected parts of the global system of finance coming all together producing a crisis that as a whole ended up being the states, the people, and as a whole the citizens problem. According to the author, there are four elements that he believes that counterfactually cannot be removed and still explain the crisis: the structure of collateral deals in the United States repo markets, the structure of mortgage-backed derivatives and the role in repo transaction, the role played by correlation and tail risk in amplifying the problems, and lastly the damage done by a set of economic ideas that blinded both the bankers and the regulators (Blyth, 2013).

According to Dani Rodrik, among all the calamities spawned by the global financial crisis, none was as easily avoidable as the idea that austerity policies were the only way out. He described that the author is a political scientist that exposes the one of economics profession’s most dangerous delusions is an indication of a state of macroeconomics (Rodrik, 2013). So who originated the intellectual history of austerity – the dangerous idea? England famous philosopher is behind this idea, John Locke. He was concerned with the appropriate foundation for civil government. His writing was an essential propaganda for the emerging merchant classes that by little taking power from the British aristocratic elites. He was part of a movement that culminated in the Glorious Revolution that happened in 1688, the disempowerment of the monarch and empowered the people. Locke begins imagines the market by wondering how it is possible from the Almighty, who have given to men and allow unequal, if not unlimited accumulation of wealth and this conception of property is what it begins.

The author describe that if Austerity has been applied during the European financial crisis, it would produced failure result that one could expect if it has been investigated with regards to historical ideology. The cost would be disastrous, if the European economic policy makers, just like the practicing medical doctors, would have to swear “ to do no harm” to their patients, they would be banned from practicing economics. With regards to their counter-part, if austerity becomes a policy in the US, despite that there was evidence that has been made, any time soon we can expect it to be equally destructive as well, for we all know that Americans are more heavily armed and they have all the resources. Despite that austerity has many negative ideas; it too has also good reasons for continuing its application, especially in Europe- that is, clearing space on the balance sheet of sovereigns in case if a certain region’s too big to bail bank goes bankruptcy.

A series of event happens if one country has debt. Based on the book, bailing would lead to debt. Debt will lead to crisis. Crisis led into austerity. Perhaps this could be avoided if there were moments of good choices. Global finance has made so many assets, not through efficient markets but by riding up and down with the three interlinked giant asset bubbles mentioned by the author which use huge amount of leverage: The first began in 1987 throughout 2007 when the United States equities boost up stock markets all over the world. The second phase was in 1997 until 2006 when the crisis hit, smart cash made on equity market found real estate. And lastly, it happened in 2005 to 2006, were the commodities burst quickly with regards to volume of liquidity undergoing either safety or downfall. Because sovereignty was stretch, both liquidity and the zero rates will have an end on a much weaker economy. The business models of banks for the past years are failing, then why do prolong the agony if it has already busted and is too much expensive? So what do you think? Banks are drastically been failing: bank equities, market capitalization, revenues by classes are losing its integrity that results in reduce lending capability and growth as well. Bonuses are low and the fix costs are rising. This discomforting idea suggests that with regards to banks, they should not be bailed from the first place.

There is a county that surpasses many big nations and countries, and that it was Iceland. It has survived by not letting its bank goes bankruptcy thus it became a healthier and more equal society. Iceland may be a small country, literally a size of a city, perhaps there are still reasons of comparing two important lessons for the natural history of austerity. First, it has an ideology that by doing the exact opposite of doing austerity, it both survive as well as prosper. And lastly, they do not bail there banks. Iceland gives a positive lesson. The option of moving forward with indebted society are much of a limited and uniformly bad: with regards to inflation (these are worst for capital and creditors), deflation (worst in regards to workers as well as debtors), devaluation (bad for longer terms of workers and worse on Euro), and lastly default (which all people loses).

This book has examined the case for austerity as both sensible economic policy and as a coherent set of economic ideas, and it has found out that austerity both lacks this scope. In overall view, austerity does not really work. For some instances, it must be caused by either driven factors that trigger a sense of proponents that simply is wrong. The most way to address the problem regarding debt is to write-down, coupled with recapitalization of banks that will suffer in a huge amount of loss. This may seem extreme, but it simply recognizes the reality that the existing debt will not be paid back without new flows of official financing. As a result of this catastrophe, somehow the European austerity policies have prevented any recovery from the crisis of 2009, while protecting the banks and financial institutions that created the crisis. In general, the deployment of austerity as economic policy has been effective in bringing peace, prosperity, and sustainable reduction of debt.

Austerity has already been tried and will continue to be tried, at least in the Euro zone, until it will be abandoned. As all ways it does not really work. As repeatedly seen, it makes a debt higher. Debt is always there, and it must be paid off, or forgiven which would surely not happen, and other means such as inflations and defaults are far worst. The ongoing recession and negotiations of maximizing the taxes as part of its resolution is simply the beginning of it. Through taxes and not through austerity, this is the way to deal with the overall debts. Not because austerity is unfair but because there are many debtors with regards to creditors and not because democracy has inflation biases but because of its thought that austerity simply does not work. Overall, the book implies that Austerity is not really working at all.

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