Austerity measures in italy literature review

Parts of the World, European Union

Introduction

Austerity is an economic term used to define fiscal policies of reduced spending achieved through cutting of deficits mainly in public service provision and benefits. These policies are in most cases used by governments in an attempt to reduce the amount of money spent on deficits; in several instances, austerity policies are used together with tax increases. This is done to increase long-term financial solvency for investors. As is the case with other economic policies, the implementation of austerity policies has both supporters and critics. Those who support austerity policies argue that by reducing the government's expenditure, it is possible to alter expectations on government spending and taxation which would consequently lead to increased private consumption. On the contrary, critics argue that austerity policies end up being counter-productive; this is because a reduction in government expenditure lowers the GDP and increases the rate of unemployment (Brancaccio, 2012). Critics also argue that short term spending by the government helps boost GDP especially when the private sector is unwilling to do so.

In early 1993, several European countries formed what is currently known as the European Union (Brancaccio, 2012). The economic significance of this union was vital as it gave the region increased fiscal strength that consequently increased its competitive edge in global markets. Historians identified that this was the first time a majority of European countries had a common currency since the fall of the Roman Empire. However, with time the European Union, commonly referred to as the Euro Zone, failed to achieve its intended objectives. This was chiefly because of economic hardships experienced by several member states which weakened the trading bloc (Brancaccio, 2012). In an attempt to revitalize the European Union, members agreed to implement austerity policies. As a result, there have been increased studies on the effectiveness and limitations of austerity policies in the Euro Zone. To effectively understand the effects of these policies, most studies focus on individual members states as their sample population. Similarly, this research focuses on the success of austerity policies in helping increase Italy’s GDP. It is essential to note that this section of the research will analyze various secondary sources to identifying current theoretical frameworks and also gaps in the knowledge available.

Austerity Policies in the Euro Zone

According to Samuel Brittan, an economic columnist, the key fiscal problem in the Euro Zone is the assumption that what works for one member states, can produce similar positive results for the union (International Economy, 2012). Samuel points out that austerity is not an effective solution for the economic troubles faced by members of the Euro Zone. This is true because, though countries like Germany are benefitting from austerity policies, majority of the member states are burdened by the same policies. It is essential to understand that austerity policies produce positive results in Germany because the country has a significant export surplus. As a result, countries like Greece that lack export surplus cannot achieve economic growth through implementation of austerity policies. Yves Merch who is a former president of the Central Bank in Luxembourg, points out that some of the issues facing the Euro Zone cannot be fixed using conventional economic theories (International Economics, 2012). Merch argues that the key issue that needs to be addressed in the Euro Zone is the mistrust and lack of confidence in each other amongst member states. Based on the argument presented by this argument by Merch, what is urgently needed in the Euro Zone is a restoration of confidence in its ability to improve national economies. It is as a result of this reduced confidence in the economic bloc that some countries such as Britain are considering renouncing their membership in the European Union.

As a result of increasing discontent with austerity policies, it is essential to first trace their implementation in the Euro Zone. The first country in the Euro Zone to adapt austerity policies was Spain in January 2010. The Spanish government outlined a three year plan based on austerity to help grow the country’s economy. This announcement by Spain was closely followed by the bail out of Greece in May 2010; consequently, the country agreed to implement more austerity policies. In July the same year, the Italian finance minister announced the country’s adoption of austerity plan totaling up to € 25 billion (Luttwak, 2012). In November 2010, Ireland agreed to adapt an austerity plan after it was bailed out by the European Union. France and Portugal adopted austerity measures in 2011 (Telegraph Editorial, 2012). France’s decision to adopt the policies was independently made while Portugal’s decision was as a result of the bail out the country received from the European Union. At this point, it is essential to understand that the requirement for countries like Greece and Ireland to adapt austerity policies after being bailed out was considered a regulatory strategy by the European Union to boost their national economies. However, as is evident at present, this strategy did not end up achieving the desired objectives. For example, Greece is currently facing its worst recession and highest inflation rates, and this is after the implementation of the austerity policies (Jolly & David, 2012).

The ongoing cuts in government expenditure in the Euro Zone have been implemented with very high costs. This is because there have been unprecedented attacks on the Euro Zone's welfare. For example, reduction in government expenditure has led to retrenchment of several public officers, reduced education budgets, and reduced spending on health care (Jolly & David, 2012). As a result, residents of the Euro Zone member states are faced with harsh economic conditions such as reduced income and low quality public services. This has consequently led to unrest in various countries as citizens of member states feel that they are being forced to carry the burden of other failed national economies. These increased protests across countries such as Spain, Portugal, Ireland and Britain raise the question on how effective austerity measures are for members of the Euro Zone. Most protesters argue that austerity is a conspiracy to enrich major corporations at the expense of the masses (Brancaccio, 2012). As a result, several scholars have shown that the growing opposition to austerity in Euro Zone countries is an indicator that the policies have a negative impact on national economies.

Key Economists Arguments on Austerity

According the Keynesian theory in economics, the right time to initiate austerity policies is when an economy has reached its lowest ever and not just when a downward trend is noted. The Keynesian's argument in this case is based on the knowledge that there are other more beneficial policies to revive an economy other than austerity (McKee, Karanikolos, Belcher & Stuckler, 2012, p. 346). It is essential to understand that budget deficits help increase the employment rate during a recession and hence should not be reduced. Paul Krugman's economic arguments are perhaps the best summary in the austerity debate; the economist points out that in a national economy, what one person spends is what another gets as income (Editorial, 2010). Consequently, if the expenditure is reduced, it reduces the income. As a result, austerity policies end up being counter-productive as it accentuates economic problems such as unemployment and inflation (Minder & Jolly, 2012).

Most modern economists feel that the insistence on using austerity policies even after they have been proven as ineffective is more out of pride than verifiable economic data. This is because there is clear evidence on why Euro Zone countries should not adapt austerity policies, yet most governments still insist on using it.

Effects of Austerity Policies in Italy

Italy adopted austerity policies in November 2010 after Prime Minister Monti came into power. These policies were mainly meant to cushion the government from the country's increasing sovereign debt (Pribac, 2011). The prime minister assumed that the policies would foster economic growth since other European countries such as Greece were adopting them. However, the adoption of these policies only led to reduced investor confidence in the Italian government which in addition to reduced government spending led to a slump in the GDP (Pribac, 2011). Reports indicate that the then Italian government assumed that by taking responsibility for debts incurred by banks and other national corporations, it would increase confidence in Italy as an investment destination (Editorial, 2010). However, this move worked to the detriment of the country's economy. This is because most investors felt that the government was making risky economic decisions at the expense of the public, which would result in public resentment of foreign investors (Neri & Maino, 2012).

In October 2012, trade unions and student movements organized mass protests in Rome against Prime Minister Monti's decision to adopt austerity policy. Though the prime minister aimed at increasing the GDP when he adopted the policies, the more than 150, 000 protesters noted that the policies had increased the economic hardships (Neri & Maino, 2012). As a result of the policies, a greater percentage of students clearing college could not secure employment opportunities. Also, the level of education in the country had significantly reduced due to under-funding by the central government (Luttwak, 2012). Contrary to most economic theories, the Italian government failed to recognize that the most appropriate way out of a recession is by economically empowering the public. Such empowerment is best achieved through education, improved living standards and a better health care system. In contrast, the Italian government weakened its people by denying them quality education and health services. Consequently, instead of the GDP increasing after implementation of austerity policies, it continued its downward trend.

It is necessary to note that countries such as the United States and emerging economic giants in the East are adopting Keynesian economics which call for alternate policies other than austerity to revive the economy (McKee, Karanikolos, Belcher & Stuckler, 2012, p. 346). Based on these countries' economic success, Italy should denounce austerity measures and push to increase government spending. The prime minister and his cabinet should also focus on other alternate ways of growing the GDP. For example, the government can implement quantitative easing which would increase the volume of money supply. As a result, the Italian population would have an increased income which would then increase their expenditure. As Paul Krugman pointed out, the most appropriate strategy to fight a recession is to ensure people spend more and the most effective way to ensure people spend more is to increase their income.

In his defense, the Italian Prime Minister argues that austerity policies implemented in his country have helped foster the survival of the Euro Zone. According to the prime minister, if Italy had not implemented these measures, it would have been forced to leave the European Union which in turn would to disintegration of the monetary bloc (Rowley, 2012). However, the prime minister's argument falls short of his key responsibility as Italy's leader. Prime Minister Monti makes a case for using austerity policies to strengthen the Euro Zone economy but completely ignores his country's economic prosperity. Studies show that this ignorance also seen in other Euro Zone leaders comes from the assumption that strengthening the Euro Currency would strengthen national economies (Bansal & Bradbury, 2012, p. 4). However, as pointed in the introduction of this chapter, what works for a group of countries does not always work for individual nations. Also, economists point out that the most appropriate way to grow the Euro Zone's economy is by strengthening national GDP's (Rowley, 2012). The goodwill of the public and private sector in supporting economic policies is also vital for the latter’s success; however, the current austerity measures in Italy lack the support of these two vital sectors.

Conclusion

The current austerity policies implemented in Italy and other countries in the Euro Zone have aggravated the economic depression in Europe. This has significantly minimized the capability of the Italian government to provide welfare services to its citizens. The literature reviewed show that the negative effects of Italy’s austerity policy outweigh its positive impacts. However, there lacks specific studies which show any positive gains achieved through the implementation of the policies. As a result, this research will ensure it identifies which group of people is benefiting from the austerity measures in Italy.

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