

January 23, 2013 10:40 pm

Wrong kind of austerity was better than none at all

From Profs Alberto Alesina and Francesco Giavazzi.

Sir, “My best guess is that history will accord [Mario Monti] a role similar to that played by Heinrich Brüning, Germany’s chancellor from 1930 to 1932. He, too, was part of a prevailing establishment consensus that there was no alternative to austerity,” writes Wolfgang Münchau (Comment, January 21). We disagree.

Let’s keep some perspective. The alternative to a reduction of the budget deficit would not have been – in Italy like in other euro area countries – more growth, but even higher interest rates, possibly a restructuring of the debt and even weaker bank balance sheets – in other words, a return to the conditions prevailing in the winter of 2008. This being said, there are different ways to implement fiscal austerity.

The empirical evidence – assuming someone still cares – shows that spending cuts, accompanied by labour and product market liberalisations, are much less costly than tax hikes, in some cases implying no cost at all. Mr Monti – our former colleague at Bocconi University – should have pursued fiscal austerity differently: cutting spending, rather than just raising taxes. But to say that he should have done nothing – maybe even raise spending a bit – when Italian interest rates were 600 basis points higher than German rates, borders on the irresponsible. And we are surprised that the FT would agree to publish such a view.

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