

# Unmasking Austerity

LESSONS FOR AUSTRALIA

Dexter Whitfield  
August 2013

Report prepared for Don Dunstan Foundation and Public Service Association of SA

WISeR  
Informing Decisions





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Don Dunstan Foundation and Public Service Association of SA

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*WISeR also specialises in socio-economic impact assessment including the distributional impacts and human dimensions of change on different population groups and localities. Our research plays a key role in informing policy and strategy development at a national, local and international level.*

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## KEY FINDINGS AT A GLANCE

- Austerity was intended to rapidly reduce public debt by a combination of cutting public spending, reducing or freezing labour costs, tax increases and privatisation alongside reconfiguring public services and the welfare state. These measures would in turn allow the private sector to generate economic growth.

### **Austerity has failed because:**

- Government debt has continued to increase.
- Reduced demand in economies has intensified the recession and the theory of 'growth friendly' fiscal consolidation has been discredited.
- Negative or weak economic growth has prevailed and the private sector has failed to fill the gap in investment created by significant reductions in public sector expenditure.
- With trading partners also in recession export led growth has been stunted.

### **The economic and social effects of austerity:**

- Soaring economic costs – the loss of output, reduced wealth, unemployment and government intervention and support runs into trillions of dollars in the US alone.
- 5.5 million young people are unemployed in the European Union alone.
- 2.2m public sector job losses have followed deep cuts in public spending in the UK, US and Spain alone.
- Cuts in wages, benefits and pensions have reduced take-home earnings by up to 20%.
- Closures and business failures have increased in parallel with austerity.
- The financial crisis led to the bankruptcy of several US towns and cities.
- The house price slump resulted in large-scale foreclosures, mortgage arrears and between 10%-31% of mortgages in negative equity in the UK, US, Spain and Ireland in 2012-2013
- Health services have suffered closures and patients face increased charges and longer waiting times.
- Austerity has increased poverty and widened inequality and public spending cuts increased inequalities between regions.
- Bailouts have protected bank bondholders, except in Iceland, in a gigantic wealth transfer from taxpayers to the corporate sector and wealthy individuals.
- Meanwhile corporate profits have risen, share price highs achieved in 2013 and cash hoarding by large US corporations has mushroomed.
- Public services and the welfare state are being reconfigured to embed marketisation and privatisation in parallel with austerity.
- Despite public spending cuts governments are widening corporate welfare through financial aid to the private sector, deregulating markets and increasing the role of business in public policy making.
- The idea that governments have no option but to adopt austerity policies is incorrect. Not only was the scale of austerity unnecessary, it was unjust and based on flawed economic theory.





# 1 THE SWITCH FROM STIMULUS TO AUSTERITY

Austerity was intended to rapidly reduce public debt by a combination of cutting public spending, reducing or freezing labour costs, tax increases and privatisation alongside reconfiguring public services and the welfare state. These measures would in turn allow the private sector to generate economic growth.

Systemic banking crises occurred in seventeen countries between 2007 and 2011, five of which were outside of the European Union and North America according to an IMF banking crisis database. Fifteen countries nationalised bank assets. A further eight countries, including Russia and Switzerland, were borderline – i.e. almost met the systemic criteria (Laeven and Valencia, 2012).

The bailout of banks and the collapse of revenue following housing and property crashes led to plummeting house prices and foreclosures in several countries. ‘Bad banks’ were established to manage the assets of failed banks by governments in the UK, Germany, Ireland, Spain and several other European countries.

Bailouts were needed in Ireland, Iceland, Portugal, Spain, Greece and Cyprus. Bailout terms and timetables were set by the troika of the International Monetary Fund (IMF), European Union and the European Central Bank.

The initial response to the crisis was essentially Keynesian with stimulus strategies, although many were considered inadequate. For example, almost 40% of the US\$787bn American Recovery and Reinvestment Act programme was tax cuts that “...were probably only half or less as effective in stimulating demand as actual increases in government spending” (Krugman, 2012a).

However, the deficit hawks took control in 2010 when austerity policies became the core policy. In the run up to the G20 Toronto meeting the German government and the European Central Bank lobbied extensively for fiscal consolidation winning over the UK and Canada and leaving the US isolated (Blyth, 2013a). The G-20 Declaration duly stated “...‘growth friendly’ fiscal consolidation plans in advanced countries and that will be implemented going forward” (G-20, 2010).

This is the first of three papers that will examine austerity strategies in Europe and the US and assess their impact. Subsequent briefings will examine the importance of alternative policies to reconstruct the economy and the public sector.

## 1.1 CAUSE OF THE FINANCIAL CRISIS

There were three main causes of the financial crisis.

Firstly, it was caused by *the failure of markets and deregulation*. It was a private sector failure, not a sovereign debt crisis caused by excessive government spending. Deregulation in general and specifically the failure to regulate, monitor and review financial markets was a key factor. Unregulated markets are not efficient, stable or self-correcting. Neither do they produce socially and environmentally acceptable outcomes. The economic and financial models that focused on the threat of external shocks “...simply misled us – the majority of the really big shocks come from within the economy” (Stiglitz, 2013).

Secondly, *financialisation and a private credit-led speculative boom* ultimately led to the collapse of housing markets in the US, Spain, Ireland and Iceland. Securitisation, the slicing and dicing of packages of mortgages and other loans, created asset-backed securities for sale to other investors. Computer models predicted low risks, although the separation of credit decisions from debt management was inevitably high risk. It “...revealed an actual world of hyper-leveraged excessive lending, over-borrowing and

*wilful risk blindness*” (Blyth 2013a). The financial sector offered much higher profits than could be obtained through productive investment and led to the growing power of finance capital in the economy (Callinicos, 2012).

Thirdly, *neoliberal ideology and values* such as free trade, competition, debt-driven consumerism, tax cuts for the wealthy, deregulation and privatisation underpinned economic policies and attitudes. Democratic accountability and transparency were expendable whilst profiteering and exploitation were considered ‘business as usual’.

The origins of the financial crisis lie in “...*the intensification of the drive for shareholder value, which set high profitability thresholds for investment and exerted intense pressure on labour, delinking productivity and wage increases. With median wage growth depressed, and growing inequalities in wealth and incomes, the dynamic demand required by the shareholder-value agenda was provided by the expansion of credit, supported by low interest-rate policies; debt-based household spending allowed consumption to grow at a faster rate than incomes and wages*” (Aglietta, 2012).

## 2 WHY AUSTRITY FAILED

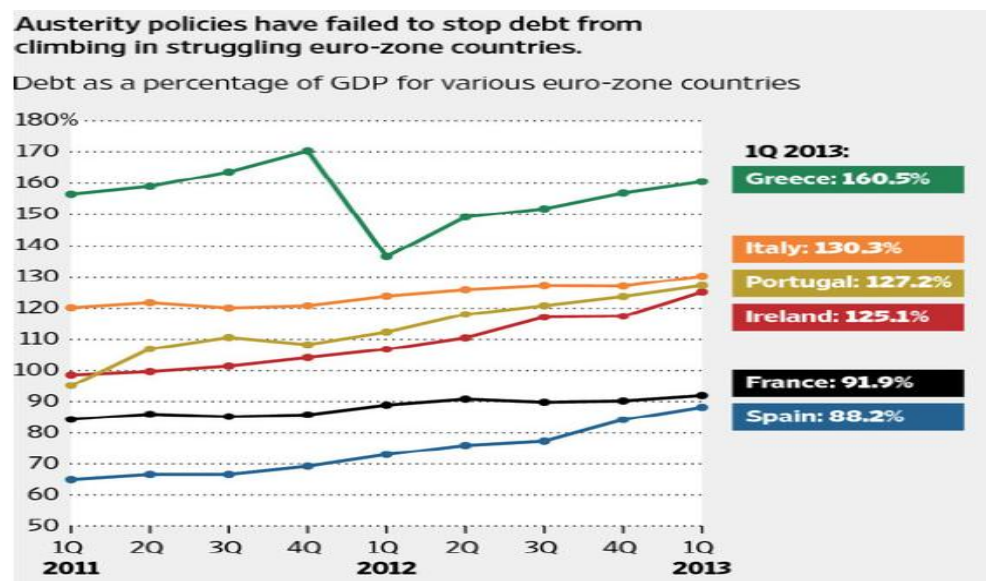
### 2.1 GOVERNMENT DEBT CONTINUED TO INCREASE

Public debt as a percentage of Gross Domestic Product (GDP) continued to increase in Spain, France, Ireland, Portugal, Italy and Greece between 2011-2013 (see Figure 1), the UK and US likewise, with a very small decline in Germany in the first quarter this year.

When pre-financial crisis debt ratios are taken into account, the increase is even more substantial. Ireland’s debt to GDP ratio increased from 24.8% in 2007 to 125.1% in 2013; Portugal’s increased from 62.0% in 2006 to 127.2% and Greece’s rose from 106% in 2007 to 160.5% in 2013. The ratio rose in both the euro area (from 88.2% to 92.2%) and in the 27-country European Union from 83.3% to 85.9% (Eurostat, 2013a).

Public debt as a percentage of GDP increased in Australia between 2007-2012 from 14.6% to 32.4% but it remains the third lowest of the thirty-four Organisation for Economic Co-operation and Development countries (OECD, 2013a). Canada is in a similar position with 32.9% debt/GDP ratio but both federal and provincial governments have adopted austerity policies. “*Austerity has slowed the recovery instead of encouraging it*” (Canadian Center for Policy Alternatives, 2013). Ontario inflated debt projections that were “...*based on misleading assumptions and were deliberately intended to stoke an austerity agenda of service cuts and wage freezes*” (Hennessy and Stanford, 2013).

FIGURE 1: PUBLIC DEBT AS A PERCENTAGE OF GDP



Source: Eurostat and Wall Street Journal

The frequently cited Reinhart-Rogoff paper (Growth in a Time of Debt) claimed that economies “fall off a cliff when government debt exceeded 90% of GDP. Herndon et al (2013) recalibrated the Reinhart-Rogoff model and concluded “...average GDP growth at public debt/GDP ratios over 90 percent is not dramatically different than when debt/GDP ratios are lower”. The “...revelation that the supposed 90 percent threshold was an artifact of programming mistakes, data omissions, and peculiar statistical techniques suddenly made a remarkable number of prominent people look foolish” (Krugman, 2013a).

## 2.2 LESS DEMAND IN THE ECONOMY

Austerity increased unemployment, drove down wages, reduced and/or made welfare benefits more restrictive and cut government spending. In addition, households increased saving to pay off mortgage and consumer debt. Austerity agreements brokered by the IMF, EU and ECB included public spending cuts, tax increases, wage and pension cuts, public sector reform and privatisation. The scale of these measures was wide-ranging and draconian. Ireland’s agreements in 2009 and 2011 were equivalent to 15.2% of take-home household income (all income, minus direct taxation and social insurance payments). The 2011 Greece austerity package alone represented 13.7% of take-home household income (Financial Times, 2011).

Advocates of ‘expansive austerity’, such as Alessina and Ardagna, claimed that cutting public spending would lead to higher output, precisely the opposite of the Keynesian proposition that cutting spending in a weak economy would weaken the economy and trigger stagnation. Their work was influential in promoting the austerity strategy in the European Central Bank and other European institutions and has now been thoroughly discredited (Blyth, 2013b, Krugman, 2013a, 2013b, Quiggin, 2012).

*Just as zombies are grim and distorted versions of their living selves, so the ideology of expansive austerity is a grim and menacing version of the ideology of market liberalism (Quiggin, 2012).*

Forecasts for economic growth in the post-austerity period were systematically overstated by the IMF (and by the European Commission and the Organisation for Economic Cooperation and Development) (IMF, 2012). The IMF originally claimed that ‘fiscal consolidation’, mainly public spending cuts, would have a relatively minor impact on economic growth. A fiscal multiplier of 0.5 was commonly used in austerity packages,

but this did not fully take account of the economic and financial conditions in a recession. This 'justified' austerity measures, but dragged economies further into recession and stunted economic growth.

In this case, the selection of a low multiplier minimised the effect of austerity on economic growth. The same organisations have consistently overstated the economic and employment impacts of development and infrastructure projects and accepted at face value consultants exaggerated traffic and toll forecasts for PPPs.

The IMF's World Economic Outlook 2012 conceded that "...the multipliers have actually been in the 0.9 to 1.7 range since the Great Recession" (IMF, 2012). In other words, "...the gap between reality and forecast is thus extremely large. The negative effects on economic growth have been three times as great as forecast by the IMF, EU or OECD" (Hall, 2013).

*Reducing public expenditures during a recession, in contrast, can be expected to increase the national debt as increasing unemployment and falling incomes lower tax revenues and increase social welfare payments (King et al, 2012).*

IMF researchers Blanchard and Leigh (2013) concluded that multipliers were significantly above 1 in the early years of the crisis. Auerbach and Gorodnichenko (2011) found fiscal multipliers of about 2.5 in a recession, and Batini et al (2012) revealed two-year cumulative multipliers of 2.49 for public spending cuts compared to 0.35 for tax increases in the Euro Area and 2.17 and 0.65 multipliers in the US.

*...when account is taken of the magnified impact of consolidation in a depressed economy, and of the spillover effects of coordinated fiscal consolidation across almost all EU countries, fiscal multipliers will be considerably larger than in normal times, and the impact on growth correspondingly larger. ....the policies pursued by EU countries over the recent past have had perverse and damaging effects (Holland and Portes, 2012).*

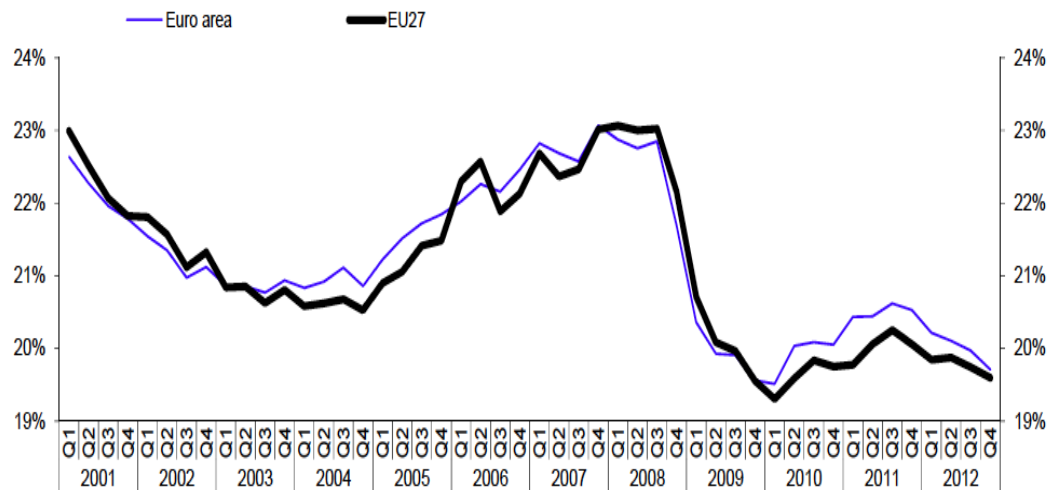
Public spending cuts accounted for 75% of austerity measures in the UK between 2010-11 and 2014-15.

### 2.3 NEGATIVE OR WEAK GROWTH

A stream of business closures and bankruptcies, bank restricted access to credit, reduced economic demand, coupled with drastic cuts in state and local government spending had a negative impact in regional and local economies. This led to a low level of business confidence and reluctance to invest.

The business investment rate fell to 19.7% in the Euro area and to 19.6% in the European Union 27 countries in the third quarter of 2012, significantly below the 2008 rate (see Figure 2) (Eurostat, 2013b).

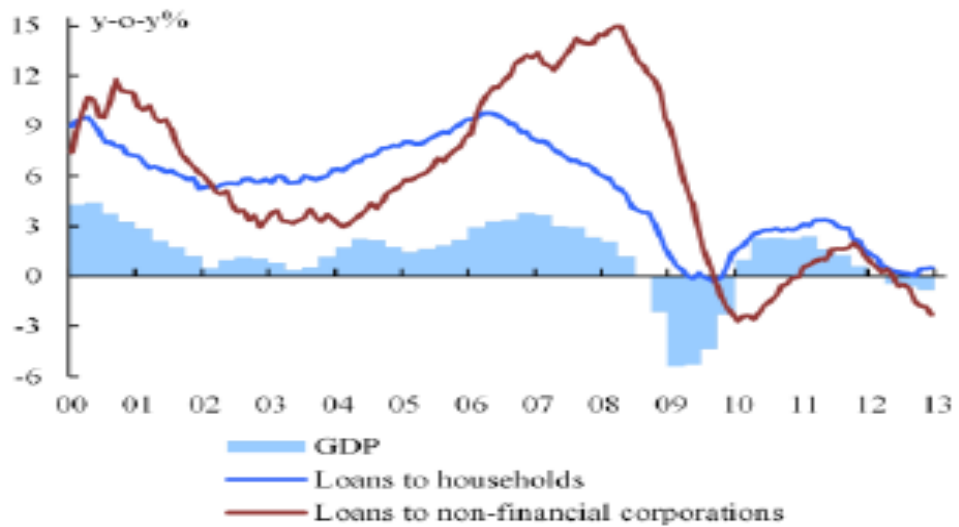
**FIGURE 2: INVESTMENT RATE OF NON-FINANCIAL CORPORATIONS IN EUROPE (SEASONALLY ADJUSTED)**



Source: Eurostat 2013

Bank lending to non-financial corporations in the Euro Area plummeted in 2008-09, has a temporary recovery in 2011-12 only to fall again (see Figure 3).

**FIGURE 3: BANK LENDING TO HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS, EURO AREA**



Source: European Commission 2013

The Euro Area GDP growth rate since 2010 reached 1%, but has since hovered just above or below zero between last quarter 2011 and the first quarter 2013.

Gross Domestic Product fell sharply in the Euro area, US and Japan in the financial crisis and was above zero after 2010 except the Euro Area reverted to negative in 2012 (see Figure 4).

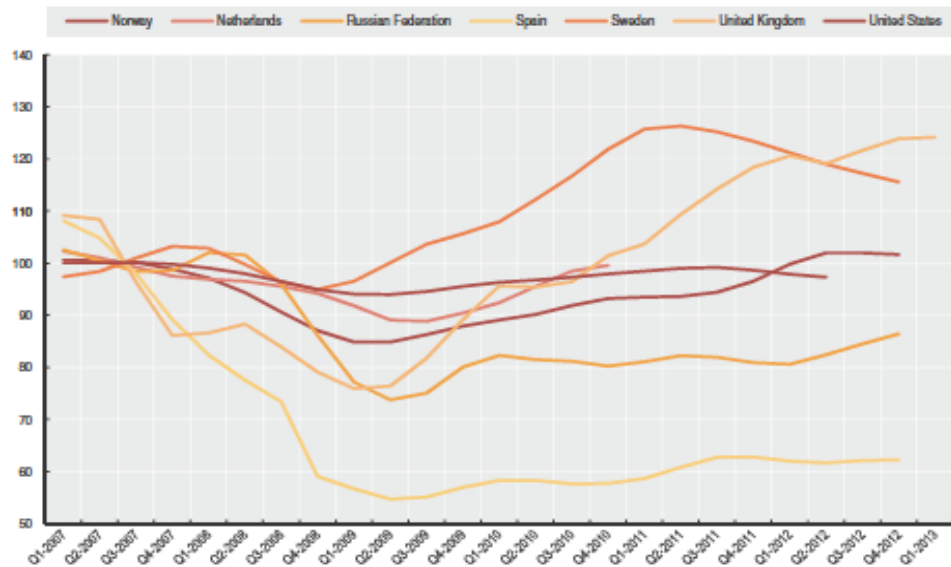
**FIGURE 4: GDP GROWTH RATE EURO AREA, US AND JAPAN 2000-2012 (ANNUAL % CHANGES, QUARTERLY DATA)**



Source: European Central Bank Monthly Bulletin, 07/2013

Business start-up rates remain below pre-crisis levels, particularly in the Euro area according to July 2013 OECD data (see Figure 5). Australia and the UK show ‘tentative signs of a pick-up in start-ups, but this is driven by sole-proprietor self-employed businesses.

**FIGURE 5: NEW ENTERPRISE CREATION 2007-2013**



Source: OECD 2013

Start-up rates are particularly low in Spain (OECD, 2013b). Business failures and bankruptcies are below the high rates reached in 2009-10, although rates in Denmark and the Netherlands increased in 2012 (ibid).

The IMF’s analysis of the UK economy is for “weak growth” and it is “...still a long way from a strong and sustainable recovery. Notwithstanding the recent uptick in activity, per capita income remains 6 percent below its pre-crisis peak, making this the weakest

*recovery in recent history. Of particular concern is that capital investment (as a share of GDP) is at a postwar low, and that youth unemployment is high” (IMF, 2013a).*

Public spending cuts have reduced capital spending, particularly infrastructure investment, both direct investment and Public Private Partnerships (PPPs). Many countries have developed national infrastructure plans, but have lagged in project delivery. The global volume of project finance lending fell from US\$159bn in 2011 to US\$99bn in 2012 (Financial Times, 2013a).

Although the financial crisis led to a slowdown in PPPs, particularly in the UK, austerity conditions led to an increase in governments approving PPP legislation and establishing central PPP units designed to ramp up the flow of contracts.

## 2.4 CONNECTED ECONOMIES

Reduced economic growth in one country usually has a negative impact on growth in their trading partners, particularly if they too are also imposing austerity and seeking export-led growth. This is particularly the case in Europe where export-led strategies have been hampered by recession in the target countries. The Australian economy is affected by the economic performance of its main trading partners such as China, Japan and US.

Ireland, for example, has adopted an export-led growth strategy. A recent IMF Working Paper concluded the *“...decline in domestic costs registered since the crisis, together with the associated boost to inward FDI (foreign direct investment), suggests that even with the tepid external demand currently projected for the medium-term, Ireland can still register moderate exports growth and a boost to GDP and fiscal revenue”* (Nkusu, 2013). The study stressed that trading partners’ demand is an important driver of exports and also the single most important driver of Ireland’s GDP and revenue performance. It did not take account of *“...high household debt, high unemployment, and bank fragility”* and assumed that *“...public spending is kept in check”* (ibid). Ireland’s exports are highly complicated by the presence of transnational pharmaceutical and IT companies and its low corporate tax regime.

A Central Bank of Ireland study reported *“...the vast majority of indigenous employment (which makes up 78 per cent of private sector employment) is still accounted for by traditional sectors such as Hotels & Restaurants, Wholesale & Retail, Business & Administrative services and Transport & Storage”* (Lawless et al, 2012). They stressed the importance of the domestic-demand driven services economy in job creation strategies.

## 3 THE ECONOMIC AND SOCIAL EFFECTS OF AUSTERITY

This is no short-term crisis. After five years of austerity policies every small sign of ‘growth or ‘recovery’ has exaggerated significance. Yet most governments, particularly the bailout countries, Ireland, Portugal, Spain, Greece and Cyprus, plan further public spending cuts, labour market ‘reform’ and tax increases for at least the next five years. For example, unemployment in Spain is forecast to fall to 25.3% by 2018, only a marginal change from the current rate of 27.2% (IMF, 2013b).

### 3.1 SOARING ECONOMIC COSTS

The full cost of the financial crisis runs into trillions in any currency. It is important to distinguish between the overall cost of the financial crisis and the cost of individual bailouts in which the state may make a ‘profit’ at privatisation.

Lost output, measured as lost Gross Domestic Product (GDP), can range from 19% of pre-crisis GDP to 158% depending on whether the possibility of permanent effects are taken into account (Basel Committee on Banking Supervision, 2010).



Atkinson et al (2013) assess the US loss of output between US\$6 to US\$14 trillion plus the cost of reduced wealth (US\$15-30 trillion), the cost of unemployment, lost opportunity and public trust (up to US\$14 trillion) and the cost of government intervention and support (US\$12-13 trillion). US households lost about US\$9.1 trillion (in constant 2011 dollars) in the value of home equity between 2005-2011 (Government Accountability Office, 2013). The full social and human impact will probably never be known.

The fiscal costs of the financial crisis in the Euro Area and US between 2007 and 2011 were broadly comparable. The loss of output, increased debt, monetary expansion and fiscal costs were 55.1% and 67.0% respectively of GDP. However, the Euro Area had a significantly higher provision of liquidity support as a percentage of deposits and foreign liabilities (Laeven and Valencia, 2012).

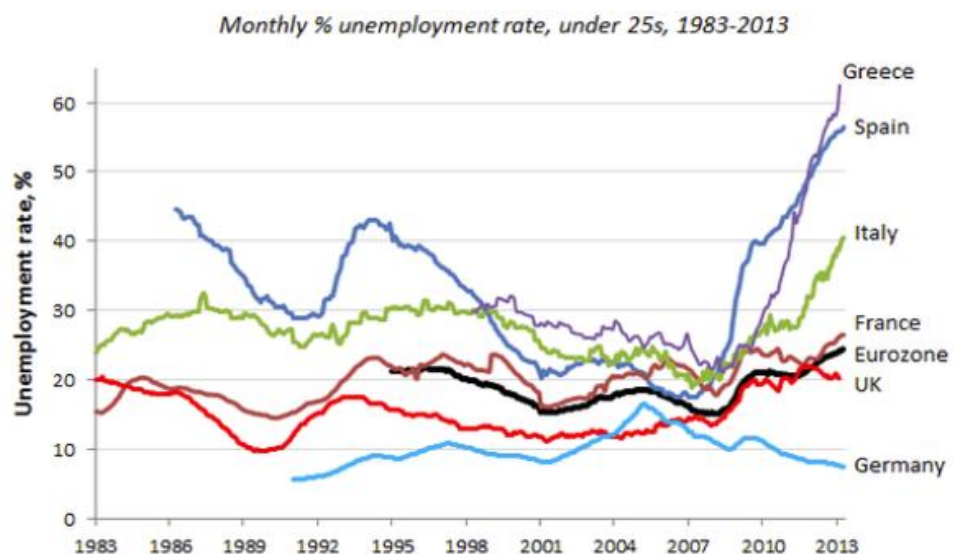
The resale of shares, repayment of loans, fees from guarantees and other financial mechanisms may result in governments achieving a profit for individual programmes, for example, the US Federal Reserve Bank gained US\$17.7bn from loans to and asset purchases from the American Insurance Group. The net cost of the US Troubled Asset Relief Program has fallen to US\$23bn compared to the US\$419bn spent in bailing out companies since 2008.

The European Central Bank could eventually break even or make a surplus on the €276bn (A\$408bn) of assets it acquired between 2009 and 2012. Similarly the UK government must sell its stake holding in RBS and Lloyds banks for at least £34bn (A\$58.8bn) just to cover the total cash injected into the banks and the cost of financing the purchase of shares (National Audit Office, 2013). However, any gains are a drop in the ocean compared to the financial, economic and human cost of the crisis.

### 3.2 RISING UNEMPLOYMENT

Unemployment climbed to 26.9% and 26.8% in Spain and Greece respectively in May 2013 compared with the European average of 11%. Germany's rate was 5.3%, compared to the UK (7.7%) and US (7.6%). There were 5.5m young people (under 25) unemployed in the European Union. Youth unemployment continues to rise in the bailout countries led by Greece (59.2%), Spain (56.5%), Portugal (42.1%) and Ireland (26.3%) (see Figure 6) (Eurostat, 2013c).

FIGURE 6: EUROPEAN YOUTH UNEMPLOYMENT



Source: Eurostat and [www.theatlantic.com](http://www.theatlantic.com)



### 3.3 PUBLIC SECTOR JOB LOSSES

2.2m public sector jobs will be lost in just three countries: the UK (1.1m by 2018 - Office for Budget Responsibility, 2012), the US (737,000 between 2009-2013 – Economic Policy Unit, 2013) and Spain (375,000 between 2011-2013 – Government of Spain, 2013). Over 30,000 public sector jobs were lost in Ireland between 2009 and the first quarter 2013 (see Figure 7). The public sector in Greece is required to lose 150,000 public sector jobs by 2015. Portugal plans to cut 15,000 by the end of 2014 and Canada will cut nearly 30,000 federal jobs. In addition, recruitment embargos, temporary and zero hour contracts have increased.

FIGURE 7: PUBLIC SECTOR JOB LOSSES: IRELAND



Source: Central Statistical Office Ireland

### 3.4 CUTS IN WAGES AND BENEFITS

Austerity policies have significantly reduced take-home earnings by between 5% and 20% in most European countries since 2008. They include pay cuts, reducing the starting pay of new workers, pay freezes, the withdrawal or reduction in allowances, bonuses and overtime payments (European Public Services Union, 2010).

Ireland imposed a pension levy equivalent to an average 7.5% of pay, changed pension arrangements for new starters from 2010 by raising the minimum retirement age from 65 to 66 and based pension payments on career average earnings rather than final salary (European Public Services Union, 2010). Other countries imposed similar measures.

The average funded ratio of US state pension funds fell from just over 80% in 2008 to 72.9% in 2011 as investment losses became evident in the actuarial value of assets. However, "most states have sufficient assets in their pension trusts to fund payments over the near to medium term and in many cases, long term" (Standard & Poor's, 2013).

Seventy seven per cent of the 598,000 net rise in new jobs in the UK since June 2010 are in low paid industries such as retail, catering and residential care with an average hourly wage of £7.95 (A\$13.75) – the 25 percentile of average hourly earnings (TUC, 2013). There is growing public and private use of zero hour contracts that provide no guarantee of regular work and stability of income, sick pay or holidays. Austerity and marketisation of home care services has meant 97% of local authorities use homecare contracts that don't guarantee care providers any work from one week to the next. They in turn employ already low paid care workers on zero hour contracts, leading to worse services for the elderly (UNISON, 2013a).

### 3.5 CLOSURES AND BUSINESS FAILURES

Corporate insolvencies in Western Europe (EU15 plus Switzerland and Norway) increased by a third between 2007 and 2011. Insolvencies continued to increase between 2010-2011 in the countries that had adopted austerity policies (Greece 27.3% increase, Spain 18.7%, Portugal 17.1%, Italy 16.9%, Ireland 7.0% and UK 6.3%) whereas they decreased in Sweden, Denmark, Germany, Austria and three other countries (Creditreform Economic Research, 2012).

UK retail business failures of medium and large companies soared to 54 in 2008, declined in 2010 only to increase again between 2011 and the first half of 2013. A second economic downturn led to weak retail sales and *"...the exiting of many companies that could survive a year or so of recession but not four years or low profits or losses. So far, 2013 looks to be even worse"* (Centre for Retail Research, 2013).

### 3.6 FINANCIAL CRISIS OF TOWNS AND CITIES

US ultra conservative political groups, think tanks and corporate interests have used austerity to impose more stringent fiscal discipline on states and cities (Peck, 2013). The American Legislative Exchange Council (ALEC) has widely promoted model privatisation legislation, tax cuts and drastic public spending and pension cuts.

Detroit filed for bankruptcy in 2013 with \$US18.5bn debt and was preceded by Stockton, California (US\$26m) and Jefferson County, Alabama (US\$4bn) (Governing, 2013). Five other cities and towns had filed for bankruptcy since 2010, although three were dismissed. Another 28 utilities, water districts, hospital authorities and other municipal bodies had gone bankrupt in the same period. Counter to media claims, the crisis in Detroit and several other cities was not caused by costly pension schemes. *"Detroit pays a relatively modest median pension" and "...well funded @ 82% in 2011 (and at 99% for its police and fire retirement system)"* (Long, 2013).

Bankruptcy and financial crisis has meant renegotiation of employment contracts, drastic cuts in services, reduction of pension fund obligations for current workers, outsourcing and sale of assets threatening the stability of the US\$3.7 trillion municipal bond market.

The longer-term financial squeeze on US cities led to wide use of Tax Increment Financing for development (future increases in the tax base are used to finance current investment), long-term leasing of existing infrastructure assets, such as toll roads and parking garages and meters, and economic development subsidies to retain or attract corporations.

European cities have traditionally relied on public/private borrowing and government transfers or grants than on bonds. UK local government spending cuts have forced the closure of libraries, children's centres, art and cultural facilities and restricted opening hours of others. The London Borough of Barnet is set to become the 'model neoliberal authority' through mass outsourcing (European Services Strategy Unit, 2012).

### 3.7 FORECLOSURES AND HOUSE PRICE SLUMP

The year-on-year changes in European house prices illustrate the dramatic falls in Ireland and Spain (see Table 1) (Standard & Poor's, 2013). Mortgage arrears continue to rise in Ireland – 12.3% (95,554) of residential mortgages were in arrears over 90 days at the end of March 2013. In addition, one in five mortgages for buy-to-let properties was in arrears over 90 days at the same date (Central Bank of Ireland, 2013). Irish mortgage arrears are expected to increase beyond the current 16.5% by value – about a third of distressed borrowers not in employment. The ratio of mortgage repayments to income is over 60% for a quarter of distressed borrowers, *"...so even debt write-downs may not be sufficient for a large cohort of borrowers"* (Davy Research, 2013).

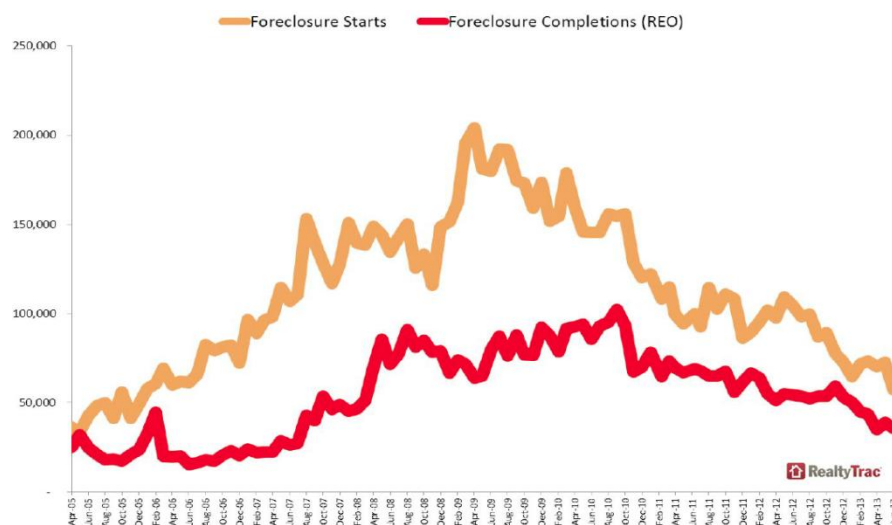
TABLE 1: CHANGES IN EUROPEAN HOUSE PRICES

European Nominal House Prices % Change Year On Year						
	2009	2010	2011	2012	2013 (f)	2014(f)
Belgium	1.1	5.8	2.0	1.4	0.5	1.5
France	(4.2)	7.7	3.7	(1.9)	(4.0)	(4.0)
Germany	1.5	2.9	6.8	3.6	3.0	3.0
Ireland	(19.1)	(11.0)	(15.8)	(6.1)	(0.9)	0.0
Italy	(3.4)	(1.4)	(2.8)	(4.6)	(3.0)	(1.0)
Netherlands	(5.0)	(1.0)	(3.4)	(7.3)	(5.5)	(1.0)
Portugal	(0.6)	1.6	(0.9)	(2.7)	(3.5)	(0.5)
Spain	(6.6)	(3.3)	(7.1)	(10.5)	(8.0)	(5.0)
UK	0.3	3.8	(0.5)	2.3	2.5	2.0

Source: Standard & Poor's 2013 (f – forecast)

The *monthly* rate of US home foreclosures soared to over 200,000 per month in 2009 (see Figure 8). There were 801,359 properties with default notices, scheduled auctions and bank repossessions in the first half of 2013, a 19% decrease on the previous six months. However, bank repossessions have risen in several states including Maryland, New York and Washington (RealtyTrac, 2013). In Ireland 31% of mortgages are in negative equity (Kennedy and McInhoe, 2012), 24% in Spain (Moody's, 2012), 21.5% in the US (PropertyWire, 2013) and 10% in the UK (Council of Mortgage Lenders, 2012). The UK figure masks wide regional variations with 35% in Northern Ireland and 14% in the North compared to 5% in the South East.

FIGURE 8: US FORECLOSURES APRIL 2005 TO JUNE 2013



Source: RealtyTrac, 2013

### 3.8 DAMAGE TO HEALTH

Many European countries have reduced per capita spending on healthcare. Health systems have suffered closures, increases in a wide range of patient charges and longer waiting times (WHO, 2013). Spain shifted health coverage from a universal to employment based system in 2012 (Karanikolos et al, 2013).

Recession has led to increased suicide rates in Europe and the US (Stuckler and Basu, 2013). A long-term decline in infant mortality has reversed in Greece since 2008, with two consecutive years of increases. The number of stillbirths increased 32% since 2008 (WHO, 2013). A major upsurge in HIV infections among intravenous drug users coincided with a large reduction in funding for needle exchange programmes.

Stuckler and Baus (2013) conclude not only did “...the IMF underestimate austerity’s economic harms, but it overlooked the even greater damage that resulted from cutting public health. Health and education had the largest fiscal multipliers, typically greater than 3.”

### 3.9 POVERTY AND WIDENING INEQUALITY

Income from work and capital fell considerably in most OECD countries between 2007 and 2010, although welfare state benefits and lower income taxes (the automatic stabilisers) reduced the level of inequality. However, the richest 10% of the population did better than the poorest 10% in 21 countries (OECD, 2013c).

The OECD study covers the period up to 2010 *before* austerity measures began in earnest. *If sluggish growth persists and fiscal consolidation measures are implemented, the ability of the tax-benefit system to alleviate the high (and potentially increasing) levels of inequality and poverty of income from work and capital might be challenged* (ibid).

A UN Department of Social Affairs study examined fiscal consolidation measures for a sample of 17 OECD countries over the period 1978-2009. “...fiscal consolidation episodes have typically led to a significant and long-lasting increase in inequality” (Ball et al, 2013).

*Across Europe the effect of the crisis on young people has been severe. While some of the overall effects have not been so great in the UK as in, say, Southern Europe, the way in which young adults have been disproportionately affected here has been similar. There is some irony that those who have been worst affected are those born in the decade – the 1980s – when financial liberalisation was set in train, ultimately contributing the financial crash that precipitated the crisis* (Hills et al, 2013).

Public spending cuts have often increased inequalities between regions. An analysis of local authority expenditure in England revealed London and the South East gained a net £235m (A\$406m) between 2010 and 2012, but other regions had a net £4.5bn (A\$7.8bn) cut in resources. Of the top 50 most deprived local authorities, 46 suffered a reduction in funding that was above the English average (Special Interest Group of Municipal Authorities, 2013). This makes a mockery of the claim that ‘we are all in it together’.

The economic impact on families is worsening:

*A two-child family, with parents working as a nurse and on an average private sector worker’s wage, will lose 18.9% or £8,009 (A\$13,800) by 2015.*

*The lowest paid workers have faced the hardest hit; a single healthcare assistant with income when adjusted for tax and benefit top ups, the pay freeze, service cuts and inflation (UNISON, 2013b).*

Austerity has increased inequalities and restricted rights and non-discrimination across the board with the loss of jobs and cuts to wages, benefits and pensions; reduced access to employment; cuts in welfare state benefits and allowances; increased taxes and charges for public services including cuts in personal budgets; the closure of local facilities and services; decreased public funding of non-governmental and community organisations; the weakening of equality laws and draconian budget cuts in some equality authorities.

### 3.10 BANK BONDHOLDERS PROTECTED EXCEPT IN ICELAND

Demands for bank bondholders to be ‘burned’ or take a ‘haircut’ (suffer losses) have been prominent in the media. Governments, banks and corporations sell bonds to finance long-term investment with a contractual agreement to repay the capital at a fixed date and make regular interest payments and can often be resold in the secondary market. For example, Anglo-Irish Bank’s eighty bondholders in 2010 were a cross section of German,

French, UK and other banks and financial institutions including Deutsche Bank, Goldman Sachs, HSBC, Credit Suisse and Barclays holding over €4bn of Anglo bonds.

Depositors (the public and businesses) together with tax authorities and senior debt holders have priority if a bank has a financial crisis, followed by bondholders, owners of asset-backed securities and shareholders (wealthy individuals and financial institutions). Depositors and bondholders were protected in earlier bailouts, but not in the €23bn (A\$34bn) bailout to recapitalise banks in Cyprus. The Laiki Bank will be wound down with EU insured deposits of €100,000 (A\$148,000) or less moved to the Bank of Cyprus. Uninsured investments in Laiki Bank over this limit, many held by offshore investors including wealthy Russians, will have 47.5% of their deposits converted into shares with the money used to contribute €4.2bn (A\$6.2bn) to the bailout. In this case the ECB and EU found it politically expedient to demand a 'haircut' or 'bail-in' of investors, whereas they have previously protected investors, fearful of the response of financial markets increasing borrowing costs and ratings agency downgrades.

Investor protection has been at an enormous cost as the following illustrates;

*...a €200 billion (A\$296bn) subsidy to sovereign creditors is a gigantic wealth transfer from the taxpayer to essentially the richest 5% of the world. In the US, the 5% richest households control roughly 70% of all financial wealth, and this percentage is not much different in the rest of the world. Ultimate ownership of bank capital and sovereign debt is so concentrated among high-wealth individuals that we should characterise the bailout subsidy as... a wealth tax supporting the rich (Hau, 2011).*

This is another example of the socialisation of losses and privatisation of profits.

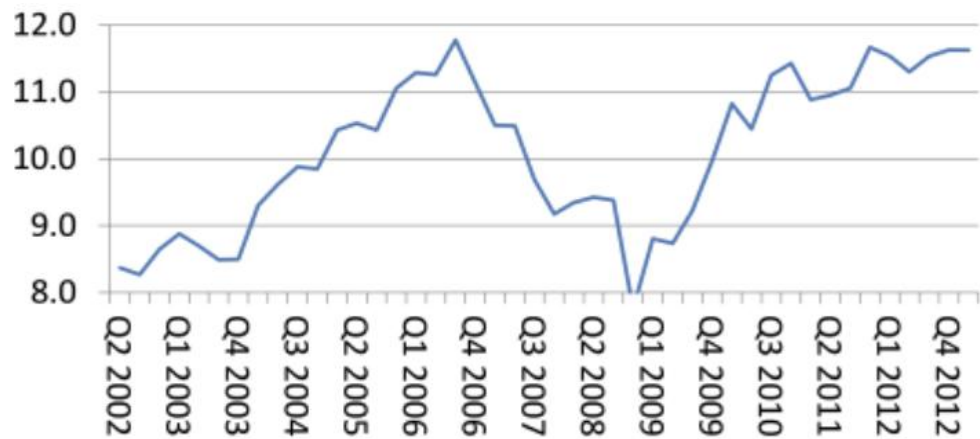
Iceland privatised its banking system in 2000 which rapidly expanded into international markets. Three years later house finance was deregulated resulting in a house price boom. Iceland, not an EU member, raised interest rates up to 15%. Funds flowed in and bank loans and assets were more than ten times the country's GDP. The financial crisis in 2008 led to a sharp depreciation of the krona and the three largest banks became unsustainable. The government let the banks go bankrupt, devalued the krona, imposed capital controls and secured a US\$10bn loan from the IMF and other countries. Three new banks were set up to take over the domestic assets of the collapsed banks. Although it was a costly recapitalisation it was significantly less costly than Ireland's bailout.

The Icelandic crisis led to across the board wage cuts, tax increases, public spending cuts, lost savings and 25% of homeowners in mortgage default. Large demonstrations led to voters twice rejecting repayment agreements for foreign investors (Mosesdottir, 2013). GDP expanded 4.6% in the first quarter of 2013 over the previous quarter and *"...competitiveness gains have been sustained, should help attract investment and support the recovery. We project growth of around 2 percent a year over the next five years"* (IMF, 2013d).

### 3.11 MEANWHILE CORPORATE PROFITS RISE, SHARE PRICE HIGHS AND CASH HOARDING

As the consequences of austerity policies and continuing recession bite, it is business as usual for much of global capital. Profits have rebounded, particularly in financial companies such as Goldman Sachs, JPMorgan Chase, Citigroup, who were at the centre of the financial crisis. The US Dow Jones Industrial Average, the Standard & Poor's 500 and Nasdaq Composite recorded all-time highs in July 2013. The net surplus to GDP ratio of US corporations returned to its pre-crisis level in 2012 (see Figure 9).

FIGURE 9: US CORPORATIONS: NET SURPLUS TO GDP (%)

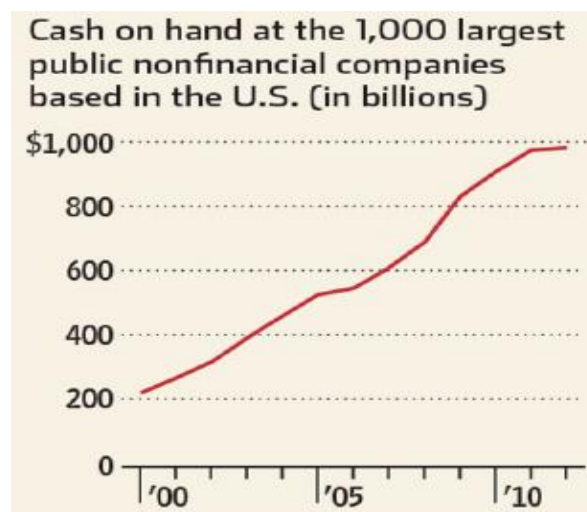


Source: Michael Roberts

The cash hoard of the one thousand largest US companies rose to US\$981 billion in 2011, a fivefold increase in a decade, in an attempt to avoid US taxes (see Figure 10) (Wall Street Journal 2013a).

*American companies reported earning 43% of overseas profits in Bermuda, Ireland, Luxembourg, the Netherlands, and Switzerland in 2008, while hiring 4% of their foreign workforce and making 7% of their foreign investments in those economies (Congressional Research Service, 2013).*

FIGURE 10: CASH HOARDING BY US COMPANIES



Source: RE/CFO Magazine Working Capital Survey

Sixty US companies parked US\$166 billion overseas in 2012. Many technology and healthcare companies have transferred intellectual property, such as patents and marketing rights, to subsidiaries in low tax countries (Wall Street Journal 2013b).

Lost revenue is even more critical when governments are trying to reduce debt and fund stimulus projects. However, tax avoidance is escalating as corporations exploit differences in the tax treatment of debt and equity, tax competition between countries and gaps in tax treaties and the rise of 'stateless income'. Corporate tax accounted for 22% of Australia's federal tax receipts in 2011-12, a higher share of GDP than most other OECD countries, but it is confronted by the same risks as other countries (Australian Government Treasury, 2013).



## 4 RECONFIGURING PUBLIC SERVICES AND THE WELFARE STATE

The political, financial and business interests that believed austerity was the 'only option' were equally committed to embedding neoliberalism in the public sector and welfare state and reconfiguring the role of the state. Reconfiguration centred on marketisation and privatisation, with a new emphasis on financialising and personalising services to create new pathways to privatisation. The mutation of privatisation recognised that public services could not be sold off in the same way as state owned corporations (Whitfield, 2012a and 2012b). In fact, financialising and personalising services were essential to reconfigure public services to ensure that marketisation and privatisation were permanent and not dependent on outsourcing, which could be reversed by terminating or not renewing contracts.

Austerity did not create a 'new opportunity' to reconfigure the state, nor was it an example of 'shock doctrine'. The financial crisis merely allowed the acceleration of reconfiguration, because the implementation of neoliberal policies in the public sector and welfare state has been systematic and continuous for over three decades. The financial crisis, austerity policies and subsequent recession created new opportunities to advance private ownership, finance and service delivery; freedom of choice through competition and markets; deregulation; the deconstruction of democracy to increase the role of business in public policy making and to consolidate corporate welfare; and reduce the cost and power of labour.

There is a real danger that the 'automatic stabilisers' of unemployment and welfare state benefits will not be so effective in the next recession, because they may be privatised with more restrictive access and be less beneficial financially.

Public expenditure cuts and subsequent severe budget constraints have increased pressure to outsource, although much of UK local government regards this as a policy of 'last resort'. The promotion of social enterprises and voluntary sector contracting and the parallel promotion of a social investment market and social bonds, have aided this process. The closure of libraries, children's centres and other local facilities with many others reduced to statutory minimum, has made a mockery of 'localism'.

The fracturing of the state has been extensive. Academies, free schools and US charter schools, have opted out of local government to become part of private profit and non-profit chains. Other services have been transferred to trusts and social enterprises or to arms length trading companies. New business dominated Local Enterprise Partnerships are now responsible for economic planning and investment in the UK with large sums of redirected public money.

Austerity and five key neoliberal objectives have legitimated new ways to financialise and personalise public services as a precursor to marketisation and privatisation (see Table 2). These policies are designed to destabilise and disinvest in public services and to dispossess, depoliticise and disempower service users, community organisations, staff and trade unions.

TABLE 2: EMBEDDING NEOLIBERALISM IN PUBLIC SERVICES AND THE WELFARE STATE

Neoliberal objectives	Neoliberal pathways in public services and welfare state	Consequences of neoliberal policies
Free trade, competition & markets to allocate resources and deliver services	Financialisation ↓ Personalisation ↓ Marketisation ↓ Privatisation	Destabilise
Deregulate to create new opportunities for accumulation		Dispossess
Deconstruct democracy to partnership with finance & business and consolidate corporate welfare		Depoliticise
Reconfigure the role of the state		Disinvest
Reduce the cost and power of labour		Disempower

In sum, marketisation and privatisation provide new opportunities for accumulation, to gain more power and control in the economy, transfer risk, cost and responsibility to individuals and enable capital to radically reduce the role of the state, yet safeguard corporate welfare. *“...we are witnessing a consolidation and centralisation of class power into the hands of a few institutions that escape public control”* (Harvey, 2010).

#### 4.1 EMBEDDING CORPORATE WELFARE

Political, financial and business interests are equally committed to ensuring the continuation and enhancement of corporate welfare. This has three elements:

Firstly, direct financial aid in the form of grants, subsidies, tax breaks and guarantees.

Secondly, market-making and outsourcing lead to a shared client/contractor ideology, values and vested interests in which the state outsources an increasing range of services, functions and infrastructure provision. Support for markets extends from the creation of, and support for, local economies to international Free Trade Agreements.

Thirdly, regulatory concessions to reduce ‘red tape’ and the cost of doing business, for example, curtaining the scope and penalties in health and safety and employment regulations.

Corporate welfare requires the state to adopt a business-led partnership model of governance for a wider range of functions, for example, Local Enterprise Partnerships for economic development and investment and Public Private Partnerships for infrastructure projects. Deep public spending cuts and welfare state restructuring imposed new or increased charges for services, restricted access to welfare benefits, initiated a blame culture that led to attacks on immigrants, which further atomised the poor and working class.

The focus on economic and financial matters led to democratic governance and accountability, equalities and environmental sustainability being marginalised.

## 5 LESSONS LEARNT

The idea that governments have no option but to adopt austerity policies is incorrect. Not only was the scale of austerity *“...unnecessary and ill-timed”* (Wolf, 2013), it was unjust and based on flawed economic theory. Furthermore, austerity *“...is a dangerous idea, because it ignores the externalities it generates, the impact of one person’s choices on another’s, and the low probability that people will actually behave in the way that the theory requires”* (Blyth, 2013b).



An alternative strategy should set out policies to reconstruct the economy, the state *and* public services. Economic and industrial policies should target investment for a clean-energy economy, infrastructure investment, job creation and the reform of financial institutions and regulatory regimes. These issues will be examined in Report No 2.

The socialisation of losses and privatisation of profits is the prime political and economic objective of austerity. Working people and the poor are made to pay for the failure of the banks, financial markets and wealthy elites.

Austerity has both short and long-term consequences that extend well beyond the implementation of the policy, for example, the loss of output, lost or delayed investment, health inequalities and poverty, the social effects of unemployment, migration and the loss of skills will be borne for years.

Comprehensive regulation, monitoring and review is a fundamental part of all sectors in the economy to ensure objectives are achieved. They must be democratically accountable and transparent and should not be drawn by corporate interests alone, nor left for them to self-monitor. The financial cost to the state and private sector should be accepted as a basic cost of public service or business.

Public spending cuts led trade unions and community organisations to launch anti-cuts campaigns. However, the focus on spending cuts diverted attention from the equally damaging imposition of neoliberal policies in public services and the welfare state. Alternatives to austerity and action strategies should therefore challenge neoliberal ideology and values.

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