Book Reviews

Austerity: When It Works and When It Doesn't
Alberto Alesina, Carlo Favero, and Francesco Giavazzi
Princeton, N.J.: Princeton University Press, 2019, 296 pp.

Fiscal austerity has been one of the leading policy measures characterizing crisis management of the euro area since 2010. However, austerity is not a new economic approach, as the new book *Austerity*—by Alberto Alesina, Carlo Favero, and Francesco Giavazzi—indirectly demonstrates while assessing the effectiveness of tax increases and expenditure reduction. In order to overcome ideological prescriptions that risk the validity of the debate, the authors analyze thousands of fiscal policy decisions deliberated by 16 advanced countries since the late 1970s. Given the complexity of this book, which also aims at demonstrating the existence of several typologies of austerity, it seems useful to follow the logical/analytical structure adopted by the authors.

Austerity is divided into 11 chapters. The first straightforwardly starts by answering why austerity measures often must be adopted. The most likely answer is that governments tend to accumulate high public deficits even in times of positive economic growth, making them less prepared to effectively face crises. At the same time, it would be misleading to think of "austerity" as a single-faceted concept. Instead, the authors theorize that one form comes as increases in (in)direct taxes—which mostly turn out to be recessionary—while the second form relies on spending cuts, which bear no costs in terms of output losses. Therefore, in combination with increases

Cato Journal, Vol. 40, No. 1 (Winter 2020). Copyright © Cato Institute. All rights reserved.

in other elements of aggregate demand, austerity might even be expansionary. The authors investigate existing causal relations by focusing on OECD countries—results for less-advanced economies might be different—and look at a short-run (five-year) period.

In a preliminary chapter ("Theory"), the authors sum up the main features of the simple Keynesian model (that is, a demand-side economic approach) and question its validity today. In fact, expectations should also be taken into consideration, particularly policy announcements and the incentive effects of tax and spending measures. A clear-cut distinction between austerity typologies is crucial. Therefore, in the chapter called "Expansionary and Recessionary Austerity up to the Financial Crisis of 2008," the writers highlight the restrictive fiscal policies that occurred widely in the 1980s and 1990s as a response to debt accumulation. In short, austerity might have been on everyone's lips during the financial crisis of 2008, but it is nothing new. The authors analyze the cases of Austria, Belgium, Canada, and Spain as representative of expansionary austerity. The Irish and Portuguese cases, which ended up recessive, are also explored to show how significantly the outcome might have differed. Each episode of austerity is different and should be carefully analyzed before drawing conclusions about its costs.

The chapter "Measuring the Effects of Fiscal Policy" looks to the concrete results—if any—that come from tax-related policy decisions. There is substantial disagreement, for example, about the estimated multipliers of various tax policies. The authors also recognize that early literature failed to identify exogenous shifts in fiscal variables, therefore limiting the estimation potential of such models. In light of this, the authors address this issue in a chapter called "Fiscal Plans," which adopts a multiyear approach. This is the analytical basis put forward in the data featured in the appendix, which covers 16 OECD countries over a sufficiently long time period (1981–2014). Over that time, there were 184 austerity plans, two-thirds being expenditure based while one-third were tax based, according to the authors. The authors also looked for precise statements from policymakers to differentiate, on one hand, between policies aiming at slightly correcting some minor budgetary items and, on the other, at substantially improving the ratio of debt to GDP. Classifying austerity typologies is a critical

step in reaching the preliminary conclusion of the seventh chapter ("The Effects of Austerity"), namely that expenditure-based plans do not cause significant output losses while tax-based ones go hand in hand with long-lasting recessions. Investors' confidence also gets a boost from plans that contribute to renewed economic growth.

After having created a framework to critically analyze austerity episodes, the chapter "European Austerity during the Great Recession" argues that commentators against restrictive fiscal policies are driven by ideology rather than facts. The authors differentiate between European countries that pursued an expenditure-based approach (the British and Irish cases), those that instituted a mix of more taxes than expenditure cuts (the Italian and Spanish cases), and those that had more expenditure cuts than taxes (the Portuguese case). At the same time, the writers dedicate a section of the chapter to a counterfactual experiment: evaluating if different austerity plans would have changed anything. Yet it's unclear what would have occurred without austerity.

The ninth chapter, "When Austerity," wrestles with the most appropriate time to implement austerity. It is not easy to evaluate when austerity is best implemented. Recognizing the effects of different times of implementation is complicated by varying methodological choices.

In the chapter "Austerity and Elections," the authors explore whether significantly lowering budget deficits truly represents a "kiss of death" for governments. Conventional wisdom argues that increasing public spending (or decreasing taxes) might contribute to the re-election of political parties. The authors raise doubts about this alleged correlation and, more precisely, guess that—if governments manage austerity measures well and are also represented by charismatic leaders—a nonrestrictive fiscal policy might prevent political parties from being re-elected.

In the conclusion, the authors remind readers that austerity mostly comes from correcting past policy mistakes. More precisely, they discover a substantial difference in the output effect of expenditure-based austerity plans as compared to tax-based ones. In fact, an expenditure-based approach tends to reduce the growth rate of the debt-to-GDP ratio. Tax-based strategies, however, are often associated with a significant deterioration of the ratio (because of the

denominator's shrinkage). And reducing government transfers results in less-pronounced effects than tax increases. In fact, even investors react positively when spending cuts are deliberated.

Austerity: When It Works and When It Doesn't wades into the heated discussion about austerity. The topic is difficult because it implies questioning the role and size of governments in modern societies. At the same time, public debt, especially in times of low interest rates, is not always problematic. But it is also equally pointless to aim at always-balanced budgets. The general debate is polarized, and those who are against any form of austerity do not provide any reliable evidence that government spending makes the economy better off. Thankfully, the last chapter, "The Models in Our Book: A User's Guide," is conceived like a long appendix providing detailed insights into the model itself.

Alesina, Favero, and Giavazzi have done great work in assessing austerity, which has recently been depicted either as a priori good or bad. The empirical effort to corroborate their analysis is impressive and it shows the reader that economics is a social, rather than natural, science. Because several factors should be considered before reaching a judgment, a "black-or-white approach" seems inappropriate to answer complex questions. The book brilliantly conveys this idea.

But what is, on the one hand, a great scientific achievement providing a multifaceted picture of recent austerity episodes in OECD countries is, on the other hand, perhaps the main drawback of the authors' argument. In other words, it is somehow intuitive that spending cuts are less restrictive to economic growth than tax increases. In fact, especially if the reduced public expenditures are unproductive, the economy as a whole benefits from spending cuts. And even if policymakers reduce useful public expenditures, people would just *get less* than before. That scenario is very different from *giving up more*, as occurs if taxes are increased. As a theoretical macroeconomist, some empirical proofs were not necessary and could have been easily replaced by a deeper historical reflection and contextualization without sounding ideological. However, the book deals with a highly relevant topic from a strongly scientific perspective and succeeds in conveying its main arguments.

Edoardo Beretta
Università della Svizzera italiana /
Franklin University Switzerland