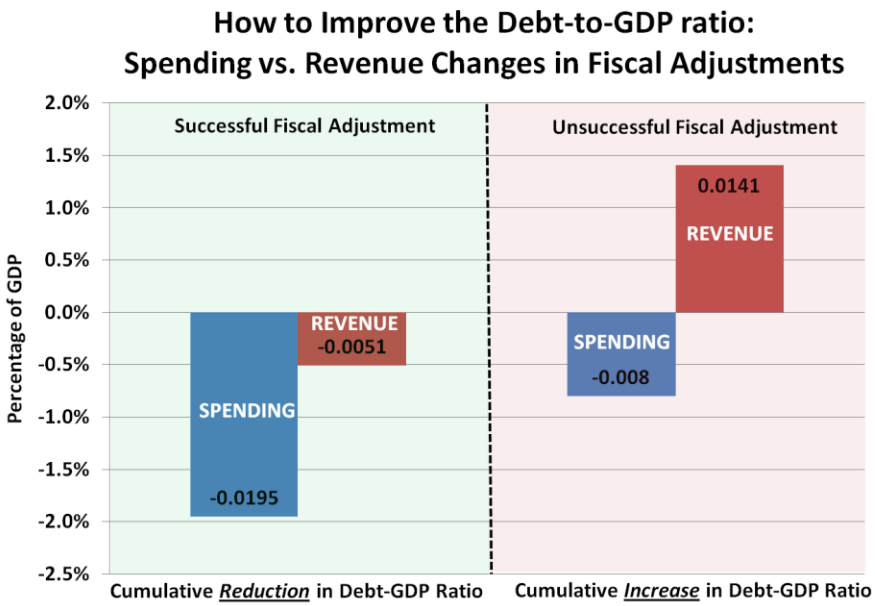

Source: Alesina, Alberto and Ardagna, Silvia. "Large changes in fiscal policy: taxes versus spending," 2009.
Produced by: Veronique de Rugy, Mercatus Center at George Mason University

This week, Mercatus Center Senior Research Fellow Veronique de Rugy draws on insights from Harvard economists Alesina and Ardagna, to chart findings from 37 years of OECD country data where 107 episodes of fiscal adjustments have occurred; these findings show an alarming consistency in austerity efforts resulting in reductions or increases in debt-to-GDP ratios. Above, successful fiscal adjustments are defined as the cumulative reduction in debt-to-GDP ratio three years after the start of fiscal adjustment.

As debt limit talks continue, it is clear that while raising the debt limit might put off a near-term default, the inability to address underlying government spending may result in a downgrade disaster and ever-growing debt. Thankfully, we are not the first nation to wrestle with unsustainable debts; we can learn from history.

In the cases where fiscal adjustments actually succeeded in reducing debts, spending cuts were much more effective than tax increases in stabilizing the debt and avoiding economic downturns. In cases of successful fiscal adjustments spending as a share of GDP fell by about 2 percentage points while revenue *also* fell by half a percentage point (left bars). On the other hand, unsuccessful fiscal adjustment packages were made of smaller spending reductions (only 0.8 percentage-point reduction) and large revenue increases (right bars).

Spending increases typically don't lead to large and sustainable growth spurts. Moreover revenue increases simply provide more fuel to the fire. So we shouldn't cut spending because we think it will make the economy grow, rather we should cut spending because it is mathematically impossible for government to constantly outpace the growth of the private sector on which it depends.

Veronique blogs policy implications of debt-to-GDP reduction at NRO's The Corner.

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