THE WALL STREET JOURNAL.
WSJ.com

OPINION | May 9, 2012, 7:20 p.m. ET

Robert Barro: Stimulus Spending Keeps Failing

If austerity is so terrible, how come Germany and Sweden have done so well?

By ROBERT J. BARRO

The weak economic recovery in the U.S. and the even weaker performance in much of Europe have renewed calls for ending budget austerity and returning to larger fiscal deficits. Curiously, this plea for more fiscal expansion fails to offer any proof that Organization for Economic Cooperation and Development (OECD) countries that chose more budget stimulus have performed better than those that opted for more austerity. Similarly, in the American context, no evidence is offered that past U.S. budget deficits (averaging 9% of GDP between 2009 and 2011) helped to promote the economic recovery.

Two interesting European cases are Germany and Sweden, each of which moved toward rough budget balance between 2009 and 2011 while sustaining comparatively strong growth—the average growth rate per year of real GDP for 2010 and 2011 was 3.6% for Germany and 4.9% for Sweden. If austerity is so terrible, how come these two countries have done so well?

The OECD countries most clearly in or near renewed recession—Greece, Portugal, Italy, Spain and perhaps Ireland and the Netherlands—are among those with relatively large fiscal deficits. The median of fiscal deficits for these six countries for 2010 and 2011 was 7.9% of GDP. Of course, part of this pattern reflects a positive effect of weak economic growth on deficits, rather than the reverse. But there is nothing in the overall OECD data since 2009 that supports the Keynesian view that fiscal expansion has promoted economic growth.

For the U.S., my view is that the large fiscal deficits had a moderately positive effect on GDP growth in 2009, but this effect faded quickly and most likely became negative for 2011 and 2012. Yet many Keynesian economists look at the weak U.S. recovery and conclude that the problem was that the government lacked sufficient commitment to fiscal expansion; it should have been even larger and pursued over an extended period.

Getty Images

This viewpoint is dangerously unstable. Every time heightened fiscal deficits fail to produce desirable outcomes, the policy advice is to choose still larger deficits. If, as I believe to be true, fiscal deficits have only a short-run expansionary impact on growth and then become negative, the results from following this policy advice are persistently low economic growth and an exploding ratio of public debt to GDP.

The last conclusion is not just academic, because it fits with the behavior of Japan over the past two decades. Once a comparatively low public-debt nation, Japan apparently bought the Keynesian message many years ago. The consequence for today is a ratio of government debt to GDP around 210%—the largest in the world.

This vast fiscal expansion didn't avoid two decades of sluggish GDP growth, which averaged less than 1% per year from 1991 to 2011. No doubt, a committed Keynesian would say that Japanese growth would have been even lower without the extraordinary fiscal stimulus—but a little evidence would be nice.

Despite the lack of evidence, it is remarkable how much allegiance the Keynesian approach receives from policy makers and economists. I think it's because the Keynesian model addresses important macroeconomic policy issues and is pedagogically beautiful, no doubt reflecting the genius of Keynes. The basic model—government steps in to spend when others won't—can be presented readily to one's mother, who is then likely to buy the conclusions.

Keynes worshipers' faith in this model has actually been strengthened by the Great Recession and the associated financial crisis. Yet the empirical support for all this is astonishingly thin. The Keynesian model asks one to turn economic common sense on its head in many ways. For instance, more saving is bad because of the resultant drop in consumer demand, and higher productivity is bad because the increased supply of goods tends to lower the price level, thereby raising the real value of debt. Meanwhile, transfer payments that subsidize unemployment are supposed to lower unemployment, and more government spending is good even if it goes to wasteful projects.

Looking forward, there is a lot to say on economic grounds for strengthening fiscal austerity in OECD countries. From a political perspective, however, the movement toward austerity may be difficult to sustain in some countries, notably in France and Greece where leftists and other anti-austerity groups just won elections.

Consequently, there is likely to be increasing diversity across countries in fiscal policies, and this divergence will likely make it increasingly hard to sustain the euro as a common currency. On the plus side, the differing policies will provide better data to analyze the economic consequences of austerity.

Mr. Barro is a professor of economics at Harvard and a senior fellow at Stanford's Hoover Institution.

A version of this article appeared May 10, 2012, on page A15 in some U.S. editions of The Wall Street Journal, with the headline: Stimulus Spending Keeps Failing.

SmartMoney Glossary: OECD, economic growth, growth rate, Wall Street, GDP