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FOR AN ECONOMIC POLICY OF PROGRESS

by Carles Manera, Ferran Navinés

The work proposes some stylised lines in economic policy, supported by a Keynesian approach to economics. The authors point out the problems that austerity policies have generated, and the mechanisms that led to increases in inequality and in the unemployment rate, as well as in deficits in large macroeconomic aggregates. The work identifies public investment as a great lever for growth. At the same time, it urges economic history to learn from mistakes and to avoid repeating them.

Keywords: economic policy, public investment, inflation, green investment.

Il presente contributo propone alcune linee stilizzate di politica economica, sostenute da un approccio keynesiano all'economia. Gli autori analizzano i problemi che le politiche di austerità hanno generato, nonché i meccanismi che hanno portato a un aumento della disuguaglianza, del tasso di disoccupazione e dei deficit nei grandi aggregati macroeconomici. Il lavoro rivendica gli investimenti pubblici come una grande leva per la crescita. Allo stesso tempo, incoraggia a che la storia economica impari dagli errori ed eviti di ripeterli.

Parole chiave: politica economica, investimenti pubblici, inflazione, investimenti "verdi".

The economic rules that have been written – rules, not laws, the difference is important – are not necessarily the Tablets of Moses. That is to say: they are subject to change, depending on the environments in which these rules are applied. These reorientations of supposedly immovable precepts, considered as perpetual laws, had to be varied according to events. For example: the rigid rules of the gold standard monetary system – all-out budget balance, non-public intervention in the economy, limitations on monetary emissions, etc. – ended up being blown up as a result of the Great Depression. The cause: they were not useful in a deflationary situation and with a collapse in aggregate demand. J. Bradford DeLong, Secretary of the Treasury of the USA during the mandate of President Bill Clinton, a rigorous historian and economist, has explained it clearly in his recent book (Bradford DeLong, 2023): that great crisis of capitalism forced us to rethink the tools considered immutable, and to use other resources, other levers, to tackle serious problems

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– the most relevant, we insist, are unemployment and deflation. From there, the thesis emerged strongly, which the Cambridge Circus – Keynes, Robinson, Sraffa, Kalecki, and Khan – had already muttered for years: the imperative need to activate public investment so that it could remove the paralysed wheels of private investment. Bradford DeLong, considered one of the most influential economic historians today, aligns himself, with his voluminous work, with what other economists and economic historians have published in recent times, namely: the claim for decisive impacts of fiscal multipliers on the entire economy, from the initiative of the public sector, in times of economic recession. See, in this sense, only two illustrative samples: the work by Robert Skidelsky (2022), or the even more recent one by Castells, de Grauwe, and Guardiola (2022).

Why are we commenting on this? Because Brussels is thinking about a review of the fiscal rules, which generates a debate within the economic teams of the eurozone. And, within the framework of the discussions, there seem to be severe positions to return to norms (which we could frame in the expansive austerity, recognised as a result of the Great Recession – cf. theorisations on the matter in Alesina *et al.*, 2017, and Alesina, Favero, Giavazzi, 2015). Among the sponsors of this return to the canonical rules, the great promoter is the German Finance Minister, Christian Lindner: "hard cuts are necessary", the leader has stated (statements published on 8 April 2023), cornering the lethal consequences of that economic policy between 2008 and 2015. There is a kind of assumption that these rigid, strict, implacable rules, with few margins of flexibility, are, in effect, *the* rules (that is to say: there are no others) to follow, to vindicate, to apply, once again. It is as if this were elevated to the category of science without any discussion: a path to return to because it is the right thing to do, the scientific thing, the convincing thing. Although empirical evidence says otherwise. Warnings formulated by liberal economists – cf. DeLong, Skidelsky, and De Grauwe – are of little or no use, as they allude to very specific examples that question, from a bottom-up approach, the entire mechanism presented as the only plausible recipe book. Given this, an economic policy with a progressive profile must take into account the most recent economic history, to avoid precisely the errors that in specific areas of the eurozone they want to reiterate. Several elements should be highlighted, as a possible discussion guide.

1. The decisive significance of public investment

We have always defended this, in different research and informative works. It can be a very repetitive message; but it cannot and should not be disregarded. It is true that some studies question its effectiveness, if it ends up translating into almost perennial items in public budgets: we then speak of crowding out, a concept that is often handled in a crooked way to downplay the resilient importance of public spending in stages of economic crisis. Therefore, there is no possible expulsion, since it is the market itself that executes such displacement due to the recessive situation. But the multiplicity of research on the positive impacts of public investment on the economy empirically raises the rigour of the measure (cf. the abundant bibliography on the matter – in many cases commented – in Palazuelos, 2022). Hence, it would be very important that, in this narrative framework and debate on economic rules, it be taken into account that, in times of crisis or when it is necessary to promote a commitment to productive change – for example, everything related to the climate change, digitalisation, or the energy transition –, public investment will not count in the orthodoxy of budget balance.

2. The revision of the inflation rate

The revision of the inflation rate starting from a basic, almost tautological premise: economic growth and an acceptable level of inflation "cut" unemployment. The rigid norm of inflation is not consistent with verified scientific studies: 2% is the totemic figure that both the Federal Reserve and the European Central Bank (ECB) have assumed almost as an economic dogma for inflation; but we do not know where the figure comes from, from what econometric model. However, it constitutes another rule that is part of those imaginary Tablets of Moses.

Let's focus on data and researchers. The relationship of inflation with other variables reveals that moderate levels of inflation do not have to be automatically negative; they can even be beneficial for economic structures. That is to say, controlled inflation – we insist on this – can represent a tolerable counterpart, as long as growth rates are positive, and unemployment rates are reduced. Some of the most prestigious American academic economists, Nobel Prize winners in Economics, have investigated this topic, which marks a point of heterodoxy within the framework of the most conventional interpretations of economic evolution. The central period of analysis of these authors is linked to the crisis that emerged in 2001, with the collapse of technology companies. Here too, comparisons and analyses were carried out between determining variables, such as economic growth, inflation, unemployment, and stock market developments.

George Akerlof stated, in a work published in 1996 and in reference to the American economy (Akerlof, Dickens, Perry, 1996), that the costs of maintaining low inflation, increasingly closer to zero, would end up representing a fall in GDP, while recommending that complete price stability could not, in any way, be the fundamental objective of the Federal Reserve. Akerlof's theory did not contradict, however, the econometric models of the issuing bank (such models adhere to the NAIRU principle, Non-Accelerating Inflation Rate of Unemployment, that is, the unemployment rate that does not accelerate inflation, being between 6% and 6.2%. In other words, if unemployment fell below those percentages, the risk of inflation was evident, according to the institution then chaired by Alan Greenspan). Akerlof did not criticise price control, which he praises unconditionally; but he questioned the obsession with achieving almost non-existent inflation, especially when the unemployment rate was at very low levels, around 6% at the time the work was published. His theory indicates that reducing inflation, when it is high, increases unemployment very little, so it is advisable to keep inflation rates low, a fact that benefits calculations about the future, given that the cost in terms of unemployment is minor.

Now, when with a certain level of productivity you want to maintain the reduction of inflation, the costs in terms of employment are very high (cf. Krugman, 1997; Madrick, 1998). The main reason given by Akerlof is that too low inflation causes important political and social costs. In other words: reducing the inflation rate to 3% is cheap in the labour vector; but below that figure, the cost rises very quickly. Akerlof uses cases from economic history – specifically, the 1929 crisis and its repercussions – to explain his model more convincingly, and highlights how, from the perspective of prices and employment, the intense deflation that occurred was accompanied by a very high unemployment rate, which reached a quarter of the active population of the USA. The works by Peter Temin support this finding, and demonstrate that the stubborn economic policy, determined to maintain the gold standard at all costs – that is, the usual rules –, was one of the central causes of the spread of the depression. This is how the monetary and fiscal authorities applied

contractionary recipes, when hindsight today shows us that expansionary policies were necessary. But any alternative approach had to transgress the gold standard regime, which had become an untouchable paradigm for politicians and economists, but dramatically fissured by reality. All alternatives were taken as aberrations with respect to the stability represented by the existing monetary standard, and were not considered by the authorities or by investors (Temin, 1995).

Paul Krugman (1997) has argued in a similar vein to Akerlof. This author says that the benefits of price stability are relative, and he uses economic history to demonstrate it: the great disinflation of the 1980s in the US economy, which pushed prices down from 10% to 4%, was reached after a prolonged period of high unemployment rates and excess productive capacity. The unemployment figure of 1979 recovered in 1988 – almost a decade of negative evolution –, so that we can speak of a relationship of sacrifice entailing enormous costs, estimated at close to a trillion dollars, to achieve a small advance in too long a period of time. The author's conclusions are clear: the belief that absolute price stability is a blessing, providing great benefits with few costs, rests more on faith than on evidence. And this points in another direction: low inflation, close to zero, infers strong penalising consequences for the economy. Krugman makes some simple correlations to support his conjectures: the first, between economic growth and job creation between 1980 and 1995, leading him to maintain that growth cut unemployment; and a second, between inflation and unemployment between 1985 and 1995, which is totally non-existent. In short, the motto that the aforementioned author ends up coining is simple but eloquent: growth truncated unemployment, while inflation did not. Along the same lines, studies on inflation for the period 1979-1990 (using monetary indicators and others related to human development) confirm the negative impact on salaries, incomes, and living standards (Bowles, Gordon, Weisskopf, 1992). Joseph Stiglitz emphasises these same ideas (Stiglitz, 2012). A country can have low inflation without growth, and high unemployment. For most economists, this nation would have a disastrous macroeconomic scheme. But since excessively high inflation often leads to low growth, and this to high unemployment, inflation is systematically stigmatised.

This leads us to a further review of the established rules: rethinking the inflation rate that conditions the actions of central banks. The thesis is not far-fetched, and a liberal economist like Olivier Blanchard (2022), in his most recent book, advocates analysing the issue.

3. Inflation and impact of "green" investment

The link between investment and prices can be a macroeconomic problem. This worries central banks, whose priority is price stability and, therefore, financial stability. The issue is of great importance, given the avalanche of investments that must be channelled towards, at least, three key sectors: *a*) the energy transition; *b*) the digitalisation and robotisation process; and *c*) the effects of climate change. Now, an apparent contradiction arises in this scenario: the suggestions of the central banks, in the sense of activating fiscal policy programmes towards the aforementioned directions, clash with the perspective of inflationary control. It is clear that prices can be pushed upwards for such investment purposes. Therefore, banking supervisors face the dilemma of strengthening the interest rate policy or, alternatively, relaxing it. In this sense, specific studies, mathematically

"modelled", are urgently needed to try to unravel this apparent dichotomy between fiscal policy and monetary policy. We have research on the impacts of "green" investments on the labour market, which indicates that they can generate job creation, especially in countries that are highly dependent on fossil fuels. This would be, for example, the case of Germany (cf., in this regard, the recent working paper by Francesco Lamperti, 2023, or the crucial contribution, more nuanced than in Lamperti's study, by Fabra *et al.*, 2023).

4. Fiscal consolidation and budget segmentation

Everything that has been explained has logical consequences on public budgets. Now, here we have another rule that, perhaps, should be rethought, along the lines recently explained by Paul de Grauwe: the budget division between current and capital items. Thus, the vision of fiscal consolidation, which, no one doubts, if it is carried out with reasonable programming, could raise this so-called budget fragmentation: the chapters of the budget that infer current spending should perhaps have greater monitoring of fiscal consolidation, while the investments, destined for the purposes that we have pointed out before, would not have to be part of that consolidation, in such a way that perhaps they could be avoided when the calculations of the aggregate public deficit of the nations are made. De Grauwe's thesis is of great interest, although it has the foreseeable inference that public investments will, in turn, generate items attributable to current spending – maintenance, personnel, etc. But it is no less true that these proposals that we have stated are not crazy, and that they can be the object, from the outset, of analysis and research by social scientists – not just economists; but we also do not think that they would be totally rejectable at the level of the most applied economics. Rules considered to be integrated into the "Tablets of Law", such as spending control, maintaining the deficit, drastic debt reduction, and less public intervention, became volatile as a result of the pandemic crisis. Let's not forget this.

"When the facts change, I change my mind. And what do you do?", John Maynard Keynes snapped, half ironically and mockingly, at a journalist who was trying to put him in a contradictory situation. Perhaps we economists should think of this phrase as a frontispiece to hide or, better, eliminate the arrogance that we too often comment on and divulge and that those who have greater direct responsibilities in government actions – such as the already appointed German Finance Minister – execute. Just as if the context were immovable.

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