

# The biggest economic policy mistake of the last decade had nothing to do with academic economists

By Simon Wren-Lewis

September 3, 2018 – *Social Europe*

“The biggest policy mistake of the last decade” is the title of an article by Ryan Cooper, and the mistake is of course austerity (it is a very US focussed piece, so Brexit is not on the map). Cooper goes through all the academics who gave reasons why austerity was necessary and how their analysis later fell to bits. How much they fell to bits is still a matter of dispute as far as these authors are concerned.

Here is his concluding paragraph:

As we have seen, the evidence for the Keynesian position is overwhelming. And that means the decade of pointless austerity has severely harmed the American economy — leaving us perhaps \$3 trillion below the previous growth trend. Through a combination of bad faith, motivated reasoning, and sheer incompetence, austerians have directly created the problem their entire program was supposed to avoid. Good riddance.

There is a lot I could say about the details of the article, but this conclusion is essentially correct, and it applies at least as much to the UK and to the countries of the Eurozone. With Trump’s large tax cuts for the rich paid for in large part by borrowing, the Republicans can no longer credibly tell everyone austerity is essential. In contrast, the political right’s enthusiasm for austerity in Europe remains strong.

## Anti-austerians

Reading the article brought back memories of my first year or two writing this blog, where I became part of a mainly US blog scene of mainstream academics opposed to austerity, lead by Paul Krugman and Brad DeLong. We were trying to take down the academic arguments for austerity, and we succeeded. As Cooper’s article suggests it was not a very difficult task. Sometimes very senior economists who should have known better

made simple mistakes of the kind I discussed elsewhere. On other occasions, like the predictions of massive inflation from Quantitative Easing that Cooper discussed, events quickly proved the Keynesians correct. Only in the case of the studies from the two pairs of Alesina & Ardagna and Reinhart & Rogoff was additional research required to challenge their conclusions.

As far as us Keynesians were concerned, the intellectual battles were won by the end of 2012, if not before. In particular Paul De Grauwe’s influential analysis of why Eurozone countries were experiencing a debt crisis, pointing to the lack of a sovereign lender of last resort, put an end to the academic credibility of ‘we are going to become like Greece’ stories. When the ECB introduced OMT in September 2012 and the Eurozone debt crisis came to an end, De Grauwe was proved right. In 2013 Krugman wrote of austerity:

Its predictions have proved utterly wrong; its founding academic documents haven’t just lost their canonized status, they’ve become the objects of much ridicule.

What we didn’t know for sure then was the lasting damage that austerity would bring, and which Cooper notes.

## Blinkered media

I want to add two important points that Cooper’s article does not cover. The first is that although by 2013 most academics had become convinced about the austerity mistake (it was always a minority view anyway), economic journalists in the non-partisan media could not recognise that because the politicians were continuing to implement the policy. Here is Robert Peston in 2015:

And before I am savaged (as I always am) by the Krugman crew of Keynesian economists for even allowing George Osborne's argument an airing, I am not saying that the net negative impact on our national income and living standards of cutting the deficit faster is less than their alternative route of slower so called fiscal consolidation. I am simply pointing out that there is a debate here (though Krugman, Wren-Lewis and Portes are utterly persuaded they've won this match – and take the somewhat patronising view that voters who think differently are ignorant sheep led astray by a malign or blinkered media).

We now know that voters were indeed being led astray by a malign or blinkered media, or at least a media that did not have the courage to call the result of the academic debate.

The second point is that this academic debate had zero impact on politicians. In that sense Cooper's article is of purely academic concern. Austerity was not begun because politicians chose the wrong academic macroeconomists to take advice from, and the fact that the Keynesians won the debate therefore had no impact on what they did. The academic debate was in this sense a complete sideshow. I think many Keynesian academics understood that: it was a fight we had to win but we were under no illusions it would change anything. I wrote in 2012 that if all academics were united we might have an impact on public opinion, but that illusion did not last very long and Brexit showed it was indeed an illusion.

### **Without influence**

I think this lack of influence that academic economics can have is not understood by many. It often suits some heterodox economists to pretend otherwise. Economists can be influential, but only when politicians want to listen, or the media is prepared to confront them with academic knowledge. For example politicians have not done nearly enough to ensure another financial crisis does not happen, but that isn't because economists have told them not to or have not shown them how to do so. It is because politics prevents it from happening.

The reason why economists like Alesina or Rogoff featured so much in the early discussion of austerity is not because they were influential, but because they were useful to provide some intellectual credibility to the policy that politicians of the right wanted to pursue. The influence of their work did not last long among academics, who now largely accept that there is no such thing as expansionary austerity or some danger point for debt. In contrast, the damage done by austerity does not seem to have done the politicians who promoted it much harm, in part because most of the media will keep insisting that maybe these politicians were right, but mainly because they are still in power.

*Simon Wren-Lewis is Professor of Economics at Oxford University.*