


The clash of economic ideas: the striking resilience of expansionary austerity

 blogs.lse.ac.uk/politicsandpolicy/the-clash-of-economic-ideas/

11/12/2015

 *Ideas are a key, yet surprisingly neglected, dimension of political economy. It is easy to claim that ideas matter; it is rather challenging to explain the origins and evolution of ideas, let alone empirically test when and how a specific idea actually influences policy. Here, [Sebastian Dellepiane](#), tackles these issues in relation to the idea of fiscal austerity.*

The making and the study of economic policy make little sense without ideas. Yet research design in this area is somewhat underdeveloped. This motivated my [recent study](#) on the cognitive roots of expansionary austerity. Additionally, the work of [Douglass North](#) inspired me to look at choice situations where people hold conflicting beliefs, 'mental models', on a specific *causal* relationship. Put simply, take a situation where actors disagree on whether a particular road is actually heading North or South. The issue is that not even a rational actor would be able to pick up the 'right' course in the face of diverging road maps. In this case, the road is deficit reduction; the alternative destinations are either recession or growth. Welcome to one of the most contested issues in modern economics: are fiscal adjustments contractionary or expansionary?

Despite the unsexy name, the story of expansionary fiscal contractions is fascinating. In a 1990 [paper](#), Francesco Giavazzi and Marco Pagano reported non-Keynesian effects of fiscal policy in two critical cases: Denmark and Ireland. The punch-line was that a decisive attempt to tackle the deficit may end up boosting rather than depressing the economy *even* in the short run. This early finding, with roots in the rational expectations revolution, rapidly gained traction. Due to the works of [Alesina](#), [Perotti](#), [Ardagna](#) and others (the Italian twist got more evident), the original insight evolved into a Holy Trinity of claims: fiscal contractions can be expansionary; expenditure-based consolidations are more likely to be successful; budget adjustments are not necessarily penalized at the polls. This was music to the ears of Conservative politicians, and indeed of social-democrats 'moving right'.

Eventually, this neoliberal fiscal compact penetrated policy circles, becoming 'common sense' (to evoke a different kind of Italian, [Gramsci](#)) among influential epistemic communities and shaping institution-making, notably the Economic and Monetary Union of the EU. Enter the financial crash of 2008 and events turned dramatic. What followed was a bitter battle of ideas over the predicament of expansionary contractions.

In this regard, my study is a subplot of Blyth's [popular book](#) on [austerity](#). My research approach explores two core themes: ascendancy and influence.

Firstly, the rise of this peculiar idea, from scientific finding to dominant policy belief, is striking. The social construction of expansionary fiscal contractions has been a highly political process, even involving intellectual repression. Perhaps not an eye-opening discovery. However, my paper reports systematic biases and omissions in the 'lessons-from-successful-consolidations' literature. The self-serving reading of Ireland's stabilization in the 1980s is remarkable. The distributional implications of expansionary contractions have been blatantly ignored (spending cuts are better, but better for whom?). Another neglected issue is the role of currency realignments in lubricating fiscal adjustments. This is important because the role-model expansionary contractions of the past involved, inconveniently, devaluations.

Influence is a more elusive analytical issue. How can we convincingly assess the independent effect of ideas when all the relevant factors appear to be hopelessly entangled? My case studies examine whether the idea of expansionary fiscal contractions was instrumental in shaping policy during the Great Recession. The Irish case illustrates the problem of inferring motivations from observed outcomes. Although policy choices 'suggest' the endorsement of expansionary austerity, Irish politicians actually adopted a traditional 'no gain without pain' logic. In

Spain, consolidation has not been driven by faith in the Holy Trinity, at least not directly. Socialists moved reluctantly towards austerity under intense coercion from Europe; the Conservatives deepened adjustment by peddling the narrative of ‘there is no alternative’. In both Ireland and Spain, politicians were under no illusion regarding the costs of austerity. They knew it would hurt, economically and politically.

The British case is particularly intriguing. At first glance, the crisis management strategy chosen by Osborne had the hallmarks of a bet on expansionary austerity. The way the Chancellor *narrated* the crisis seemed to fully fit the gospel of pro-growth consolidation. Moreover, the causal chain of the policy solution was candidly exposed: front-loaded, expenditure-led deficit reduction, rising expectations, private-led recovery. Yet, as often, initial impressions can be misleading. Building on Alan Jacobs’ useful [work](#) on ideational process-tracing, we can pose the following question – was the apparently influential idea ‘exogenous’ to other key aspects of the policy choice, including partisan strategy?

The answer would appear to be not very likely. If anything, the UK experience may confirm Blyth’s insight that ideas are usually clustered with interests and institutions. Further research is needed to tease out the causal complexity behind austerity politics, in the UK and beyond.

But another striking aspect of the UK case is learning. Or more aptly, the lack of it. I have found little evidence of policy learning in the face of mounting disconfirming evidence and growing expert consensus around Plan B. It is often argued that the Cameron/Osborne indeed retreated to a sort of Plan A minus. This is a fair point, but hardly a surprising one. Implementation gaps are pervasive in policymaking. My argument is that, despite some tactical re-positioning and high-profile policy blunders, the coalition remained *largely* committed to its default plan. Some accommodation was observed, but the driver was hardly learning, let alone lesson-drawing. The reason is: politics. All along Osborne had powerful incentives to stick to its long game.

Institutional constraints might have also prevented a more nuanced approach. In my [work](#) with Miguel Coelho (from the Institute for Government), we argue that the institutional setting of British democracy may not be especially learning-friendly. An adversarial political culture doesn’t promote deliberation and consensus-seeking. There is a clear tendency to manipulate evidence in a partisan way.

This begs the big question of the survival of the expansionary-contractions narrative. The perception is that huge anomalies, however brutal (whatever happened to the ‘even in the short run’ clause of the deal?), have not fundamentally challenged the intellectual edifice of expansionary fiscal contractions. Moreover, according to commentators (e.g. [Andrew Gamble](#)), fiscal conservatism even got reinforced over the crisis, proving once again the malleability and resilience of neoliberal ideas. To a good extent, this is true. The spending-cuts-are-better-than-tax-increases dogma is still dominant. The stories that ‘it has been tough, but the worst has been prevented’ and that ‘we are now out of the woods, so the therapy worked in the end’ are on the rise. These core-centred accounts merit serious intellectual scrutiny. For starters, the world looks different from certain peripheries.

Let’s conclude with a cautionary tale, though. We typically stress the political power of economic ideas by citing Keynes: the world is ruled ‘by little else than ideas’. To inspire future research on ideational political economy, I wish to offer readers a subtler insight. In his *Essays in Persuasion*, Keynes observed, with obvious frustration that ideological battles ‘are won mainly by the irresistible pressures of events and only secondarily by the slow undermining of old prejudices’. In other words, the game is on...

Note: the article represents the views of the author and not those of the British Politics and Policy blog nor of the LSE. Please read our [comments policy](#) before posting.

 [Sebastian Dellepiane](#) is a lecturer in Public Policy at the University of Strathclyde.

(Featured Image credit: [Number 10](#) CC BY-NC-ND 2.0)