

*English translation of the Manifesto ECONOMISTAS FRENTE A LA CRISIS*

<http://www.economistasfrentealacrisis.com>

## **ECONOMISTS CONFRONTING THE CRISIS**

A candidacy for the upcoming elections at the *Colegio de Economistas* of Madrid

Typically, economic crises call into question certain principles commonly accepted by economists. The current economic crisis is deep and has severe social implications. Yet, it has had very little influence on economic thought. Economists continue to rely, as indisputable principles, on a set of propositions that reality contradicts on a daily basis.

The Spanish society is suffering from the crisis as well as from the serious consequences of the economic policies derived from such principles. Under the conviction that economists cannot remain indifferent, we address a range of issues in order to promote public debate.

### **1 – UNEMPLOYMENT**

Economic policy aims at promoting a more efficient resource allocation. Among all the potential policies, the worst, the most inefficient of all, are those that fail in allocating idle resources; in other words, those that lead to unemployment. From this perspective, it is paradoxical that the policies imposed on the Spanish government by the European Union have exacerbated the crisis, to the extent that they have led to a sharp fall in aggregate demand.

The current crisis has two stylized facts: massive job destruction together with the inability to create stable and productive jobs. Under the shadow of neoliberal paradigms, policy makers have tried to tackle unemployment by solely relying on labor market reforms. Notwithstanding the need to achieve a more efficient labor market, the reduction in unemployment will only be achieved through a boost in aggregate demand.

The collapse of investment and private consumption has been followed by a drastic cut in public spending- as required by the European Council. This pro-cyclical and contractionary policy will prevent any economic recovery in the years ahead. The high unemployment rate, with its most dramatic impact among the young and the long-term unemployed, requires a shift towards economic policies that understand that economic growth is a necessary condition for employment recovery. It is true that the Spanish labor market has serious shortcomings that must be addressed in consensus. However, those reforms that undermine employment stability will not contribute to ending the crisis.

## 2 – FINANCIAL MARKETS AND RATING AGENCIES

It is still assumed that financial markets, guided by rating agencies, do a good job in efficiently allocating risks. And yet it is beyond any reasonable doubt that it was precisely the practices of financial institutions and the absence of a proper regulation of rating agencies which significantly contributed to the outbreak and deepening of the crisis.

Surprisingly, rating services, whose purpose is to ensure transparency and competitiveness of markets, are not regulated despite the fact that they hold the highest degree of market power ever known. Without regulation, their activities are open to all kinds of manipulation, which induce inefficiencies in the real economy. How is it that the EU, which integrates a very powerful economic area, is unable to counteract financial market inefficiencies? One might think that there are powerful interests – economic interests and also paradigms, - which are firmly established, and which deter any public debate on these issues. We, as economists, cannot remain indifferent.

The role that markets can play in facilitating the optimal resource allocation is out of question, as long as they are competitive. Nevertheless, as it is well known, market efficiency is jeopardized in oligopolistic settings, especially in sectors with systemic importance such as, the financial sector or the energy sector, among others. Liberalization and regulation are not substitutes but complements. More specifically, liberalization in the absence of regulation has perverse effects when it affects sectors which are crucial for the competitiveness of the economy.

## 3 - CORPORATE GOVERNANCE

Corporate governance creates serious agency problems: a large fraction of the big financial and industrial companies are run by managers who, by delegation, hold the property rights of short-lived and dispersed owners. In this context, the agents (i.e., the managers), rather than the principals (i.e., the firms' owners), are those who set their own incentive schemes as a function of the business objectives they pursue. The combination of oligopolistic power and agency problems, which sometimes generate further social scandal, induce inefficient short-termism, which in turn leads to unsustainable and undesirable outcomes for the businesses as well as for the economy.

## 4 - PUBLIC DEFICIT

It is commonly assumed that a major problem in the current economic context is the public deficit caused by overspending. However, one of the sources of the deficit is the strong and rapid reduction in income, which directly depends on the evolution of GDP. Instead, would it not be more appropriate to focus on income recovery as a way to reduce the deficit? (of course, without overlooking the efficiency of public spending).

Most likely, the recovery of income would require a longer-time horizon than the one imposed by the EU goals. There is no reason to apply such a restrictive calendar, especially when one notes that the relevant part of the Spanish debt is not public debt, which remains within acceptable limits, but private debt. Perhaps, it would be wiser to tackle the debt by boosting economic activity and by relaunching businesses. As a by-product, the debt would also be financed with lower risk-premia. In any case, there is a serious lack of coordination of macroeconomic policies within the EU. Economic policy is limited to monetary policy, and this is subject to the interests of lobbyists who are active in financial markets. The increase in the interest rate spread between the German and Spanish government paper drains the capacity of the public sector, thereby strengthening the private interests of those who would benefit from the privatization of social benefits. Inevitably, this would lead to the consolidation of a dual society in Spain.

## 5 - THE WELFARE STATE

An essential part of government spending is devoted to finance education, public health, security, social benefits and territorial balance, i.e., basic social services. All these elements contribute decisively to the efficiency of the economic system. They allow for income redistribution within the society, thus explaining a great part of their contribution to efficiency.

Drastic reductions in public spending imply a sharp decrease in the degree of income redistribution. It is legitimate to question whether this is their real objective. Let's avoid any misunderstanding: no one is against the need for adjustment. The goal should be to manage fiscal consolidation within a reasonable time horizon, which would be consistent with enough GDP growth so as to stop job destruction, restart economic recovery, and cease the setbacks of the welfare state.

The trend is clear. A successful attack against wages, social benefits and the welfare state is in progress. An offense which is jeopardizing the social progress achieved during recent decades. We are been forced to accept the *bad* under the argument that the alternative may be worse. This is nothing but a great demonstration of power.

## 6 - THE EUROPEAN UNION

Financial strains, together with the current political and ideological composition of the governing bodies of the European Union, endanger the implementation of policies other than the ones that have recently been implemented in Europe. Spain cannot be forced into a rescue with conditions such as those imposed on Greece and Portugal. Moreover, our country is highly interested in staying in the Euro zone. Thus, what is the real alternative to the contractionary policies that we are witnessing? Beyond the maintenance of the hallmarks of the European construction, based on the social market economy (which have been somehow lost in the implementation of the policies imposed from the new conservative majority in

Europe) it is true that there exist few alternatives in the current European institutional framework. What are we here for then?

Our aim is to challenge the dominant economic paradigms. We have to go beyond the standard toolkit used to diagnose and manage the crisis. In the end, economic crises are a great opportunity for economists to refute any proposition that is in open contradiction with reality.

We bring these brief thoughts in order to bring forward an open debate on the crisis and the economic policies applied in Spain and the EU. We have expressed them in terms that contradict principles that are commonly accepted by those who have implemented these policies, trying to induce the analysis and create controversy over issues that affect all citizens.

Economists have a responsibility to society and, at current times, this responsibility is much more intense. There is barely no debate within our profession on the measures that have been applied and the theoretical principles underlying them. Where are the institutions that bring economists together?

We appeal to economists, and in particular those based in Madrid, so as to promote a broad debate on proposals capable of influencing the understanding of the crisis, and therefore, capable of providing policy suggestions to manage the crisis in an effective way. Economists cannot remain oblivious or indifferent to the increase in social inequality. It is not just a question of solidarity, it is also a question of efficiency— both go hand to hand.

Without institutional support, the discussions and proposals are short-lived. However, if framed within institutions, they acquire the ability to influence the public debate and media, which at the end have a great influence on policy choices. The *Colegio de Economistas* may become - why not? - the institution that allows economists to fulfill the social role that they should not give up: making knowledge available to society.

With this task, the undersigned make a call to all the economists of Madrid. The upcoming elections will be an opportunity to achieve the institutional platform that we are lacking today.

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