

What is a Left economics? (Or, why economists disagree)

By [Guillaume Allègre](#)

What is a Left economics? In an opinion column published in the newspaper *Libération* on 9 June 2015 ("[la concurrence peut servir la gauche](#)" ["Competition can serve the Left"]), Jean Tirole and Etienne Wasmer reply that to be progressive means "sharing a set of values and distributional objectives". But, as Brigitte Dormont, Marc Fleurbaey and Alain Trannoy meaningfully remark ("[Non, le marché n'est pas l'ennemi de la gauche](#)" ["No, the market is not the enemy of the Left"]) in *Libération* on 11 June 2015, reducing progressive politics to the redistribution of income leaves something out. A Left economic policy must also be concerned about social cohesion, participation in social life, the equalization of power, and we could also add the goals of defence of the environment and, more generally, leaving a fair legacy to future generations. Paradoxically, if the Left must not *a priori* reject market solutions (including the establishment of a carbon market), the de-commodification of human relations is also part of core left-wing values. The authors of these two columns insist that it is the ends that count, not the means: the market and competition can serve progressive objectives. This is not a new idea. The merchants of the 18th century had already understood that holding a private monopoly could allow them to amass great fortunes. Tirole and Wasmer draw on more recent debates, including on the issues of taxis, housing, the minimum wage, the regulation of the labour market, and university tuition fees. Their conclusion, a bit self-serving, is, first, that more independent evaluations are needed, and second, that our elected representatives and senior officials need to be trained in economics.

Does the Left define itself by values? To accept this proposal, we would need to be able to distinguish clearly between facts and values. Economics would be concerned with facts broadly speaking and would delegate the issue of values to politics. Disagreements about facts would be exaggerated. Political differences between the Left and the Right would be only a matter of where to put the cursor on values or preferences, which would be independent of the facts. According to this viewpoint, the instruments need to be designed by trained technicians, while the politicians just select the parameters. The Left and the Right would then be defined by parameters, with progressives more concerned about reducing inequality and conservatives more concerned about the size of the pie. In this scheme, disagreements among economists would be focused on values. Paradoxically, the examples used by Tirole and Wasmer are the subject of important controversies that involve more than just values: economists are very divided over the [liberalization of the taxi business](#), the [level of the minimum wage](#), and the possible [introduction of university enrolment fees](#). There are important disagreements, even among progressive economists.

Why the disagreement? There are fewer and fewer disputes over the facts, strictly speaking. The system of statistics has made considerable progress. However, pockets of resistance remain. For example, on taxis, it is difficult to know who holds the licenses and the prices at which they were acquired, even though these are very important issues. If the vast majority of licenses are held by people who received them for free, then increasing the supply via private cars with drivers ("VTC") poses no real problem of fairness. On the other hand, if most licenses were acquired on the secondary market at exorbitant prices (up to 240,000 euros in Paris), then the question of compensation arises. Buying 17,000 licenses at 200,000 euros apiece would cost the State 3.5 billion euros just for the licenses in Paris. This problem cannot be dismissed with a simple, "of course these are often expensive"

(see "Taxis vs chauffeur-driven private cars: victory of the anti-innovation lobby?").

While the facts are in little dispute, the disagreement often comes down to what matters. Should we put the emphasis on a lack of equal outcomes or a lack of equal opportunity? Should we count real estate gains when examining inequalities in capital? Should we be concerned about relative poverty or absolute poverty? Should we worry about inequality between households or between individuals? All this reflects that disagreements are not just a matter of where you put the cursor, but the prioritization of goals that are sometimes complementary and sometimes contradictory. The very way the system of statistics is constructed is not to produce pure facts but instead results from a logic that dictates that what you measure is the representation of a norm. But this norm is in fact reductive (it excludes others), so much so that the measure has meaning only from when we agree on the norm's value: the measure is never neutral vis-à-vis values.

This vision of an economic science that can distinguish facts from values is too reductive – it is often difficult to distinguish between the two. For example, depending on whether we measure the impact of tax policy on individuals or on households, the policy may be characterised as redistributive or as anti-redistributive. Often there is no easy solution to this problem, because it is difficult for the statistician to know how incomes are actually being shared within households. The current solution for measuring living standards and poverty is to assume that resources are fully shared within the household, regardless of the source of the income (labour income from one or another member, social welfare, taxation, etc.). Yet numerous studies show that for many households this assumption is false: empirical studies show that spending depends on who provides the resources, with women spending a larger portion of their income on the children.

Does the free character of the higher education system make it

anti-redistributive? To public opinion this is obvious: the students come from wealthier families and will receive bigger salaries than those who don't study, while everyone pays taxes, including VAT and the CSG wealth tax. This seems to be true if we think about it at time t . On the other hand, if you consider the life cycle the issue becomes more complicated: many students do not get high-paying jobs. School teachers, artists and journalists are often highly educated but make lower-than-average wages. For them, paying income tax is more advantageous than paying enrolment fees. Conversely, many people who have little education receive large salaries. Over the life cycle, having higher education paid for through income tax is redistributive (see "[Dépenses publiques d'éducation et inégalités. Une perspective de cycle de vie](#)" ["Public expenditure on education and inequality. A life cycle perspective"]).

Should we measure income at the household level or individual level? Over the life cycle or at a given point in time? These examples show that what is measured by economists usually depends on a norm. This does not however mean that the measure is completely arbitrary and ideological. In fact, social science measurement is neither entirely normative nor merely descriptive: facts and norms are intertwined.

Economists do not reason simply with raw facts. They develop and estimate behavioural models. They do this to answer the question, "What if ...?" What if we increased the minimum wage, what would be the impact on employment and wages at the bottom of the scale? You could classify the answer to such questions as facts. But unlike facts in the strict sense, they are not directly observable. They are generally estimated in models. However, the disagreements over these "facts" (the parameters estimated in the models) are very important. Worse, economists tend to greatly underestimate the lack of a consensus.

The parameters estimated by economists have meaning only within a given model. However, the disagreements between

economists are not just about the parameters estimated, but the models themselves, that is to say, about the selection of simplifying assumptions. Just as a map is a simplification of the territory it represents, economic models are a simplification of the behavioural rules that individuals follow. Choosing what to simplify is not without normative implications. The best map depends on the degree of accuracy but also on the type of trip you want to make: once again, facts and values are intertwined. Differences between policies are not simply parametric, but arise from different representations of society.

Thus, contrary to the conclusion of Tirole and Wasmer, economic evaluations cannot be simply left to objective experts. In this respect, economists resemble other social scientists more than they do physicians: in fact, agreement on what constitutes good health is easier than on what constitutes a good society. Economic evaluations must therefore be pluralist, in order to reflect as much as possible the diversity of views in a society. What separates us from implementing the reforms needed is not a pedagogical deficit on the part of the experts and politicians. Nor is it simply a problem of educating the elite. There is obviously no agreement among the experts on the reforms needed. However, the economic reforms are often too technical to submit to a referendum and too normative to be left to the "experts". To resolve this problem, consensus conferences and citizens' juries seem relevant when the subject is normative enough to care about the representativeness of the participants and technical enough that we need to seek informed opinions. In economics, these kinds of conferences could deal with the issue of the individualisation of income taxes or carbon offset taxes. In short, economists are more useful when they make the trade-offs explicit than when they seek the facade of a consensus.

Does inequality hurt economic performance?

By [Francesco Saraceno](#)

Economic theory has long neglected the effects of income distribution on the performance of the economy. Students were taught right from Introduction to Economics 101 that the subject of efficiency had to be separated from considerations of equity. The idea is that the size of the cake had to be expanded to the maximum before it is shared. It was implicit in this dichotomy that economists should address the issue of efficiency and leave the question of distribution (or redistribution) to the politicians. In this framework, the economist's role is simply to ensure that choices about the channels for redistribution through taxation and public spending do not affect growth by interfering with the incentives of economic agents. Echoes of this view can be found both in the debate about the taxation of very large incomes envisaged by the French Government as well as in authors like [Raghuram Rajan](#) who justify inequality with references to technical progress and international trade, a view refuted by [Paul Krugman](#).

Since the work of Simon Kuznets in the 1950s, some economists have of course questioned whether excessive inequality might not inhibit economic growth, in particular by blocking the accumulation of human capital. But this has long been a minority view among economists. Indeed, the dramatic increase in inequality documented among others by [Atkinson, Piketty and Saez](#) as well as by institutions such as the [OECD](#) and the [IMF](#) failed to give rise to a deep-going reflection about the relationship between inequality and economic performance.

It was the crisis that revived this concern. Growing inequality [is now suspected](#) of being a source of increasing household debt and speculative bubbles, leading to the accumulation of internal and external imbalances that have set off the current crisis. This is the argument developed by authors like [Joseph Stiglitz](#) and [James Galbraith](#).

Today the dichotomy between efficiency and distribution is no longer tenable. Inequality is becoming an essential theme in economic analysis, for both the short and long terms. To stimulate discussion on this topic, the OFCE and the SKEMA Business School are holding a workshop on "[Inequality and Economic Performance](#)" in Paris on 16 and 17 October 2012.

The economic crisis is a crisis of economic policy

By [Jean-Luc Gaffard](#)

The simultaneous increase of inflation and unemployment in the 1970s indicated that Keynesian theory and policy had run into a wall. No longer was it simply possible to arbitrate between the two evils and fine-tune economic activity by acting solely on aggregate demand through the budget channel. This failure together with the persistence of high inflation eventually convinced policymakers of the need and urgency of prioritising the fight against inflation.

The economic theory devised by the new classical school came in support of this policy decision with the claim that inflation and unemployment were distinct phenomena that should

be handled with distinct methods. If inflation takes off, it is because of a lack of monetary discipline. If unemployment rises, it is due to increased rigidities in the functioning of the markets. The famous Phillips curve, the basis for arbitrating between the two, theoretically becomes vertical, at least in the long run. Macroeconomic policies thus become dissociated from structural policies: the first are intended to stem inflation, the second to curb unemployment. The only relationship that they have with each other is that cyclical policy does not allow the economy to escape for long from the position determined by structural policy, a position that reflects the so-called natural unemployment rate. One attraction of this theory is the simplicity of its recommendations to government. Policymakers can (and should) meet a single target, inflation, by using a single instrument wielded by a central bank that is now independent, especially as hitting this target also ensures that the natural employment level will be achieved at the lowest cost in terms of inflation. If by chance the unemployment rate is considered too high, policymakers should take the view that this reflects dysfunctions in the markets for goods and labour, and they can then decide to introduce a well-organised set of structural reforms designed for market liberalisation. In this wonderful world, reducing the budget deficit is always profitable. The basic model teaches that, after such a reduction, income and employment decrease initially, but then, thanks to a reduction in interest rates, private investment quickly increases and with it income and employment. The new medium-term equilibrium may even correspond to a higher level of income and employment, as private investment expenditure is considered to be more efficient than government expenditure. An independent central bank and financial markets that are deemed efficient play the role of disciplining the government by punishing any inappropriate budget deficits.

Europe has been a prime testing ground for this theory. Monetary policy is in the hands of a central bank, and its

governing treaties ensure that it is independent and that its sole objective is price stability. Structural policies and reforms are a matter for the states, which are responsible for choosing the natural unemployment rate that they consider acceptable or, if they consider unemployment to be too high, they can impose reforms. If unemployment is higher in one country than in another, in the medium term, this can only be due to structural differences, in other words, to the existence of greater rigidities in the way the markets in this country operate. Once the recommended reforms are implemented, things will get back to normal. The theory thus formulated is expected to survive the crisis: for Europe to regain its lost coherence is a simple matter of policy choices. Excessively indebted countries need to reduce their budget deficits and make the structural reforms that they have put off for too long in order to restore growth, full employment and price stability. At most, some are proposing that debts be pooled in return for a commitment to implement structural reform. Germany, which has preceded the others down this particular path to virtue, has nothing to fear from this scenario, since the renewed growth of its partners will ensure the long-term viability of its commercial outlets. Furthermore, the European Central Bank does not need to concern itself with financial stability, as markets punish impecunious States and force them into fiscal austerity by driving up the interest rates paid on their borrowings.

This entire beautiful structure rests on assumptions that are not very robust, in particular that any increase in market rigidities, particularly on the labour market, *e.g.* due to an increase in unemployment benefits, redundancy costs or employee bargaining power, shifts the long-term equilibrium position of the economy and inevitably produces an increase in the "natural" unemployment rate. It is, of course, always possible to compare long-run equilibria that are distinguished only by the value of certain structural data. It is riskier to deduce the path that leads from one to another. We should have

learned from the experience of the 1930s that rigidities in prices and wages are a way to stem rising unemployment in a depressed economy, that is to say, when it becomes important to block reductions in prices and wages that are increasing the burden of private debt and putting downward pressure on aggregate demand. It should also be clear that structural reforms intended to reduce the natural rate of unemployment often lead immediately to a redistribution and reduction in income, which leads in turn to higher unemployment. But nothing says that this increase will only be temporary and will not trigger a chain reaction through the channel of aggregate demand. Rigidities remain a factor in reducing the risk of instability inherent in any structural change, whether this involves reforms in market organisation, the emergence of new competitors on the market or technological breakthroughs. A better allocation of resources may justify calling these rigidities into question, but care must be taken to avoid the inherent risk of instability. Certainly, when structural reforms aimed at introducing more flexibility undermine domestic demand, the latter can then be boosted by stimulating external demand with lower prices. The unemployment rate may then fall. But it is actually exported to countries that might well not yet have undertaken such reforms, where unemployment thus inevitably exceeds the level deemed natural. "Every man for himself" begins to prevail over solidarity.

Europe is currently going through this scenario. Germany, in particular, carried out the structural reforms required by the prevailing theory, but at the cost of the segmentation of its labour market and the growth of low-paid insecure jobs, which resulted in turn in a slowdown in domestic demand. The improvement in Germany's export performance, based on the quality of its goods as well as on the international fragmentation of the production process, has been offsetting the slowdown and helping to contain or even reduce the budget deficit. The unemployment rate has been rising in many other European countries in parallel to their budget deficits. The

correction required by the experts (and in fact imposed by the financial markets), which involves simultaneously reducing public spending, raising taxes and making structural reforms, will very likely further reduce domestic demand in these countries, increase their budget deficits and ultimately hit German exports. [Recession, if not a general depression, lies at the end of this path.](#) The cause is a series of internal and external imbalances. And things could get even more complicated if performance gaps in the countries concerned widen even further and lead to divergences in their goals and interests.

Economic policy is unfortunately more complex than modern macroeconomics would have it. The long term is not independent of the short term; and the goals pursued are not independent of each other, and not always inter-compatible. Policies that are categorised as cyclical and structural are not really independent of each other, nor can they be targeted exclusively at a single goal. If there must be structural reforms, they need to be accompanied by expansionary cyclical policies to counteract the immediate recessionary effects that they may amplify. Even so, cyclical policies are not sufficient in themselves to ensure strong, steady growth.

It is unrealistic and dangerous to expect to break free of the current impasse [through generalised fiscal austerity](#) in Europe. Compromises are needed that involve the acceptance of some disequilibria in order to alleviate others. The only way out is to accept budget deficits for a while longer. [Without a recovery in the balance sheets of both firms and households, there will be no positive outcome](#) from the rebalancing of public accounts, if indeed that even occurs.

There is of course no doubt that we must achieve greater harmony in the fiscal positions of countries belonging to the same monetary zone. Fiscal federalism is necessary to deal with monetary federalism. But federalism does not stop with the actions of a central bank that has been stripped of its

basic functions and is unable to carry out common national fiscal contractions. It demands genuine budget solidarity, including to intervene to prevent the insolvency of States that are facing exorbitant interest rates. It also involves structural policies that not only refrain from reforms that could exacerbate fiscal and social competition, but also promote industrial and technological projects funded by a common European budget that has been strengthened through the establishment of a federal tax. State budget deficits will not be contained and the objectives and interests of states will not converge without the implementation of the cyclical and structural policies needed for a general recovery of growth.