AHE Conference
Solent University,
Southampton,
2-4 July 2015

The Systemic Nature of the Economic Crisis: The Perspectives of Heterodox Economics and Psychoanalysis+

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+ It builds on the macroeconomic perspective contained in the chapters 12-13 of the book with the same title, published by Routledge in April 2015.

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1. PUBLIC SPENDING AND CREDIT CREATION AS THE DRIVERS OF AGGREGATE DEMAND

1.1 Some Structural Reasons of Economic Crisis

The aim of this chapter is to identify a number of structural elements for the emergence of the recent economic crisis. As is known, such crisis had build up silently and exploded in the 2008 with the failure of the banks involved on ill-advised speculative ventures.

Since then, several authors, who had in most cases already pointed out the unsoundness of the speculative fever, have stressed the inadequacy of neoclassical theories in addressing these phenomena. The main aspect of these theories has been (and still is) to place an unconditioned emphasis on the rationality of economic man and on the maximizing virtues of free markets.

The chief drawback of this account lies in its excessive simplification of economic phenomena which prevented these economists from detecting the complexity and imperfections of the markets and of human behaviour.

Reality, in fact, has proved to be much different from these simplified pictures. It became apparent that, in particular but not only, in the financial sector, economic behaviour was often driven by irrational or non-rational elements and that, relatedly, markets not only did not adequately signalled the risk of certain ventures but in some cases provided perverse incentives to go on with these initiatives.

For this reason, many authors[1] have pointed to a number of factors in the explanation of economic crisis. Foremost among them is the marked redistribution of income in favour of the wealthier classes that has occurred in the last decade. This phenomenon has had an adverse effect on the aggregate demand because, as is known, the marginal propensity to consume tends to be higher with lower incomes. Furthermore, as this redistribution has been accompanied by a growing economic precariousness and insecurity, the overall effects of this trend has been much worse, as it has affected the (relative) stability of the economic and social fabric.

But, owing to the unconditioned faith on the market virtues, little importance had been given to these imbalances, which tended to be considered a sort of "necessary evil" of economic development. Likewise, and by the same token, little importance was paid to the massive speculative operations taking place in the financial sector.

[1] Cf., among others, for an account of a heterodox perspective on these phenomena, Harcourt and Kriesler (2013), Keen (2011), Minsky (2008), Stiglitz (2009).

In this situation, no wonder that an economic crisis was bound to emerge. Starting from these insights, we will address in the next paragraphs a number of contradictions that have contributed in determining the systemic character of the crisis.

As also noted before, economic institutions — in particular, markets, firms, and also public administration — are becoming increasingly complex and for this reason are moving away from any simplistic conception of “public” and “private” economy.

There are many reasons for this phenomenon, an important group of them referring to the need of public sector to grow and diversify its functions in order to try to manage the complexity and contradictions of the “mixed economies” of our days.

Among its many functions, public sector plays a relevant role — directly through public spending and more indirectly through credit creation — in the formation of aggregate demand.

Now we focus attention on this aspect, by analysing a number of macroeconomic features of public intervention.

1.2 The Chronic Insufficiency of Effective Demand and the Impressive Increase of the Ratio of Public Spending on GDP

One leading aspect of the growing role of public intervention is the increase of public spending (PS), not only in absolute but also in relative terms, as shown by the ratio Public spending on GDP. The available data clearly make evident this trend. The average value of the ratio has shifted, for the OECD Countries, from 20-30% of 1970s to 40-50% of recent years. Some of these data are reported in the Table 1.

Table 1

Total Public Spending as a Percentage of GDP

Nations	Year 2009
Australia	37.19
Austria	52.97
Belgium	54.11
Canada	44.37
Chile	24.62
Czec-Republic	45.95
Denmark	58.42
Estonia	45.17
Finland	55.86
France	56.74
Germany	47.50
Greece	52.85
Hungary	50.54
Iceland	51.05
Ireland	48.17
Israel	44.27
Italy	51.83
Japan	42.03
Korea	33.08
Luxembourg	42.19
Mexico	23.51
Netherlands	51.35
New Zealand	42.33
Norway	47.31
Poland	44.51
Portugal	49.85
Slovak Republic	41.54
Slovenia	49.16
Spain	45.80
Sweden	55.15
Switzerland	34.15
Turkey	39.44
United Kingdom	51.45
United States	42.18

Source: Based on data from OECD (2011), "General government expenditures", in Government at a Glance 2011, OECD Publishing. http://dx.doi.org/10.1787/gov_glance-2011-10-en

As for credit creation, the available data show (Tables 2 and 3) for the OECD Countries high values of the ratio of public and private debt on GDP. Moreover, these figures have considerably increased[2] in the last decade, from, in average, approximately 50% to 100% for public debt and from approximately 20% to 50% for private debt.

[2] For more information refer to the following link: http://stats.oecd.org/Index.aspx?DataSetCode=FIN_IND_FBS

Table 2

Debt of General Government as a Percentage of GDP

Nations	Year 2012
Australia	56,3
Austria	85,2
Belgium	106,4
Canada	109,7
Chile	18,7
Czech Republic	55,7
Denmark	59,3
Estonia	13,2
Finland	64,5
France	109,3
Germany	88,5
Greece	164,2
Hungary	89,6
Iceland	Na
Ireland	125,7
Israel	80,0
Italy	141,7
Japan	235,8
Korea	37,5
Luxembourg	30,1
Mexico	Na
Netherlands	82,7
Norway	34,7
Poland	62,3
Portugal	127,8
Slovak Republic	56,8
Slovenia	61,4
Spain	92,8
Sweden	48,8
Switzerland	46,1 (2011)
Turkey	46,3
United Kingdom	101,5
United States	123,0

Source: Based on data from "Financial Indicators – Stocks"
http://stats.oecd.org/Index.aspx?DataSetCode=FIN_IND_FBS
in OECD.StatExtracts http://stats.oecd.org/

Table 3

Private Sector Debt
as a Percentage of GDP

Nations	Year 2011
Australia	184,4
Austria	179,5
Belgium	251,8
Canada	233,7
Chile	166,4
Czech Republic	147,0
Denmark	261,1
Estonia	166,6
Finland	207,4
France	221,9
Germany	159,5
Greece	142,7
Hungary	219,5
Iceland	Na
Ireland	411,6
Israel	132,0
Italy	188,5
Japan	243,0
Korea	251,3
Luxembourg	451,5
Mexico	Na
Netherlands	252,2
Norway	254,8
Poland	119,6
Portugal	331,0
Slovak Republic	113,9
Slovenia	176,4
Spain	279,8
Sweden	295,2
Switzerland	221,4
Turkey	Na
United Kingdom	204,2
United States	198,7

Source: Based on data from "Financial Indicators – Stocks"
http://stats.oecd.org/Index.aspx?DataSetCode=FIN_IND_FBS
in OECD.StatExtracts http://stats.oecd.org/

What are the structural reasons for such an impressive increase in public spending and credit creation? As regards public spending, this phenomenon has been first highlighted by Adolph Wagner, who observed that economic and social development carries with it an enlargement and diversification of the functions of the public sector. With regard to credit creation, its role in creating effective demand[3] was spelled out by J.M.Keynes and many authors in Keynesian tradition. These authors also made clear the role of public sector (meant in a broad sense, and then also including Central Banks) in guaranteeing the value of money and in orienting the banks in their policies of credit creation

The reason why we accept banknotes of intrinsic minimal value is that we are fairly confident that their real purchasing power is monitored and guaranteed (up to a certain degree, of course) by public action. In this sense, as underscored by many authors, money is a highly institutional phenomenon.

Hence, public sector performs an irreplaceable role in providing public goods, including the legal and institutional framework; in managing and/or regulating important economic sectors; in redistributing resources; and in promoting research and innovation.

These insights have evolved into three lines of research, which often tend to be blurred: **(i)** public choice, chiefly belonging to mainstream domain, which investigates the role of interest groups in lobbying the political system for obtaining more public resources in their favour. The limitations of these studies lie in the circumstance that they tend to consider public spending only as a negative phenomenon—a kind of unwelcome departure from the perfect world of mainstream hypotheses; **(ii)** a number of theories belonging to the fields of institutional and evolutionary economics, which point out the potential of the institutional framework for the unfolding of the national system of science and innovation, and of the related framework of human and social capital; **(iii)** Keynesian oriented theories, which investigate the role of public spending and credit creation in ensuring macroeconomic stability and the full employment of the labour force.

Especially in the last three decades, the strands **(i)** and **(ii)** have received surely more attention than the point **(iii)**. In particular, both critics and advocates of public spending implicitly agree that today's level of public spending is "too high" and should be abated in one way or another. And this opinion has gained some ground even among Keynesian macroeconomists, chiefly as a result of the supposed "failure" of the "Keynesian" oriented policies of the post II World War period.

However, since the data indicate that such massive increase of PS/GDP ratio has been fully compatible with the development of capitalistic system (in reality, "mixed economies"), a

[3] Refer in particular to Keynes (1930 and 1936) and the authors mentioned in the previous footnote.

macroeconomic explanation along Keynes' insights is highly needed for casting more light on the profound reasons for such increase.

In this respect, it should also be stressed that Keynes has never been a blind advocate of public spending as such. He investigated the importance of public spending as a component of the aggregate demand and, on that account, was well aware of the contradictions of the system. In his view, as set forth in particular in *Essays in Persuasion* and in *The General Theory*, any increase in public spending should minimize its impact on **(a)** the real interest rate and **(b)** the level of taxation on productive activities. The first goal can be attained by gradually increasing the supply of money, the second by shifting taxation from productive activities to rent-based sources of income and wealth.

Public spending is important for private sector not only as a component of the aggregate demand but also because such component is paramount (along with credit creation) for forming the profit of firms. Since this aspect, however central in Keynes' theory, remains partly implicit in his analysis, in the next paragraph we try to "disentangle" the macroeconomic components of aggregate profit.

1.3 A Keynesian Oriented Interpretative Framework

Let us consider some macroeconomic effects of public spending and credit creation. As can be inferred in particular by Keynesian theories, these elements become vital for generating the aggregate demand, and hence the profit for private firms.

On that account, it is interesting to note that, in the absence of such policies, no significant aggregate profit[4] would be possible for firms.

As a matter of fact, labour cost constitutes an aggregate cost for the system of firms. This cost can be brought to zero if employees spend all their earnings but can never become a source of profit.

[4] By the expression aggregate profit we mean an amount of profit which exceeds the "normal" incomes of all the workers engaged in the private sector, including the so-called executive-salaries. Needless to say, a kind of aggregate profit can be present also in a hypothetical pure private economy, but in this case it is difficult that it acquires the nature of the extra-profits typical of expansionary period driven by public spending and credit creation. As a matter of fact, in a "pure private economy", the income differences between persons and classes find a limit in the principle of the effective demand. For instance, if the entrepreneurs want to increase their profits by reducing real wages, they must also make up for the reduction in the effective demand caused by wages reduction. In a private economy, as investment goods are intrinsically related to consumption goods, the only available way for increasing the effective demand is to attain a higher level of the entrepreneurs' consumption. However, this process finds many limitations, especially in the presence of scale-economies associated with mass consumption (the entrepreneur can buy himself a yacht, but for the class of entrepreneur buying, say, one thousand iPads each in order to sustain effective demand is likely to be a bit less practical). This aspect can help explain why the marginal propensity to consume tends to be lower for the richest sections of populations. For these reasons, we consider the consumption of entrepreneurs in the formation of aggregate profit as a relatively unimportant phenomenon.

It is important to underscore that all these economic relations embody, at the same time, also a social, cultural and psychological aspect, the study of which becomes paramount for a full understanding of the real features and problems of the examined contexts.

But, very interestingly, not even the entrepreneurs' investment expenses can create an aggregate profit for the firms as a whole. In such case, in fact, to the profit of an entrepreneur must correspond the expense of another, so that the net result for the firms would be zero.

As a consequence, aggregate profit[5] must derive from sources "external" to the system of firms: these sources — not considering, for the sake of simplicity, international trade whose balance[6] is zero at world-level — take two interrelated forms: public spending and credit creation. We can express these relations in the following way:

$$\textbf{1.}\qquad \mathbf{P + L \equiv Y = C + I + G \equiv amG + bmCD + (1\text{-}\ a)mG + (1 - b)mCD + C_p + I_p}$$

where **P** denotes the aggregate profit for the system of private[7] firms, **L** the sum of "labour" incomes, including the "executive salaries", **G** public spending and **CD** the amount of aggregate demand generated by credit creation, **m** the value of multiplier, **a** and **b,** and **(1- a)** and **(1 – b)** the ratios of the effective demand generated by public spending and credit creation accruing to private profits and to labour incomes**,** $\mathbf{C_p + I_p}$ the sum of consumption and investment originated[8] in the private sector. **CD** indicates that, in a monetary economy, credit (both short and long term based) is created through the provision of new purchasing power (e.g., of money creation) made available to borrowers. In this context, **P** constitutes a fraction of the aggregate income and are equal to:

$$\textbf{2.}\qquad \mathbf{P \equiv amG + bmCD}$$

Now, considering a "pure system" of private agents, we obtain that:

$$\textbf{3.}\qquad \mathbf{P + L \equiv C_p + I_p \equiv C + I}$$

such identity implies that in a private system, without public spending and credit creation, the sum of consumption and investment tends to be equal to wages and salaries and, therefore, there is little room for aggregate profit, in the meaning described above.

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[5] Another condition for the existence of profits as defined above is the presence of some kind of market power on the part of entrepreneurs. This can arise in the labour process, where normally entrepreneurs have a strong contractual powers over the workers, and in the market for goods, when firms hold various forms of monopoly power.

[6] Needless to say, this is a gross simplification. In fact, as well underscored by the theories of unequal exchange, the total effects of international trade tend to adversely affect the weaker countries.

[7] Also in this case, the multifarious aspects of the growing complexity of the system comport with a parallel articulation of the structure of ownership of the firms, with the presence of many "mixed" forms. It is interesting to note that this analysis will apply also to the case of state-owned enterprises, provided be they organized as administratively independent bodies.

[8] We are aware of the difficulty of "disentangling" the various components of aggregate demand in real economies. Besides, in our complex credit-based economies, it seems really arduous to find significant instances of a pure private economy. Namely, an economy in which credit creation and public spending play a minor role in creating aggregate demand. Such realities can perhaps be found in simple economic arrangements, like local markets based on craftsmanship and typical products.

1.4 Can The Cut in Public Spending Improve Public Budget?

Let us now analyze with simple examples the possible effects of a reduction in public spending on the public sector's budget.

We wish in this way to assess if, apart from other social considerations, these measures can be effective in improving public sector's accounts.

For instance, by reducing the salaries of civil servants by an amount, say, equal to 100, this entails a saving of 100 in the public sector.

But, on the other side, the cut of salaries will induce a parallel reduction of effective demand. By hypothesizing a marginal propensity to consume equal to 0.8 and an average income tax equal to 0.3, we obtain, by applying the income multiplier:

4. $$\frac{1}{1-c(1-t)} = \left(\frac{100}{1-0{,}8+0{,}24}\right) = -\left(\frac{100}{0{,}44}\right) \approx -227$$

If, then, we assume, as a reasonable hypothesis, that the total taxation (direct + indirect) is approximately equal to 50%, the reduction of public spending will cause a reduction of fiscal revenue equal to -227*0,5 = 113,5.

The net balance of this operation for public finance is then -113,5 + 100 = -13,5 and is only the role of the "social absorbers" that can mitigate this effect.

Needless to say, in real situations we need to specify much better, among others, the following aspects: **(i)** the characteristics of the "consumption functions" for the various groups and classes, in order to consider the social, cultural and psychological elements which combine to shape a given consumption pattern; **(ii)** the characteristics of the "social absorbers", and their links with other policy objectives which, as shown in the previous chapter, need to be studied in their manifold interrelations.

Being aware of all these aspects, we believe that this example can grasp an important aspect of macroeconomics.

The Reduction of Income Tax

Let us consider the instance of an income tax reduction, say, from 30% to 20%. The new income, by assuming an hypothetical starting value of 100, will be equal to:

5. $$\frac{100}{1-0{,}8+0{,}16} = \frac{100}{0{,}36} \approx 278$$

The difference between the new income (278)

and the old income, indicated by

6. $$\frac{100}{1-0{,}8+0{,}24} = \frac{100}{0{,}44} \approx 227$$

is equal to 51. The level of fiscal revenue remains almost unchanged: in fact, supposing as before a total amount of direct and in direct taxation equal to 0,5 we get in the first case 227*0,5 ≈ 113 and in the second 278*0,4 ≈ 111.

But, to what extent is realistic this hypothesis? As can be easily noted, it as realistic as it is realistic to assume a GDP increase of approximately 22% (51/227).

If, as it seems much more plausible, for a number of reasons the aggregate supply curve is likely to be steeper for a sudden and large increase in the effective demand, the increase of GDP will be much lower than 22% and the result will be a worsening of public accounts. As in the previous case, this example is only indicative of a much more complex reality.

To What Extent Private Investment can Replace Public Spending?

This analysis is linked to the following central question, namely, whether in the familiar identity

7. $$\mathbf{Y \equiv C + I + G}$$

the terms **I** and **G** are mutually replaceable. As a matter of fact, it is on this (more or less explicit) assumption that the neoclassical economists base their reasoning—namely, that the economic space now “ineffectively occupied” by the public sector can easily be replaced by private investment. But to what degree is this alternative feasible (and advisable)? For instance, let us suppose that we have, at the time zero:

8. $$\mathbf{Y_0 \equiv 800 + 50 + 150 \equiv 1000}$$

In this case, neoclassical oriented theories tend to posit that a diminution, say, by 100 in public spending would entail a parallel increase in **I**. In the opinion of many, if 1000 is an equilibrium of underemployment, the reduction in public spending would generate an increase in **I** even higher than the correspondent reduction in public spending. In this way, the new level of $\mathbf{Y_1}$ would be higher than $\mathbf{Y_0}$. By assuming, for the same marginal propensity to consume 0.8, that the decrease in public spending by 100 is accompanied by an increase of **I** equal to 150, we obtain:

9. $$\mathbf{Y_1 \equiv 1000 + 200 + 50 \equiv 1250}$$

However, this idyllic result for mainstream economics is hard to be attained as the hypothesis of perfect substitutability between **I** and **G** is very far from reality. In fact, as we have seen, public spending and credit creation are the main drivers of aggregate profit. Furthermore, a perfect substitutability[9] between **I** and **G** finds a limit in the circumstance that the amount of investment goods need be geared to the amount of consumption goods that firms plan to produce which, in turn, depend on the available income of the labour force. We can represent this situation with the general equation:

10. $$\mathbf{C = f(I)}$$

we define this equation general to imply that, in order to produce a given amount of consumption goods, many productive ways are possible. However, the possibility of choosing different productive techniques does not imply the perfect flexibility of productive factors postulated by neoclassical economics.

Quite the contrary, this formulation takes into account that any kind of productive process — with their present and prospective techniques — is highly evolutionary and path-dependent as it is fully

[9] As noted in the previous part, the notions of public and private action, markets, competition and efficiency are determined by the complex and evolutionary systems of norms, institutions, policies in their relation with the cultural and psychological orientations at the individual and collective level. In this respect, one noteworthy phenomenon is the growing importance of the “mixed forms” of economic activities. They are characterized by an articulated presence of “stakeholders” which carry different objectives and systems of value.

Also for this reason it becomes more and more necessary an adequate level of coordination between institutions and policies in order to take in due account the multifariousness of these issues.

ingrained in the complexity of the social and cultural context. In any event, and for whatever productive technique employed at the time, a fundamental implication of the Keynesian theory of aggregate demand is that investment expenses are made with a view to produce a programmed amount of consumption goods. Hence, the trend of the demand for consumption goods will affect, positively or negatively, the demand for investment goods.

1.5 The Unrealistic Hypothesis of a "Pure Private Economy"

A general implication of this analysis is that a "perfect" private economy is unlikely to be attained in the modern world. Such an economy, in allowing little growth, little innovation and little change, can have as its correlate only with very simple economic systems, based on vicinity and direct personal relations. But, as soon as these systems start growing, the role of public sector becomes paramount. Both public spending and credit creation originate from public intervention. This is evident for public spending, but also for credit creation the role of public sector is no less important. In fact, as just noted, public sector (meant in a broad sense and then including also the Central Bank) plays an exceedingly pivotal role in creating and guaranteeing the value of money.

Public spending and credit creation can accrue to aggregate demand in numerous ways: as for public spending, in particular, **(i)** classic multiplier effects related to public consumption, public investment and civil servants' incomes; **(ii)** subsidies and incentives to firms, which can accrue to both firms' consumption and investment expenses. And, **(iii)** as for credit creation, the various types of consumer credit and investment credit, which also combine to shape the level and forms of public spending.

For these reasons, it appears clearly that the neoclassical idea of a *crowding out* effect of public spending on private sector can display, if any, only a limited effect in our economies. As we have tried to show, in a "pure private economy" aggregate profit is unlikely to be very high. Public spending and credit creation play the fundamental role of pushing the growth of the system, also because they contribute to create an important part of the aggregate demand, which accrues to the private sector.

Itt can also be interesting to note that these conclusions hold true whatever be the elasticity[10] to prices of the aggregate supply function. As a general remark, we believe that the aggregate supply

[10] It can be worth noting that the classic hypothesis of vertical aggregate supply curve, corresponding to full employment, in which there is perfect flexibility of prices and wages, is quite unrealistic for a host of reasons: **(i)** Full employment is hard to achieve not because of too high wages but owing to an insufficient level of effective demand; **(ii)** Technological progress can contribute, in a complex way, both to the rise of the unemployment and to the shifting of the "supply functions" at firm at industry level; **(iii)** The role of expectations, which makes the distinction between short run and long run more blurred; **(iv)** The phenomenon of sticky prices, which do not depend only on "market

function is in most cases elastic enough in the short run, and even more in the medium and long run, due to the effects of technological progress.

2. ECONOMIC AND PSYCHOLOGICAL IMPLICATIONS

2.1 The Growing Contradictions of the System

The pivotal role of public spending and credit creation in ensuring an adequate level of aggregate profit engenders many contradictions, which tend to become more and more unmanageable.

As we have seen, there has been, since the inception of the industrial revolution, a rather stable increase of public spending, both in absolute and relative terms, also on account of the role of public spending in increasing the aggregate demand, and, hence, the profit of firms. In this regard, the present economic crises do not depend on the Keynesian policies of the past and/or in an alleged inefficient and lobbistic nature of public intervention — even if, of course, it is true that public spending is not always effective and/or can be driven, at greater or lesser extent, by the dynamics of various interest groups — but in the necessity to manage the growing contradictions of the system. In this regard, we can mention two major, and interrelated, contradictions:

(I) As just noted, public spending and credit creation play a paramount in the formation of effective demand and aggregate profit of economic systems, and this aspect constitutes a key explanation of their impressive growth over time. The relevance of these aspects is, however, only imperfectly acknowledged in our societies. Both for this reason and for the influence of neo-liberalist attitudes, public spending is in general appraised in a negative way, as a kind of obstacle which crowds out resources from the private sector. This has been accompanied by a even more negative attitude towards taxation. Every candidate, of whatever political orientations, knows that in order to win

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imperfections" but are often needed in order to provide the system with a minimum of stability and reliability: if everything were wild flexible, no stable economic and social life would be possible (see also the previous chapter); **(v)** Also for this reason, the decision to change prices necessitates some planning activities in order to foreshadow the possible consequences. As this activity should be made in advance, it constitutes a good explanation, set forth in particular by the theory of "small menu costs", of the reason why firms do not quickly adjust their prices even when it would seem more profitable to do so; **(vi)** The same phenomenon has been observed in labour markets, where both firms and workers prefer to negotiate long-term contracts.

As can easily be seen, all these relations do not take place in a *vacuum* but are heavily interlinked in the social and cultural domain. For all these reasons, an interdisciplinary approach can help to look more deeply into the microeconomic foundations of the macroeconomic aggregates.

elections he/she must promise a tax reduction and that the worst and fatal accusation that can be levelled at a government is that it has increased taxation.

Consequently, as the increase of taxation has fallen systematically behind the level of the increase in public spending, public budget deficits in OECD Countries have reached considerable values.

In order to finance these deficits, a huge accumulation of public debt followed. The increase of public debt is particularly detrimental for economic development owing to a different type of crowding out effect. As a matter of fact, the payment of interests on public debt diverts to rent-based incomes a good deal of public resources which could have been devoted to objectives of public utility. This constitutes, in our view, the crux of the supposed inadequacy of public spending to pursue economic and social objectives.

The gross inadequacy of this situation both for stimulating economy and for addressing economic and social imbalances is self-evident.

In this sense, we believe that the issue related to the difficulty of payment of public debt is largely exaggerated. Conversely, what seems highly needed for solving the public debt problem is: **(a)** to restore a climate of trust, so that people would reinvest in bonds their assets once they come due. **(b)** To reduce public sector's deficit, by rationalizing public spending and/or by realizing a more progressive taxation, especially for rent-based incomes and wealth. In this regard, it is important to recall from the "Haavelmo's theorem" (1945) that public spending is likely to positively influence aggregate demand even with a corresponding level of taxation, since the marginal propensity of consumption of the public sector is likely to equal unity, whereas that of private sector is likely to be less. **(c)** To lessen as much as possible the real interest rate, in order to reduce the burden for public sector and promote investments. **(d)** Of course, also more radical solutions can be envisaged, such as a partial or total debt cancellation. In our view, these measures are interesting but, taken in absence of a far-reaching perspective of economic and social change, run the risk of acting only as a temporary relief. What seems really needed is a structural transformation of the system in which the need of public debt will be gradually eliminated. In this regard, the attainment of the previous points, together with other measures oriented to ensure an equitable and sustainable growth, seem particularly important.

(II) Another macroscopic and disruptive contradiction — which has paved the way for the eruption of the present-day economic and financial crisis — can be found in the relation between **(a)** most credit policies, which aim to uplift, also through well organized advertisement strategies, persons' spending capacity well beyond their real earnings; and **(b)** business strategies which, in order to gain "competitiveness", tend to reduce employees' incomes and work conditions to a minimum.

Under these growing burdens, personal bankrupt is likely to arise, with the spreading of all its negative consequences on the whole system. It can be interesting to note that these contradictions can find a relevant explanation in the relations of accumulation in a monetary economy, which are expressed by the expression $\mathbf{M} \rightarrow \mathbf{C} \rightarrow \mathbf{M'}$, where **M** indicates money and **C** the commodities. As is known, this formulation was proposed by Marx and then was taken up and elaborated by Veblen, Keynes and many other scholars. In this sense, it represents one of the cornerstone of economic theory.

It means that, in a capitalistic economy, all economic transactions are, at the same time, monetary transactions, and hence, for a growing economy this means, for the same level of prices, a continual accrual of their monetary value.

In order to carry out a more precise theoretical and empirical analysis on these issues, a careful study of the following factors is highly needed: labour and goods markets and the institutionally-based "mechanisms" of prices and salaries formation; firms' organization, industrial structure, and any other relevant aspect of the social, legal, policy and institutional framework[11].

Bringing Together Macroeconomic Objectives and Sustainable Development

In the analysis of these problems, and also on the account of the interrelations between policies discussed earlier on, it seems pertinent for our issue to look into the interrelations between macroeconomic policies (typically, more short-term targeted) and structural policies (typically, more long-term oriented).

As a matter of fact, on the one hand, macroeconomic policies, as is widely recognized and analysed, impinge on structural policies—for instance, environmental, industrial, competition, innovation and regulatory. But, on the other hand, structural policies also bear on macroeconomic policies. Indeed, structural policies also influence, in a complex interlink, **(i)** the effects of macroeconomic policies on the short-term targets of employment, inflation and interest rates and **(ii)** the economic and social framework in which the macroeconomic policies are interlaced. As underscored in particular by institutional and evolutionary economics, political economy is profoundly bound up with the social and cultural domains. For this reason, a comprehensive approach also embracing other important fields of social sciences — in particular, sociology, psychology and anthropology — would be of particular value for enquiring into the intrinsic multifariousness of policy action.

In this regard, one aspect that emerges from our institutional-rooted analysis is that policy cooperation does not acquire only a "technical character" but involves a profound "cultural

[11] The importance of these aspects was highlighted in particular within the field of institutional economics, see Commons (1913, 1924 and 1934); Hodgson, Samuels and Tool (1994), Veblen (1899, 1914 and 1919).

revolution” of the historical, political, institutional, social, economic and psychological dimensions of any given context.

2.2 The Difficulty of Devising Alternative Paradigms: A Psychoanalytic Interpretation

This interdisciplinary and encompassing character of policy action, while prospecting new avenues of progress, can help explain, at the same time, the difficulty of its accomplishment. In fact, owing to this complexity, policy measures taken in an uncoordinated and piecemeal way are unlikely to be successful. As a result, a feeling of frustration and pessimism can ensue.

For this reason, it can be pertinent to get a closer look on how psychological and social phenomena are interlaced.

As regards the recent economic crises, an interesting strand of research, often labelled as “socioanalysis”, has pointed out the role of unconscious fantasies and group behaviour in the analysis of the phenomena of money, finance and capital, with particular reference to speculative behaviour of financial institutions and citizens. These studies (cf. in particular, Long and Sievers, 2012, Tuckett, 2011) underline that financial investments are unlikely to be “rational” owing to the strong emotional involvement and the role of psychological conflicts in this respect. A marked ambivalence characterizes these mental states, in which aggressive behaviour plays a relevant role. Typically, the first stage is one of greedy euphoria, which often spreads out on account of some optimistic stories relating to the quotations of the financial assets. In this honeymoon stage there tends to be a total identification with the “good object”, and any warning on the risk of the investment is strongly denied. Then, when the quotations start to go down, a depressive and pessimistic phase follows in which the “good object” has now transformed itself into a “bad object” and nothing is supposed can be done to help the situation.

In this sense, a psychoanalytic perspective can also be employed for the study of other economic and social issues. On that account, it can be very interesting to analyse how people perceive and interpret their economic and social realities and the reasons that can hinder the attainment of a more equitable and sustainable society.

We can see these aspects by investigating how people tend to perceive and interpret the increase in public spending of the past decades.

In this situation, a vicious circle tends to arise: as a result of the structural tendency towards increase in public spending, it is gained ground the opinion, even across various sectors of the progressive domain, that the only remedy to the present crisis consists in a progressive reduction of public spending and public deficit. Needless to say, these targets[12] are quite different, but in the conventional wisdom, and also in the unconscious perception, they tend to be equalized. The basic and widespread perception is that public spending is anyway "too high" and so must be abated at any cost.

In these situations, in which the only faith in economic progress rests on a kind of a wild and unregulated competition, the market tends to be psychologically perceived as an inflexible and punitive *superego*. In that vision, the only possible thing we should do is to comply with the "needs of the market", without any further enquiry on the adequacy of the system to respond to the profound needs of economy and society.

In order to better appraise these complex phenomena, an enquiry into how people tend to perceive market phenomena becomes paramount. For instance, if, as just noted, market is perceived as an inflexible and punitive *superego* this implies that persons try to repress their neurotic aggressiveness, which, however, can find many expressions in the marketplace in a more or less disguised way. A typical instance is the behaviour towards financial assets reviewed before.

A psychoanalytical interpretation can make light of the unconscious reasons lying behind the need of reducing public spending[13]. Such need may refer to the child's desire of possessing its mother's affection and nourishment and to the feeling of guilt[14] that often arise in relation to such a desire. As well expounded by the contributions of Sigmund Freud, Melanie Klein and many others, the child, in its early relation with the mother, is likely to experience complex feelings[15] — which can include anger, ambivalence and frustration — related to its utter desire of being nourished and protected.

[12] As a matter of fact, public budget deficit can be reduced not only by cutting expenses but also by increasing taxation.

[13] In this regard, the attitude towards public spending tends often to assume the typical trait of a neurotic disturbance, namely, a compromise between the "desire" and the "defence". For instance, some persons can express their greediness and related aggressiveness by showing an exploitative attitude towards public spending. Others persons, instead, can air their greediness and aggressiveness by denying their need of the mother and identifying themselves with omnipotent and aggressive parental figures. Needless to say, also the latter category of persons is often ready to get advantage of public spending, if the occasion presents itself, but they try to strongly deny it.

Both patterns of behaviour tend to be profoundly destructive: in the first case, people display indirectly their aggressiveness by being "lazy" and trying to live on public spending. The inner sense of guilt expresses itself by keeping the persons in a passive and dependent condition, which of course hinders the true expressions of their personalities. In the second case, people tend to be overactive, but often in destructive way: for instance, by making career and money in an unscrupulous way and letting little room in their life for affective and social relations. In this case, the feeling of guilt creeps up on persons by leaving them always discontent, no matter what they have achieved, and preventing them from having a rewarding social and affective life.

[14] Of course, such feeling can also be related to the characteristics of our "affluent societies" — which induce people to consume more and more in order to keep the productive process going — when compared with the realities of the poorest Countries. In this instance, however, it is quite appropriate to enquire about the adequacy of our provisioning process in ensuring a real possibility of development for everyone. What we are referring to here is the neurotic feeling of guilt (cf. also the previous footnote).

As we will also see in the next part, J.K.Galbraith and other heterodox economists have pointed out that, owing to the massive increase in labour productivity, the real problem in our societies relates not to the real scarcity but to the artificial scarcity (cf. the chapter 7), the latter being created by the legal and institutional frameworks of our economies—and also, we can add, by their intertwining with psychological conflicts and orientations. Of course, one significant element of reality in the discourse on scarcity refers to the wild exploitation of natural resources. However, For these reasons, the attempts to reduce public spending are unlikely to really improve the situation. Our impression, instead, is that these measures are likely to worsen a vicious circle of economic and social crises, most often accompanied by an increase — as we have seen before, mostly neurotic-driven — of xenophobia, intolerance, prejudice, localism and disruptive rivalry[16] in the international relations.

2.3 A (Supposed) Lack of Alternative Theories

This leads us to the following fundamental questions: is the level of social participation in collective issues satisfactory? If not, for what reasons? And what can we do to improve the situation?

Let us consider, for instance, financial speculation. It is well known that the sources of this speculation originate from the large capacity of credit creation of big banks and other financial institutions. They often act through a concerted action which, if carried out to an extensive scale, can spell uncertainty and turbulence for the social and economic fabric. Also, many of these speculative attacks are backed by the opinions of rating agencies and supranational institutions, which are not precisely heterodox oriented.

However, the critical analysis of these facts is heavily missing in public debate and even in street protests. For instance, when a Government, also as a result of a speculative attack, applies a drastic cut of public expenditure in order to keep the public sector's budget "in order", all the protests tend to be directed only towards the direct effects of these measures. True, many protesters would criticise the action of the "big powers" and would uphold very different systems, such as socialism or communism.

The problem, however, is that, when confronted with the policy measures that need to be taken here and now in order to handle comprehensively the problems at the stake, there is a lack — short of

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as just noted, in the typical negative attitude towards public spending the elements of real "scarcity" are only imperfectly appraised: what is "scarce", in conventional wisdom, are not natural resources and the associated patterns of conspicuous consumption, but the supposed "easy and lazy life" made possible by public spending.

[15] In this regard, it can be interesting to note (see also the previous footnotes) that the aggressive attitude towards public spending as a symbol for a maternal figure can help explain why we tend all too often to think of the problem of scarcity as it involved a real lack of goods. This feeling is conveyed through the following expressions, "by now, there is no money left", "we cannot afford these expenses", "we need to tighten up our belt", and what not. As well expounded by Melanie Klein, the child, as a result of an early feeling of abandonment, can react very angrily and so develop a neurotic and aggressive reaction of excessive greediness — and corresponding feeling of guilt — which can express itself by the fantasy of destroying or exhausting the mother's breasts.

It can easily be noted how such early experiences can impinge on adult life, for instance, on their ambivalent attitude towards public spending.

[16] It can be interesting to note that these aspect have been spelled out also by Veblen (in particular 1915, 1917, 1921, 1934) in his historical reconstruction of the emergence of modern nation-states. In this sense, there is a promising area of convergence between institutional theories, psychology and psychoanalysis.

triggering an unlikely revolutionary process — of viable alternative proposals to mainstream oriented policies. Even when there are alternative proposals on specific aspects, it is in general difficult to go beyond the ingrained habits of thought and life prevailing at the time. In this sense, the arguments of the protesters and of progressive public opinion not always square the heart of the questions: what are the profound reasons of the steadily increase of public spending? If (for the reasons illustrated above) it is virtually impossible to diminish public spending without lessening effective demand and profit, is it really so frightening to slightly increase taxation in order to allow an effective and transparent public spending? And why a progressive taxation is still considered an "intolerable sign of socialism"? Why should we allow disruptive financial speculation? Should we consider such speculation as "a free play of market forces" or as an unscrupulous activity made possible within a definite set of institutional and legal framework? And, as a way of synthesis, how can we build a viable alternative economic and social system, really based on democracy and participation in economic, social and political spheres?

These issues converge towards the basic fundamental theme: why has it occurred over time a steady deterioration of relevant aspects of the quality of life—for instance, difficulty to find and retain a motivating job, environmental decay, lack of participation and highly uneven distribution of incomes and power?

In the analysis of these problems, even within the progressive domain, few alternatives are left open: in fact, as the policy of "public spending" is associated with the theory of John Maynard Keynes and, since this theory is often considered to have been a failure, the survived theories are mainstream economics and Marxism. Of course, we cannot agree with none of these points.

First, as we have tried to show, public spending is a key driver of capitalistic growth and Keynes was the first scholar to spell out this aspect. But Keynes was not a superficial advocate of public spending as he was well aware of the many contradictions of the capitalistic system and the corresponding need of long-term solutions to these imbalances.

And second, there are important theories, which are most often overshadowed in public debate, which highlight the role of norms and institutions in the provisioning process of society.

For this reason, institutional, socialist and Keynesian theories can usefully interact for a better understanding of the structural tendencies of our economic systems.

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