Global & Local Economic Review

Volume 18 No. 2 2014

Edited by
Nicola Mattoscio

Federico Caffè and the "Humanism" in Economics and Economic Policy

McGraw Hill Education

Global & Local Economic Review 2014 Vol. 18 No. 2
McGraw-Hill Education

€ 18,00 (i.i.) www.ateneonline.it ISSN: 1722-4241

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GLOBAL AND LOCAL ECONOMIC REVIEW

Commemorating the 100th Birthday Anniversary of Federico Caffè

Acknowledgements

The Editors and the Editorial Board of G&LER are deeply grateful to Edgardo Bucciarelli for his relentless help with the call for papers, and to Donatella Furia for her precious editing work.

Global & Local Economic Review

«Global & Local Economic Review» is included in JEL on CD, e-JEL and Econlit, the electronic indexing and abstracting service of the American Economic Association

Editorial Offices: Corso Umberto I, n. 83 - 65122 Pescara
Tel. +39 0854219109 – Fax +39 0854219380
Website: www.gler.it
E-mail: gler@fondazionepescarabruzzo.it

Publisher: Paolo Roncoroni
Acquisition Editor: Daniele Bonanno
Produzione: Donatella Giuliani
Realizzazione print on demand: Ilovebooks, Verdellino Zingonia (Bergamo)
Stampa: Prontostampa, Verdellino Zingonia (Bergamo)

McGraw-Hill Education (Italy), 2014
ISSN (print) 1722-4241 - ISSN (online) 1974-5125

Global & Local Economic Review

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INTRODUCTION

Federico Caffè, born in Pescara on 6 January 1914 and mysteriously disappeared in Rome on 15 April 1987 (to be eventually declared dead on 30 October 1998), was an outstanding Italian scholar and a leading economist for more than one generation. In 2014, the journal "Global & Local Economic Review" (G&LER) joins the University of Chieti-Pescara (Italy) and the "Caffè-D'Ascanio" Research Centre Foundation (Italy) in honouring his 100th birthday anniversary. With the present *Special Issue*, G&LER publishes a number of remarkable contributions variously engaging Caffè's legacy or entirely dedicated to his memory and generally submitted at one specific *International Call*.

Federico Caffè's deepest scholarly interests laid in the fields of economic and financial policy and welfare economics, with a special focus on the social implications of theory. His lectures on economic policy (*Lezioni di Politica Economica*, 1978) are widely regarded, among his many seminal works, as the most comprehensive summary of his social and economic thought. A strong critic of the market economy as a myth to dispel, Caffè was avowedly Keynesian in inspiration, and gradually developed a sincere interest in the Scandinavian welfare model. Serving as a Professor from 1959 until his retirement in 1987, Caffè left an indelible and precious mark on Italian intellectual life.

He mentored several generations of Italian economists and scholars, many of whom rose to senior positions in academia, political life and public administration. Among the others, he was a guide for the former Governor of the Bank of Italy and current President of the European Central Bank Mario Draghi, and for the current Governor of the Bank of Italy Ignazio Visco, as well as for a large number of prestigious scholars and academicians.

Several institutions have been named after him, including the Faculty of Economics at "Rome III" University and the Roskilde University Centre for Southern European Studies. The "Sapienza" University of Rome runs in his memory an annual special event which hosts some of the most remarkable economists of our

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age, with many of the resulting lectures being regularly published in a Cambridge University Press series. The University of Chieti-Pescara honoured him by dedicating its Pescara campus *Aula Magna* (Lecture Hall) to his name.

The increasing influence of Caffè's economic thought over the past years has been recognized as the debate over the traditional foundations of political economics analysis has come to the fore. The "Great Recession" affecting the Western world since 2007 has prompted a strong critique of standard economic models, which have proved neither able to accurately interpret real economic dynamics nor sufficient to make correct predictions. Since traditional models mainly focus on pure market economies with inadeguate concern for institutions and historical-structural transformations, the discussion on their pertinence for contemporary economies has flared up.

As one of the most influential economists to discuss in detail these transformations, Caffè has emerged as a key figure in this context, with his studies ostensibly gaining increasing attention. The present *Special Issue* enters the contemporary debate by offering a range of intellectual inquiries investigating both the structural transformations of contemporary economies and some heterodox and interdisciplinary new perspectives. The essays collected here show a methodological focus alongside an empirical one.

It has been a reasoned choice of the journal editorial board to particularly address Federico Caffè's favourite topics. These include the human behaviour and the new economic humanism, the role of the State in the economic system, the monetary sector and the stability of the economic system, some perspectives on the rise of financial capitalism, complexity and welfare economics, income distribution and economic inequality, public institutions and socio-economic development, positive *versus* normative economics, Keynesian and post-Keynesian economics, public education and job creation, public choice and market failures. The many proposals we have received attest to the extraordinary and lasting relevance of these issues for contemporary economics. Limiting the number of contributions to nine has thus been a painful but necessary editorial decision. A brief outline of the selected papers is as follows.

After providing a detailed historical frame for Caffè's theoretical elaboration, including the establishment of Economic Policy studies as an autonomous discipline in the particular context of Italian academia, Nicola Acocella focuses on Caffè's commitment in studying the viability of a State systematic intervention in the performance of markets. Giuseppe Amari's contribution, on its part, highlights the originality and innovative potentiality of both Federico Caffè's and Bruno de Finetti's reformisms, pointing out how they rest on the inherent mechanisms of economic policy to offer new solutions to major socio-economic problems such as the quality of jobs.

The next two articles explore the implications of some of Caffè's theories in different aspects of policy making. Antonio Bianco proposes an accounting model of three fundamental drivers of fragility in a non-depository financial sector, such as the excessive issuance of collateralized debt, the poor liquidity transformation, and the excessive collateralized-debt rollover frequency in relation to issued ABSs liquidity. In each of these cases he considers the endogenous character of money and credit supply, and highlights the respective policy implications. Showket Ahmad Dar and Badar Alam Iqbal analyse the role of policy makers and the utility of policy itself in the modern socio-economic environment characterized by extreme complexity and rapid change. The two authors particularly focus on how public policy is formulated and implemented in India, while taking the chance to suggest new measures to improve public policy making by addressing issues of fiscal deficit, corruption, governance and infrastructure development.

In the following essay, Monika Poettinger investigates the impact of the economic ideas grounding Caffè's work with a particular attention to their relevance to the social sphere. Caffè's vision of the prominent intellectual's future role, combining his own take on the historical Italian experience with the growing attention to the Welfare State models, is also sketched in this article against the background of Caffè's lasting cultural legacy for other economists, scholars and policy makers.

Paolo Ramazzotti provides a thorough appraisal of Caffè's modernity for contemporary complexity economics in the light of the present contributions on economic policy in a complex environment. Taking complexity and coordination as his starting points, the author then proceeds to analyse the implications of Caffè's work for such approaches and for a proper understanding of the relation between economic theory and policy. A privileged personal experience as a direct testimony informs Mario Tiberi's thorough commentary on Caffè's economic and intellectual legacy.

The focus here is primarily on Caffè's vision on economic policy, as well as on his radical reformism in terms of ethics and social improvement in the economic-historical perspective. In his address *Learning never ends … Federico Caffè, economist and teacher for the young generations*, Ignazio Visco praises Professor Caffè as an outstanding teacher and a valuable guide in the Italian economic scenario, drawing special attention to the application of his ideas during the current period of economic crisis. The availability of modern resources to overcome such crisis, the possibility to invest in the human capital and the dissemination of knowledge and technological progress are all usefully highlighted in Visco's intervention.

Tatiana Yugay concludes this *Special Issue* with a detailed survey of the current academic debates on austerity policies and their influence on real policy decisions. Her contention, supported by a comparative case study of anti-crisis fiscal policies in Russia and Italy, is that, far from bringing about benefits, austerity policies have – not surprisingly for Caffè's followers – slowed down the economic recovery in many advanced economies.

As a whole, this compact yet intellectually rich collection in honour of Federico Caffè is a tribute to the originality, audacity and courage shown by a scholar endowed with an impeccable intellectual integrity. Similarly to Augusto Graziani, Paolo Sylos Labini, Claudio Napoleoni and Pierangelo Garegnani, whom I consider his true peers, Caffè has always been seen going against the tide, even when he moved in the field of so-called "orthodox" or "mainstream" economics with its many variants. An all-accomplished intellectual like few others, he was part of a generation of Italian economists who were able to welcome the contributions of Anglo-Saxon economic thought in a critical though open-minded way, with no fear of subordination and with a continuous habit of integrating their own original elaborations into the larger frame.

Indeed, in my opinion, this is precisely the Italian economic tradition which deserves to be upheld, in that it combines the history of economic thought, the development of alternative theoretical schemes, and a vision of economics as part of a deeply critical social science. Among its many credits, it is important to remark how in such a context the theoretical debate was continuously integrated with issues of economic policy, thus never slipping into abstractedness or allowing for theory *versus* practice hiatuses. Although Ezio Tarantelli's and Fausto Vicarelli's premature deaths stripped us of his direct heirs, Caffè's legacy today turns into an inescapable necessity for Italian economists to counter the contemporary decline of Italian economic thought, while still overcoming the supposed crossroads of either unapologetically importing foreign economic theory or withdrawing into short-circuited marginalized strands.

Reading in detail the various contributions outlined here, moreover, highlights Caffè's ability to understand the relevance of human feelings and needs within that field of study that Thomas Carlyle defined the "dismal science", and to which Caffè dedicated his whole life. A relentless attention for the 'ordinary' man and woman as the protagonists of real economic phenomena is Caffè's most remarkable feature as an economist. Such solicitude forms a major contribution to contemporary economic thought, since it does not merely imply a generic consideration for ordinary people's social or economic troubles, but rather entails an entire new notion of "humanism" in economics and economic policy.

Even though Caffè never used this word explicitly besides a rather unmarked evocation in his 1986 "Micromega" article *Umanesimo del welfare* (Welfare's Humanism), the notion of humanism was included in what he considered his fundamental points (Caffè 1986a). Stemming from a slow elaboration which built up gradually throughout his entire scholarly life, such "humanism" does not mean a generic celebration of man's value and dignity, but rather gestures towards, in his own terms, a specific "urgent concern for human troubles" (Caffé 1970).

Such a 'sentimental' perspective entails reconsidering man as "value in himself" (Caffè 1986b) and envisaging an economic science notably intended to "serve man himself" (Caffè 1986b), with human beings' social improvement as its principal interest. Used as an evaluating tool for the hypotheses and strategies of economic policy, such a humanism allows to overcome many of those theoretical weak points which induced Caffè to call for an eclectic approach in economics.

As he remarked shortly before disappearing, a "sentimental and humanitarian economics" forms the basis for a future "possible civilization" (Caffè, 1986b) since by fighting against poverty and ignorance it addresses the ultimate goal of the social sciences committed intellectual. Such a take on public interventions in economics entails, to my mind, a much wider cultural reach than the call for inward-oriented policies (*politica del piede di casa* in Italian political parlance) voiced by Caffè in other writings. His "sentimental and humanitarian economics" proves in fact definitely more relevant from a social point of view than merely calling attention on the specificity of ordinary people's real conditions.

If seen in a more general context, the situation of ordinary people allows for a richer and more coherent vision as outlined by Caffè: one which entails urgently fighting against the unequal distribution of incomes and riches; assuming egalitarianism and assistance as essential goals; interpreting the "efforts towards roughly equal opportunities" as a "government's task" (Becattini 1988, p. 50); and including unemployment among those 'real problems' of contemporary society which deserve a relentless attention. Not surprisingly for his followers, Caffè's priorities thus still prove illuminating for contemporary economists' agendas and Italian and international governments' socio-political policies.

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Nicola Acocella*

FEDERICO CAFFÈ AND ECONOMIC POLICY AS A DISCIPLINE

Abstract

The complex personality of Federico Caffè deserves attention for his uncommon qualities, as a man, a teacher and a researcher. He expressed dissatisfaction with reality and traced in his vast and deep knowledge of economic doctrines the need and the possibility for the state to intervene and change the performance of markets in a systematic way. From many points of view he anticipated the formation of Economic policy as a discipline. When this finally sprouted in Scandinavia and the Netherlands he was ready to give it a more systematic structure and spread it to the Italian academy. He was aware of the declining role of the discipline in the last years of his life and could not see its revival due to reconfirmed validity of its core.

JEL CODES: B00, B41, C61, D6, E60.

KEYWORDS: ECONOMIC POLICY; WELFARE ECONOMICS; THEORY OF ECONOMIC POLICY LIST.

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1. Introduction

The complex personality of Federico Caffè deserves attention for his uncommon qualities, as a man, a teacher and a researcher. As recent meetings on the occasion of the centennial of his births have shown, his contributions to economic thought have still to be assessed in a dispassionate and proper way. This is due partly to his prose, rich of citations and subliminal messages (Acocella 2015a) and partly to the number of fields to which he contributed. In this paper, we want to deal with only one of his many contributions to the economic science, possibly one that encompasses also some of the others. However rich his scientific interests, economic policy, both from a theoretical and a practical point of view, was at the center of them, for the reasons indicated before. Starting from a system of values caring for the well-being of people, especially the worse-off, he traced in his vast and deep knowledge of economic doctrines the economic determinants of his dissatisfaction with reality. He thus discerned the need and the possibility for the state to intervene and change the performance of markets in a systematic way. He did not intend to know how the economy worked, per se, but only for the purpose of changing it in the direction he preferred. Studying the history of economic thought and continuously updating his knowledge to the more recent theoretical and empirical findings was simply instrumental to this end for him. The paper deals only with Caffè's contributions to the formation of economic policy as a discipline. We show that from many points of view Caffè anticipated the formation of Economic policy as an 'autonomous' discipline within the realm of economic science. When this discipline finally sprouted in Scandinavia and the Netherlands he was ready to give it a more systematic structure, contributing to its diffusion in the Italian academy. He was aware of the declining role of the discipline in the last years of his life and could not see its revival due to reconfirmed validity of its 'systematic' part. In a companion paper (Acocella 2015b) we investigate the main practical issues that economic policy had to face at his time and compare them with the current ones, tracing also the main theoretical developments of the discipline that can explain this evolution.

2. The man, the teacher, the scientist[1]

Federico Caffè was generous, reserved and shy, humble yet proud. The heightened awareness and wit that set him apart, well known to all those who were familiar with him, led him not to isolate himself, but rather to look around himself, and to share the problems of other people, which presented themselves in various guises: as individual cases from students, colleagues, acquaintances, or even strangers; or as issues that he perceived as common to groups of people from his perspective as a scholar, in particular to people enjoying reduced opportunities. This attitude was at the heart of his system of values. Consistently with it, in teaching, as well in influencing the conduct of academic organisations, in writing professional essays or articles for the press, Caffè devoted his outstanding analytical capabilities to the resolution of practical issues. It was this aspect of his system of values, reinforced by his clear conviction as a scholar, which led him to interpret his profession of public employee in the fullest and most active manner. Caffè's values are reflected in his works, which were often of a seemingly subdued tone, yet exhibited a polished, scholarly, and rich prose. The declaration of his system of values together with the wealth of quotations, fruit of a vast culture and an unremitting drive for new knowledge (see also Faucci 1995), was more than a habit, it was an act of humility and respect for the reader, whom he believed should be protected from superficial claims unsupported by others' meditations, ignorant rediscoveries, ephemeral and pointless introduction of ideas, cultural trends, as well as from the alarmist tones and pressures of vested interest groups. Similarly, he was fully respectful of his pupils, the development of their background and personality. His awareness of the subjective component of economic science did not translate into biased instruction. In fact, the fear of indoctrinating his pupils was always so strong in him that there were hardly any cases of him revealing his thoughts about contemporary issues to his students. And he advised Keynesians to deepen their knowledge of Monetarism and Monetarists to do the same with Keynesianism (Ciocca 2014). While appreciating the most gifted and being proud of his ability as a “talent-scout”, Federico Caffè was aware of the possibility of being able to contribute to individual and social progress. Thus, he believed in university education for the masses, overseeing the students' progress at all stages. In his almost 30 years of teaching at La

[1] This section is drawn, with some changes, from Acocella and Tiberi (2014).

Sapienza he supervised about 1200 Master dissertations. His generosity led him to express, even in scientific works, deep sympathy for the problems of the poor, the unemployed and, more broadly, of those to whom society offers reduced opportunities, convinced of the fact that value judgments serve a useful role in the accumulation of knowledge and that the scholar's necessary effort to be objective consists in explicitly declaring his ideals, rather than introducing them surreptitiously or repressing them. Which was also a way for avoiding opportunism and making clear the reasons underlying possible justifiable changes in statement and visions. His teaching, however, was not limited to lecture halls. His was a kind of permanent school, for various educational levels, which made use of a great variety of instruments, some of which, such as the translation of scientific works or production of essays for a wider audience, were meant to broaden the range of scholars and readers of economics.

3. The central role of valuations in the system of thought of Federico Caffè

Value judgments had a central position not only in his life and teaching, but also in the development of his intellectual path. He was deeply involved in the issue of their role in social sciences. Over time this has assumed the features of a perennial puzzle of a philosophical nature, with wide differences in the opinion of economists and other social scientists, who in some cases have even changed their position through time. While, according to the first economists before the classics and also most classical authors, there was no clear separation between 'objective' propositions and value judgments, a distinction between positive and normative statements began to emerge with Hume, J.S. Mill and Senior. For a long time economists and other social scientists, up to Pareto, Weber and Robbins, tried to show both the possibility and desirability of such distinction. In particular, Robbins (1932), suggested a neat separation of economic analysis from economic policy, as only the latter needed to state goals and objectives. But Myrdal questioned this position the same year this book was published and even more forcefully later, denying both the beneficial effects of the separation and its possibility. The impossibility derives from the multiplicity of variables involved in economic reality and the uncertain results of statistical and econometric testing of economic propositions, always tied to a certain time and situation. It is true that an agreement could be reached among social scientists to suspend judgments when the outcomes of empirical tests diverge and there is an apparent degree of disagreement. However, as a matter of fact, the declaration of the need to separate objective and normative statements has often led to dissimulation of the scientist's system of values, hidden in falsely positive statements. As to the desirability of distinguishing between positive analysis and values, the beneficial role of the latter should be recognized, as they inspire and motivate scientific research and choice of the analytical field of inquiry, which is strictly related to the scientist's motivation and vision of the world. This is thus helpful in widening our knowledge of reality (see, in particular, Caffè 1955, p. 5). In Caffè's opinion, while an effort for disentangling value judgments from scientific propositions is necessary, to avoid indoctrination, one must be conscious that they cannot be totally eradicated from our knowledge of how reality works. This statement is very common in a number of Caffè's works (e.g., see Caffè 1956b). The author of this paper also reminds his very vivid discussion of the issue in Caffè's lectures as well as later, in personal conversations with him at the time when the author translated Hutchison (1964) into Italian. In addition to being strictly linked with 'positive' analysis, presence of values in social sciences is also fruitful. This position was shared by Schumpeter (1961), but Caffè had added: "it is from the insertion of new social and political premises that one can expect the economic science to progress, even if whether the outcome will be part of sociology or economic theory is an open issue" (Caffè 1943a, p. 9). We can say that Caffè fully shared Zeuthen's (1959) position on value judgments (and the role and content of economic policy as a science)[2]. New premises, in turn, can derive from either new paradigms or internal developments of the theory (Caffè 1962b, pp. 6-8). Almost any statement in Caffè's writings is a prelude to other statements and supports his whole theoretical construction. The statement about the fruitfulness of new value premises is not different. Take, the case of his vision of the pre-eminent importance of distribution[3], which for him was a prelude to stating the need for an 'equitable' distribution[4]. On the one side, this motivates his interest in the debate about the 'new welfare economics' (see later and its final conclusion due to Little (1949): production issues cannot be separated from

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[2] In fact, Caffè included this essay as conclusive in his translation and collection of essays by modern economists (Caffè 1962b).
[3] See, e.g., Caffè (1958).
[4] This is very clear, at least since 1943 (see Caffè 1943a).

distributional ones, as claimed in relation to discussions about the possibility to disregard existence of actual payment of compensation in the case when policy action benefits some people, while making others worse off, with a net benefit for the whole economy. On the other, it leads him to repeatedly insist on the possibility to reverse the position, common in mainstream economics and often also in current policy, according to which 'increasing the cake' is a step *preliminary* to satisfying demand for a more equitable distribution (e.g., see his favourable comment on Ohlin's (1949) claim that high and persistent employment necessarily *presupposes* ensuring social peace, which reverses the order of priorities between distribution and production: Caffè 1951, p. 109).

In admitting interpenetration of values and positive analysis, Caffè is not alone. Other Scandinavian economists shared Myrdal's position. Among them, and even more drastic than Caffè himself, Frisch is to be mentioned for his firm normative approach to economic policy problems. In fact, this author made a number of the analytical steps necessary to pursue this approach strictly dependent on the point of view chosen by the planner, including the very possibility of using past econometric estimations of reality derived under different circumstances as a consequence of different policy targets (Frisch 1961). This is even more striking if one considers that Frisch was one of the founders of econometrics as a discipline. Caffè, in partial contrast to Frisch's position clearly states that there can be a more analytical stage in the economic science, while maintaining the impossibility to separate value judgments from 'positive' economics (Caffè 1962). A comparison between his values and real life, enriched by his deep and vast knowledge of the history of economic thought, not disregarding its most recent developments, indicated to Caffè a possible road for reforming reality and furthering policy goals consistent with his values[5], which was his pre-eminent aim (in the same sense see Faucci 1995, in particular, p. 78). It was thus easy or 'natural' for him to focus on economic policy, rather than on purely analytical research, which, however, he did not disdain. This made him to insist on a normative point of view to look at reality within the wide realm of the economic science and can thus explain his intellectual path (Schiattarella 2015). Before turning to the development of Caffè's contribution to economic policy let us describe the slow process through

[5] These coincided with those set forth by the Italian constitution, but any economist can construct a normative system according to his own values.

which the various steps through which this discipline finally emerged abroad and its main pillars, which we do in the next section.

4. The slow progress of economic policy as an emerging discipline

The process of developing what I will call the ‘core’ of economic policy has been rather slow. At least since the industrial revolution, markets tended to be the leading economic institution. The main economic doctrines differed on the assessment of the relative performance and role of markets and the state (Roncaglia 2005). However, at least from Adam Smith on, the prevailing economic doctrine attributed to the former the role of being able to pursue ‘the public good’, with limited contribution by other institutions, notably the state. Until the end of the 19th century, the doctrine had indicated a little more than a collection of examples of market failures and, thus, cases for public policy intervention, aiming at ensuring efficiency and/or equity. Caffè (1966a) documents that most classical writers and the marginalists had suggested cases where public intervention was in order, in particularly in the case of taxation. This was so for Smith (1776), Ricardo (1817), Mill (1848), Walras (1874-1877, 1898). But their cases in favour of government intervention were not part of a systematic and consistent assessment of the foundations and the articulation of public policy. This only began to emerge towards the end of the century. The first attempts to develop such a theory were those of Sidgwick (1883), Marshall (1890) and, more important, Pigou (1912, 1920), who also laid down essential principles for state intervention, partly connecting it to the preferences of citizens (Caffè 1962a, 1964a). However, until the 1930s these principles were condemned to be applied to a limited set of circumstances. Generally speaking, supporting the virtue of markets was the commonly held view inspiring political parties and governments and this view was not contradicted by the rather satisfying evolution of the economy in most developed countries - also as an effect of a number of favourable economic circumstances - until the end of WWI and the post-war recovery. In the 1930s, important factual changes in the economic performance derived from the difficult adaptation to the post-war economic and the social situation of some countries (e.g., the United Kingdom), especially if this was approached to with the old pro-market lens and policies. Even more importantly, the emergence of the prolonged Great Depression and the progressive contraction of international economic exchanges of goods and capital showed that the re-equilibrating capabilities of a market system were too limited, thus prompting new analytical and policy developments. Caffè was well aware of the fact that only in some cases changes in economic paradigms can be attributed exclusively to changes in reality, as internal developments of the theory also play a role. In our case, the Wicksellian tradition in influencing Swedish authors was also important for the outgrowth of macroeconomic analysis and stabilization policy (Caffè 1978a, 4th ed.)[6]. Thus, Keynes (1936) introduced a new important case of market failure, as a consequence of both factual and theoretical changes. Unemployment was the first of a macroeconomic type of failures. It was soon complemented by another case of similar failures, low growth. Reflecting on the prolongation of unemployment, which had protracted for the whole 1930s, a Keynesian economist, Alvin Hansen, suggested - or reconsidered, but in a different perspective - the hypothesis of a secular stagnation, already indicated by Sismondi, some other classical economists as well as some Marxist writers (Hansen 1939). This should characterize the end of the era of growth and prosperity featuring the Western world after the Industrial Revolution. For a long time until the early 1940s and then at the end of WWII this hypothesis concerned economists and policymakers; and has been suggested again as one of the possible consequences of the Great recession. During WWII inflation added to macroeconomic targets and was effectively tamed in Anglo-Saxon countries by prices and incomes policies. Finally, after the war, as countries re-opened their economies to trade and investment, balance of payments equilibrium complemented the three macroeconomic targets devised until then. In the 1930s, some new conceptual tools were forged that are useful for empirical analysis and policy: national accounting, econometric analysis and input-output. Moreover, as an important case of a pure analytical development, a large debate began towards the end of the decade and continued after WWII on the application the basic principles of microeconomic policy intervention in a way to enlarge the cases of government action beyond those envisaged by

[6] In the previous section we saw that Caffè's flexible position about the role of changes in real life and internal developments of the theory as leading to fruitful new premises and theories. Keynes (1936) is a case in point. Caffè linked it to both the Great Depression and the Wicksellian tradition that we can say now influenced Keynes through Ohlin (see Caffè 1978a, 4th ed., quoting Otto Steiger's contribution on the role of Bertil Ohlin for the origins of the Keynesian revolution, and Acocella, 2015, for the role of Wicksell and Ohlin in the development of Keynesian thought).

the Pareto criterion. This was the so-called 'new welfare economics'. We already said that, as a conclusion of this debate, the need emerged to assess production issues together with distributional ones. For Caffè this was important as a way to assert the relevance of distribution. Thus, after WWII there existed a set of propositions clearly defining both the microeconomic and macroeconomic foundations for government intervention. This then became much more widespread and penetrating, aiming not only at traditional microeconomic goals and full employment, but also to new macroeconomic targets, which altogether made up the 'magic square' later introduced by Kaldor (1971), i.e., unemployment, inflation, growth and balance of payments equilibrium. The new theories and war experience had showed the importance of using different policy instruments (monetary and fiscal policy) and showed the possibility to add price and income control to these, while the International Monetary Fund, even within a fixed exchange rate system, allowed for parity adjustment. The need then arose of managing the different policy tools in a way to take account of the interrelations among the various targets - following guidance from input-output analysis, national accountancy and econometrics - and prepare a consistent and effective program (a plan), possibly covering more than one year, as the Marshall plan - whose source, the US, was certainly beyond suspicion of sympathy for dirigisme and leftism - itself required. The theoretical advances of the 1930s and the changes in the economic and social conditions as well as in policy aspirations following the war prompted a radical innovation in the way policymakers conceived their goals, scholars looked at economic policy and in due time generated a theory capable of dealing with the new issues, thus conceiving economic policy as an autonomous discipline. Just after WWII an experience of planning had begun in Norway and the Netherlands that was not limited to the contingencies of the after-war. This was so also in other developed countries (with the main exception of the USA) under different forms until the 1960s and 1970s. From the experience of these two countries, two authors in particular drew inspiration for the theory of economic policy, while making use of the theory in order to improve practice[7]. The first step in this intellectual process was the statement of the 'theory of economic policy' by Frisch, whose approach was in terms of

[7] The experience of planning in Socialist countries was also relevant not only for these countries, but also for other countries, such as the UK, which inspired their policy action to planning in order to pursue their macroeconomic targets during WWII. A number of authors had written in favour of planning. Among them, in addition to those mentioned in the main text, Meade (1948) should be mentioned.

'flexible targets' (1949, 1950, 1957). Tinbergen - who had built the first econometric models of the Dutch and the US economies in 1936 and 1939, respectively (Hughes Hallett, 1989) - drew inspiration from Frisch, as he recognized (see the introduction of Tinbergen 1952), but followed a different approach. In fact, Tinbergen (1952, 1956) developed the theory in terms of 'fixed targets', suggesting that a number of instruments at least equal to that of targets should be available to the policymaker in order for him to be able to exactly reach the set of target values he preferred (Tinbergen's golden rule of economic policy). Frisch's route was instead followed more closely by Theil (1956, 1964) and became the general way of setting a policy problem in a 'parametric context'. The policymaker, in the same vein as a household, should make a plan tending to maximise his preferences, or to minimise a loss function in terms of quadratic deviations from a set of target values for the variables of interest, under the constraint of a set of equations describing the given behaviour of the economic system. In the case where he has a sufficient number of instruments - as indicated by Tinbergen's golden rule - the loss function is minimized and the set of fixed target values is consistently reached by using appropriate instruments.

The second step in the process of conceiving economic policy as an autonomous discipline consisted in defining its 'core'. This was done by associating the two essential branches of this 'core', i.e. the analysis of consistency rules of public intervention to existence of market failures, i.e., the theory of economic policy to the logic of economic policy: the latter justified government intervention; the former indicated whether and under what conditions the various instruments are effective and how they should be designed. As underlined above, a set of microeconomic failures had already been indicated around 1900. After WWII they were investigated in a systematic way and codified, e.g. by Kapp (1950) and Bator (1958). Asymmetric information as a cause of market failures came much later (Akerlof 1970). However, more relevant from the point of view of computation and the definition of policy programs were the macroeconomic failures introduced since the 1930s. Market failures as the logic of economic policy together with the theory of economic policy as a tool for ensuring consistency and effectiveness of policy action thus became the ingredients of the core of the discipline. A difficulty soon emerged (Arrow 1951) from the impossibility to start from individual values to define choice of the goals of the SWF. In order to bridge the gap between individual preferences and policy goals, Frisch devised the expedient of referring the SWF to politicians' preferences, thus adopting the perspective offered by Bergson's (1938) formulation, to which also P. Samuelson (1947) had added. From a practical point of view this was enough. SWFs should be derived from official documents and statements or interviews with policymakers (Frisch 1957, 1970). The democratic process would ensure consistency between the government's preferences and those of the constituency. In his Nobel lecture, Frisch states some of the rules to be followed for deriving such a function - as a first stage in the process of cooperation between experts and politicians - and adds that he had a number of tests of their practical effectiveness. Zeuthen (1958), a book which had a large diffusion in Scandinavian countries, was the first (and successful) attempt to offer a systematic and consistent summary of developments in both welfare economics and the theory of economic policy, as cornerstones of economic policy as an autonomous discipline. The discipline entered the curricula of master degrees in Scandinavian universities in the 1960s and 1970s through Tinbergen (1956), Zeuthen (1958), Johansen (1977, 1978), etc. as textbooks.

5. Caffè's method and progress towards anticipating economic policy as a discipline

Caffè's first writings are in applied economics. His first essay (Caffè 1942) deals with grievous current issues, being about 'Spontaneous and forced savings in war financing'. In the following years it is always his propensity to care for current important issues that absorbs his energies, as an employee of the Bank of Italy and an expert or a member of various public bodies, directed at economic reconstruction of the country and drafting of its new Constitution. In some of his numerous essays published between 1943 and 1948 he explicitly refers to both microeconomic and macroeconomic market imperfections as a justification for government intervention (Caffè 1943a), suggests democratic planning as a vital instrument for dealing with the many problems of reconstruction and possibly also with the different goals that would arise in normal times, by using the whole set of policy instruments. He also cites experiences abroad, particularly in the Netherlands under the impulse of Jan Tinbergen (Caffè 1943b, 1945, 1946a, 1946b, 1947, 1948a, b). In these essays he links planning to market failures, not only for the contingencies of that time, but also for more enduring reasons. In a series of reflections from 1947 to 1949, starting again from market failures, he also firmly criticizes current policy attitudes and implicitly, but clearly, states a program of macroeconomic policy dealing with the main issues of the time, i.e. employment, inflation and the balance of payments, making use of public investment, monetary and credit action, the exchange rate and foreign aid. His awareness of the changing nature of policy issues, which need flexible actions, is to be stressed (Caffè 1949a, b, pp. 282-4 in particular). In other essays he discusses the role of public investment (1954, 1958), interest policies and investment (1956) and other policy instruments. In the following years, starting in 1953, he deepens his theoretical apparatus, being interested in one of the issues he had briefly touched upon in his papers on planning, i.e. market failures and the microeconomic policy agenda. He thus writes a number of essays on what he later will call 'the logic' of economic policy, thus dealing with microeconomic failures of the market, following the evolution of the debate on them through time, from the old to the new directions taken on this topic. He also translates the main contributions of the new welfare economics into Italian (Caffè 1953a, 1956a, b, 1958b)[8]. Caffè's interest in actual problems has thus found two firm theoretical foundations, the logic and the theory of economic policy, i.e. what I call the core of economic policy[9]. However, his intellectual formation completes only when he finds two important links. The first is what he draws from him mentor, Gustavo Del Vecchio, conceiving the path from analysis to policy as given by different stages of a unitary science, each having a theoretical setting. Thus, by mid-1950s he possesses all the ingredients for conceiving economic policy as an autonomous discipline in this realm, together with a deep and vast knowledge of institutions and history. However, he fails to link the two

[8] In the interwar period there were few Italians interested in welfare economics. One of them was Tagliacozzo. See Tagliacozzo (1933), a text that Caffè certainly knew at the time when he wrote his textbook on Economic policy (Caffè 1966).

[9] The definition of the core is mine, but in the first chapter of his main book (Caffè 1966) and in the whole book, it is clear the need for him to define it, through a systematic analysis of the microeconomic and macroeconomic foundations for government intervention, as well as of the set of logical alternative courses of action open to government, based on different possible relations between economic variables (see in particular Caffè 1966, pp. 22-23). In doing this, the set of tools created at a more abstract level (Meade's tool-making) will be exploited (Caffè 1966, p. 20). This systematic analysis of government action will be followed by an applicative stage, which will determine the real relevance of the relations between the different variables in specific actual situations (Caffè 1966, p. 24). Application to real situations, both domestic and international, is indeed done in Caffè (1970). In this second volume he also presents some formal aspects of the presentation of a social welfare function, following discussion of two new macroeconomic targets, growth and balance of payments equilibrium. A unified presentation of both the core and its applications to real situations is in Caffè (1978a).

parts of this core one to another. Knowledge of Zeuthen (1958) finally sparks his conception of economic policy and he edits the Italian translation of this book into Italian. How Caffè discovers the book, published only in Danish, a language he does not speak, is unclear. Most probably, Caffè already knows Zeuthen both for his previous publications in English (including an incomplete essay that had been requested to him by Editor of the Quarterly Journal of Economics and was published posthumously, Zeuthen 1959) and the Italian translation of part of one of them. He certainly has not traced Zeuthen (1958) directly, as he does not speak Danish, or indirectly, e.g. through Schneider's obituary in Weltwirtschaftliches (Schneider 1959), as he does not read German[10]. Caffè uses Zeuthen (1958) as one of the compulsory references in his academic course of economic policy, from 1961 to 1964. The book, while being very suggestive, proves to be rather hard to digest for most students. This might be one of the reasons why Caffè decides to write his own book and prepares the necessary bricks for it, both drawing from his previous research and undertaking new research for filling the process of formation of policy agenda through the contributions of classical and neoclassical economists (Caffè 1962a, 1964a). The logic of economic policy, including both micro - and macro-economic failures, is completely developed in a historical perspective in his Caffè (1964b). Finally, in 1965-1966 the first volume of his new book on economic policy is published where he states his version of the whole core of the discipline, with a weight attributed to its two parts more balanced than Zeuthen's (1958), where the logic of economic policy was predominant (Caffè 1970). Application of these principles to current policy, especially with reference to Italy, is made in the second volume of the book (Caffè 1970). Caffè's systematic statement of the foundations of public intervention, its design in theory and in practice - what goes under the name of 'normative' economic policy - apparently omits a detailed discussion of government failures, what later has been often referred to as 'positive' economic policy. This is not so because he did not think that government failures are irrelevant. In fact, many essays of his often refer to such failures[11]. Probably, at the time he wanted to state the normative approach as

[10] Reference to Zeuthen's (1958) book is not in Schneider's article in memoriam of Zeuthen published in Econometrica, the same year and thus Caffè cannot have traced the book through it.

[11] See, e.g. Caffè (1972). Specific mention should be made of failures of international institutions, as they involve the action of technocrats, power groups and national powers. An example of all these 'distortions' are his numerous articles on informal and formal changes of the original statutes of the international

the useful innovation to take as a yardstick. In any case, he thought that a large number of government failures was simply due to scarce people's information, participation and control. Why Caffè does not write a book on economic policy as a discipline himself, before Zeuthen, while possessing all the ingredients of its core and also having deep knowledge of the working of economic systems, in particular of the institutional and historical features of the Italian one? There may be a number of reasons, among which a personal reluctance to make up something of the kind of an 'Harlequin costume', rather than a 'coveralls' (a quote drawn from a philosopher, Guido Calogero: see: Caffè 1977a, p. 11) drawn from critical analysis of the various contributions to economic thought. This reluctance is apparently disproved by his mess of quotations which often hide his personal convictions. But this is only appearance. Again, a scientist can follow two roads when expressing his ideas: hiding the sources of his reflections or hiding his ideas and letting the source of his reflections speak. The former is chosen by Adam Smith. Federico Caffè prefers the latter, as an effect of his personal inclination, respect for others and for pluralism, modesty[12] and reluctance to speak in the first person, associated to consciousness of the vastness of his ignorance, of 'the little light and the large circle of shadow' prevailing at all levels of learning (to repeat the expression he uses in a letter to a former student and friend of him, drawn from a popular Italian novel writer of the 20th century, Virgilio Brocchi) (Amari, Rocchi 2007, p. 1011). Contrary to the apparent derivation of bits of his analysis from other authors, he follows a very clear line of reasoning of his own, not only in each essay, but also in his whole contribution to economic policy (see also Faucci 2002). Added to this is his preference, also for didactical purposes, for open and critical analysis of the history of economic thought rather than formal and closed analysis, a derivation of his inclination to apparent eclecticism, as well as his theoretical background. His eclecticism - which is anyway "rigorous, selective, critical" (Ciocca 1995, p. 149) - might also derive from acceptance of Del Vecchio's (and, before him, Pantaleoni's and Einaudi's) 'whig' conception of

organisations created at Bretton Woods (see, e.g., Caffè 1966b, 1978b). In addition, mention must be made of his reservations with respect to European Economic Community, as an acceptable and workable form of integration and as institution *de facto* allowing free capital movements. This was against the letter and the spirit of the Treaty of Rome and represents a specific example of distortions deriving from the unbalance of power among the member countries, as well as of technocrats (see, e.g., Caffè 1957, 1985).

[12] Ciocca (2014, p. 20) speaks of 'proud modesty', an expression that perfectly depicts one of Caffè's qualities.

economic science as being characterized by progress without breaks (Faucci 2002, pp. 366-367).

6. The development of the discipline in Italy

In Italy Economic policy was hardly taught as a discipline at least until mid-1920s. Economic policy as an autonomous theoretical discipline did not find a way to Italian (and, to my knowledge, French and Germany) tertiary courses, mainly because of the lags in the reception of its basic ingredients. Trade and colonial policy and law was its main substitute (Tiberi, Frinolli 2006; Tiberi, Fubelli 2006). In 1925 the term was coined and the discipline soon became a compulsory academic course (Pomini 2012). However, its content remained pretty the same as before[13]. Most Italian economists, usually people also engaged in the administration of practical policies, had followed the autarchy and corporatism credo dictated by the Fascist regime, but, being isolated from theoretical developments abroad, did not possess many of the instruments necessary for a systematic approach to economic policy. Understandably, those Italian economists who had maintained a pro-market attitude, e.g. Gustavo Del Vecchio[14], confined Economic policy to a subordinate role with respect to theoretical economic analysis, with no analytical content of its own (Del Vecchio 1933), as Pomini (2012) comments[15]. The first real systematic attempt to gain breadth to the discipline by relating it (in a loose way, really) to market imperfections, devising different main directions of state intervention and distinguishing home and foreign economic policy directed to different targets, was Bresciani Turroni (1942)[16]. However, the second edition of this book (Bresciani Turroni 1960), while having a deeper analytic feature, had a quite

[13] See, e.g., Fontana Russo (1935). A previous text by this same author referred to trade treaties and policy (Fontana Russo 1902). See also Fantini (1943), a pupil of Fontana Russo's and a predecessor of Caffè in teaching economic policy at La Sapienza University of Rome.

[14] However, according to Caffè (anno), Del Vecchio (1950) had intimately accepted some Keynesian propositions, which were very close to his writings on money.

[15] In section 5 we noticed Caffè's interpretation of Gustavo Del Vecchio's position in a much more favourable light for his conception of the theoretical content and role of economic policy. That interpretation can be easily reconciled with this statement of a practical and subordinate role of economic policy attributed by Del Vecchio. In fact, Caffè was so aware of this role as to feel obliged to add to Del Vecchio's quotation that each part of the economic science, economics, economic policy and public finance 'can be the object of a systematic analysis, from the specific viewpoint featuring it'(Caffè 1966a, p. 13).

[16] However, see Caffè (1943a) for a critical review.

different content, mainly focused on money, international trade, balance of payments and monetary systems, losing part of the breadth of the previous edition. A textbook used at La Sapienza University of Rome until early 1960's was Fantini (1962) whose previous editions had a different title (Fantini 1943, 1948). To some extent this followed Bresciani Turroni's path, but, while containing chapters on banking, monetary, financial, transport, labor, trade and international policy, this book lacked a systematic part of foundations and methodology of economic policy as well as macroeconomic policy. Similar to this was Franchini Stappo A. (1963, 1964). In the early 1950s practically only a few Italian scholars had introduced - or were about to introduce - Keynesian thought in Italy, starting from Vittorio Marrama, Giuseppe Ugo Papi, Alessandro Franchini Stappo, and Ferdinando Di Fenizio[17]. Only a few Italian scholars had introduced progresses in welfare economics in Italy (Caffè 1953, 1956 a, b and Lombardini 1954), which is apparently strange, as these were based on Paretian foundations and there were academics following Pareto's method, such as Amoroso[18]. Only a few of them had done the same thing for the theory of economic policy (Caffè, Marrama and, to some extent, Di Fenizio)[19]. In some cases, theoretical advances abroad were introduced under the form of textbooks by Italian authors (Marrama 1948, Di Fenizio 1949, various years). In other cases, some Italian journals hosted either important original articles by foreign authors or their translations[20]. Translations of books or essays collected as books also played an important role[21]. The intellectual openness of these economists was crucial also in their propensity to encourage their pupils to complete their preparation abroad, mainly in the United Kingdom and the US. By the beginning of the 1960s all the premises for devising a consistent and rather autonomous set of propositions to be called Economic policy were

[17] Marrama (1948), "which was reviewed in highly flattering terms by the American Economic Review", in Gandolfo's (1987: XV) words, Di Fenizio (1949, various years), Papi (1953), Franchini Stappo (1955). Also Caffè refers to Keynes in favourable, even if concise, terms as early as in 1943 (see Caffè 1943a) and in later essays (e.g., Caffè 1952, 1953c).

[18] Pareto had a very extensive, if lagged, impact on the academic profession abroad, in particular, for what we are interested in in this paper, not only for his principle of welfare but also for laying down the tools of mathematical economics that contributed to the foundation of econometrics (Tinbergen, 1949).

[19] Caffè's translation of Zeuthen (1958), Marrama (1962), Di Fenizio (various years).

[20] This was the case of a number of contributions by Frisch, Tinbergen, Theil, and, outside the proper realm of economic policy or economic theory, Shackle and even Kurt Godel, published in 'L'Industria', a journal edited by F. Di Fenizio, and 'Metroeconomica', founded and edited by Eraldo Fossati.

[21] Caffè, who did not edit any journal, made an extensive use of translations to let Italian students and the general public to know foreign economic thought.

there in Italy. The only problem was about the weights to assign to the different possible ingredients. There were two main lines along which the discipline was systematically introduced, by two scholars: Federico Caffè and Ferdinando Di Fenizio. As said, Caffè had searched for all the possible key ingredients for conceiving economic policy as an autonomous discipline. Indeed he did so first by publishing two short books (Caffè 1964b). These were then developed into two larger volumes (Caffè 1966a, 1970). A few years later Caffè, who had been impressed by the 1968 students' demands, tried to cope with them by rendering the two volumes easier to read and summarizing them in a single volume, at the cost of hiding some technical and analytical passages (Caffè 1973). Economic policy was conceived as consisting of a part discussing: the ultimate targets of economic policy, derived from welfare economics, problems of social choice, planning, specific (in particular short-term) policies. Such a discipline should draw mainly from economics, but also from other sciences, such as social sciences, mathematics and statistics. Caffe's path was followed by a group of economists in Naples, led by Augusto Graziani, who wrote a book first presenting foundations for public economic action, the theory of economic policy, detailed policies aiming at specific short-run or long-run targets (D'Antonio, Graziani, Vinci 1972). The method followed in this book, while maintaining the content of the discipline as devised by Caffè, has a quite different setting: instead of being rich of critical quotations of the relevant literature, it stresses the analytical content of the decision models that can be built in order to pursue certain targets by using a defined set of instruments from a formal point of view. More encyclopedic was Forte (1970), which was preceded by Forte (1963). Other authors followed a path partially different from Caffè's. Di Fenizio wrote a monumental course of economic disciplines in five volumes, devoted to: the method in economics and economic policy, macroeconomic agents and economic flows, the consumption function, short-term diagnosis, analysis and policy, macroeconomic planning (Di Fenizio, various years). An original route was followed by Franchini Stappo A. (1971, 1976, 1982), which explored connections between the concept of power and economic policy. The importance of Franchini Stappo's approach must be noticed, as the concept of power will underlie the more recent revival of the theory of economic policy in strategic terms, which has counteracted the attack to its core (see section 7). All these books include to a large extent at least some of the ingredients of what I call the core of economic policy. For many years these were practically the only economic policy textbooks circulating in Italy, widely adopted in many universities. Only around 1990 other textbooks were written. Some of them practically followed Caffè's route, either complementing and updating Caffè's or deepening its analytic content (Acocella 1989; Palmerio 1989). Along lines similar to those of Caffè, D'Antonio, Graziani, Vinci and Forte, but with greater attention to social choice and positive economic policy, are Balducci Candela 1991 (later Balducci, Candela, Scorcu 2001) and Acocella (1994, later also 1999) and Cagliozzi (1994). Valli (1986) is an example of a different approach, with almost no reference to welfare economics and the theory of economic policy, but more open to long-term issues and thus also to discussing the institutional and comparative setting, which to some extent was inspired by Di Fenizio's interest in such topics. Predetti (1989) explored methodological issues related to economic policy. A few textbooks dealt with economic policy only in strict reference to analytical short-term models (Marelli 1992, then Marelli, Signorelli 2010) or to specific Italian problems (Bianchi 1994). The following years saw a flourishing of textbooks: Ciccarone (1997), Palmerio (1997), Franchini Stappo (1993), Campiglio (1999), Chiarini (2004), containing the ingredients already present in their predecessors, with different weights. Ciccarone and Campiglio discussed problems of welfare economics and social choice; Chiarini dealt with decision models. Persson, Tabellini (1990) added policy considerations derived from the literature on time inconsistency, credibility and rules.

7. Caffè and the decline of economic policy as a discipline: the attack to the core

How contemporary are Caffè's ideas? To answer this question we need many reflections. The first one has to do with the changes in the prevailing analytical orientations. In the last thirty years or so, the role of economic policy as a discipline as he had anticipated and expressed in a systematic way, has declined. In the previous two sections we saw that economic policy as a discipline had clearly emerged not only in Scandinavia, the Netherlands and in Italy. Some of the books in the tradition of Caffè's systematic setting (Acocella 1994, 1999) were translated into English, Chinese, Polish and Croatian, being in some cases used in academic courses, but in most countries, especially outside Europe, the discipline is almost inexistent. Also in many European countries, including Scandinavia, the concept of a discipline starting from welfare economics and social choice, including the normative and positive theory of economic policy and then dealing with specific policies and targets, taking account of institutional and historical mediations before applying economic analysis for policy prescriptions has not survived. The reasons for this could be:

1. The specific circumstances - in terms of historical factors, including history of economic thought - favouring the emergence and flourishing of the discipline in Scandinavia, the Netherlands and Italy.

2. The rise and spread of the Anglo-Saxon school of thought, which has taken the lead over (other) national schools and traditions since the 1960s and has now led to a rather homogeneous literature, using the same language (English), the same methodology and building economic models based on similar visions and methodologies.

3. The negative attitude of mainstream Anglo-Saxon thinking towards active policy intervention matured in the two decades since the end of the 1960s, due in particular to: the introduction of the expectation-augmented Phillips curve and the assertion of a vertical long-run curve (Phelps 1967, Friedman 1968); fiscal policy neutrality in the presence of ultra-rationality (Barro 1974), monetary policy neutrality with rational expectations (Sargent, Wallace 1975); generalized policy neutrality, time-inconsistency and the need for rules rather than discretionary public action under rational expectations (Lucas 1976, Kydland, Prescott 1977, Barro, Gordon 1983); the need for an independent conservative central banker (e.g., Bade, Parkin 1978, Rogoff 1985); the emergence of various positions and 'schools' stressing the limitations of a theory, such as the 'classical' theory of economic policy, that ignores the identity of policymakers, their political and personal objectives, and thus the numerous agency problems arising in public governance (e.g. Downs 1957, Tullock 1965, Niskanen 1971, Nordhaus 1975, Hibbs 1977, Alesina 1987, Alesina, Tabellini 1990, Persson, Tabellini 2000). In addition to negative positions for specific tasks of the government, a more general positive attitude towards free markets and a negative one towards institutions aiming at correcting or substituting it has emerged, which are now part of current conventional wisdom.

4. Absence of theoretical advances in crucial areas of economics such as the theory of economic policy, after its practical demise as an effect of the Lucas critique. An absolute pre-condition for the existence of economic policy as a discipline is the existence of firm foundations for its core, i.e. absence of 'vital' deficiencies in it. In our case the main attack has been

moved by the Lucas critique to the theory of economic policy. Elsewhere, we have shown that other attacks either have enriched the content of the discipline (this is the case of positive economic policy, whose arguments were well known to Caffè)[22]. In the case of economic policy, the first such pre-condition has to do with recognition of the existence of market failures. Other pre-conditions refer to the possibility or necessity of supplementing (or substituting) market decisions (as an institution expressing people's preferences) with consistent and effective public action. In the period we are referring to now, no theoretical or practical objections were raised involving the existence of market failures. By contrast, as already said, Akerlof (1970) added to these by introducing asymmetric information. It is true that Coase's propositions (Coase 1960) might be interpreted as a way to re-habilitate markets or at least part of their failures, but this argument would run against fundamental theoretical difficulties (Acocella 1994, pp. 104-106, English tr.). By contrast, logical and empirical objections were moved to the other pre-conditions as an effect of the innovations introduced in the two decades after mid-1960s. Some such objections contributed to develop parts of economic policy and generated new fields of inquiry. Some others have been fatal until recently to the survival of economic policy as an autonomous discipline and have contributed to its decline, while supporting the theoretical orientations of the Anglo-Saxon schools, referred to in the previous section. The most awkward part of objections to the content of economic policy dealt with government failures. I divide them in two types: those that can be called 'minor' failures, on the one hand, and 'vital' failures, on the other. 'Minor' failures indicate government failures that have been emphasized by the 'positive' approach to economic policy, especially by the Public Choice School. Some criticisms of this kind had already been raised before 1967 and were enriched later by a copious literature. They stress very important factors, such as corruption of politicians and their capture by powerful interest groups. However, such factors must be taken account of in practical policy together with a number of other institutional and historical features characterizing the issue in question and should be part of the

[22] His works are full of citations of cases where normative policy action would be distorted by the action of interests groups or the distortions introduced by the personal interests or visions of policymakers (see, e.g. Caffè 1948c, 1949a, 1972, 1979a) or by its immaterial nature and lack of credibility (Caffè 1977b). He is also very critical towards types of public intervention that do not ensure pursuance of purely public goals, taking the form, e.g., of a mix of public and private shareholding in the same company. He is very explicit on this point also in his Caffè (1978, ch. 18).

discipline when policy action is to be devised in practice. These objections can be dealt with partly in analytical terms similar to some of those referred to as 'market failures' (asymmetric information). Both markets and governments, as human institutions, are imperfect and economic policy as a discipline could be a way to devise how they can complement one another, having recognized that both are imperfect, but can be designed in a more rational way. By 'vital' failures we refer instead to two types of objections: the impossibility of taking people's preferences as a reference for public action, underlined by Arrow (1951) and 'radical' objections to effectiveness of public action of the kind raised by Lucas (1976). Let us refer to them in turn. After Arrow's contribution, a number of economists showed that his 'vital' objection to the possibility of deriving a SWF could be healed in much more (theoretically) acceptable ways than were the remedy that had been suggested by Frisch (1957) and already mentioned in section 4, which referred such function directly to politicians in charge (see, e.g., Sen 1970a)[23]. The second type of 'radical' objections to the discipline, i.e. those concerning the effectiveness of economic policy, are essentially due to introduction of expectations, in particular the assumption of rational expectations in a context similar to Lucas (1976). Some of these objections tended to negate the effectiveness of policy action even in the absence of agency issues. In their weakest form they constrained public policy into a Nessus shirt by prescribing policy action only under a rather rigid set of rules to avoid time inconsistency and sub-optimal outcomes. Stronger versions of this kind of criticism negated any active role to public policy in conflict with the conduct of private agents. These problems have long been unaddressed, thus contributing in a decisive way to the decline of economic policy as an autonomous discipline. However, advances in the last decade or so have shown that most statements of policy neutrality and the policy prescriptions of the 1970s and 1980s were unfounded or of minor relevance. In more details, there have been advances reversing or appreciably mitigating such statements and prescriptions, e.g., in the following crucial macroeconomic area (not to mention others in the same area and those in the microeconomic realm): the irrelevance of many critiques to the 'classical' theory of economic policy (in particular, Tinbergen's 'golden rule' about conditions to be satisfied for the government to control the economy and pursue its

[23] Caffè was aware of the importance of the difficulties underlined by Arrow, but did not despair that they were only temporary (Caffè 1953a, p. 47, p. 49).

targets) based on rational expectations (Acocella, Di Bartolomeo 2005; Acocella, Di Bartolomeo, Hughes Hallett 2013); the theoretical and practical limits to time inconsistency and thus to related prescriptions of monetary policy rules that should replace discretionary action (Blinder 1998, p. 56, Acocella, Di Bartolomeo, Hughes Hallett 2013); existence of a long-run non vertical Phillips curve (more recently, Benigno, Ricci 2011, Acocella, Di Bartolomeo, Tirelli 2014a); the need for more active fiscal policy and regulation (especially with respect to financial markets and institutions) once some unrealistic assumptions of current models are ruled out; the need, in the presence of public transfers, of a rate of inflation higher than that close to zero rate prescribed by the consensus view of New Keynesian models (Acocella, Di Bartolomeo, Tirelli 2015); the assertion of very low (Barro 1974) or even negative spending and tax multipliers (Giavazzi, Pagano 1990), rejected by, e.g. IMF (2010), De Long, Summers (2012), Blanchard, Leigh (2013), Semmler, Semmler (2013), which all find high values of the multipliers.

8. Conclusions

There has been some difficulty in reconstructing Caffè's thought. To some extent, this is due to its complexity as well as to Caffè's rich prose and wealth of citations. In many cases the message that Caffè wants to transmit to his readers is implicit and subliminal (see Acocella 2015), which makes it more difficult to detect the novelty of his contribution and suspect that everything he says had already been said by others. This interpretation is however misleading. Why did he so often quote other authors? Is this simply an effect of his deep and vast knowledge of the history of economic thought? Could not be his main scientific interests and contributions in the realm of this discipline rather than in economic policy? Or are there two different types of contributions in both these disciplines in this field that are kept one separate from the other? These are apparently legitimate questions that some authors have answered in a positive sense (see, e.g., Roggi 2014, as for the existence of two separate lines of enquiry in Caffè[24]). However, the most

[24] However, Roggi recognizes that the apparent asymmetry deriving from these two lines disappears at some point later, when Caffè assigns two different, but integrated, roles, to economic theory and economic policy (and to the respective historical profiles), the former being instrumental and ancillary with respect to the latter. The author's position is simply that this was so since the beginning of Caffè's

likely explanation is that Caffè, while being profoundly aware of the richness expressed by economic thought, had a well-structured position on each of the topics he was interested in, which can easily escape at first. Caffè's thought can emerge only after a careful analysis of his words. In order to do this, one must consider that citation of any author never implies Caffè's complete adhesion to this author's system of thought. He could take only a part of this as a brick for his own system. His pupils have a disadvantage in interpreting it, as they could be misled by their devotion. However, they can also help in suggesting interpretations of his thought consistent with his value judgments, character, way of life. How valid and actual are Caffè's ideas? Firstly, one must not forget his "happy synthesis of ethics, history and economics" (Acocella, Rey, Tiberi 1999). In his case, the whole is certainly different and larger than the sum of its parts. His conception of economic policy as a discipline that needed a theoretical background to be a firm guide to action led him to a conception distant from every metaphysical determinism. His message - contained in a number of considerations filtered by his deep and vast knowledge not only of the history of economic thought, but also of history and institutions - is lasting. The recent disproval, shown in section 7, of many conceptions of the 1970s and 1980s and rediscovery of the validity and fruitfulness of Caffè's arguments in favour of significant parts of the core of the discipline, which in some cases has been obtained by researchers trained at his school, show exactly that. However, the objections to such conceptions are still largely neglected, as these have left numerous intellectual heirs and even more significant practical applications in current policies and existing institutions, especially in Europe. Caffè would have moved an additional objection, derived from Del Vecchio's conviction according to which economic science comes from history and comes back to it, without reducing to it, being thus a discipline far away from any mechanistic conception. This implies that Caffè, in a way similar to Keynes, expounded a message of a *possible* way to make social well-being to progress (Amari 2015). At the same time, it does not imply that application both of Caffè's ideas and the recent findings will be made by policymakers along the same line he advocated, as this would need a number of additional conditions to be satisfied. Vested interests will certainly resist to them.

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theoretical reflection, which is testified by the numerous quotations of his early works given in this paper. A similar position is taken by Ciocca (2014).

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G. & L. E. R., Vol. 18 No. 2, 2014

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FEDERICO CAFFÈ: THE FREEDOM OF UTOPIA FOR THE COURAGE OF REFORMISM

Abstract

Standing alone among those who believed it harmful to correct a system that would be rapidly overtaken, and among those who instead believed it useless because the system was capable of finding its best equilibriums on its own, Caffè had the courage to propose concrete solutions to the most urgent problems, starting with full and high-quality employment. However, together with his friend Bruno de Finetti, he believed a utopian vision was necessary in order to give *free way* to his reformism. He considered economic policy as being an intermediary and a *bridge* between pure economics and applied economics, in a unitary conception of the economic discipline. Caffè identified himself in the ideal program of the Constitution that attempted to substantiate as *civil servant*, teacher and "adviser to the citizen".

JEL CLASSIFICATION: A23, B41, E12, H23, I31, J58, Z13.
KEYWORDS: UTOPIA, REFORMISM, CAPITALISM, ECONOMIC POLICY, DECENT WORK, FULL EMPLOYMENT, ECONOMIC PHILOSOPHY, CONSTITUTION.

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1.

If Caffè were still among us, he would find confirmation of his timely criticism of the neoliberal tendencies that are leading us to be poorer (with the enrichment of the increasingly few) and that would see us even more uncivilized. Into an economic, ethical and institutional crisis [1].

Federico Caffè's economics are 'civil economics', meaning the economics that accompany, throughout history, the civil advancement of man and that take on the task of mitigating economic hardship. They expand the areas of freedom of the person, immersed in a society that strengthens itself into a collective, with shared values and cooperative relations. With "the ideal of building a world where social and civil progress is not a by-product of economic development, but a consciously pursued objective" (Caffè 1976g).

The same as Antonio Genovesi, who founded the first Chair of Political economy in the world (1754); an economy that operates in the light of ethics and raison critique.

Anthropology, as conceived by Caffè, is not that of the "rational fool" (Sen 1977), but the one described by Cervantes, and represented by two protagonists: one, with his fantastical features, generous and utopian, the other with his earthly materiality. The one is complementary and indispensable to the other. And when the "knight of the sad countenance" comes to his senses, and therefore dies, Sancho Panza feels lost and alien.

Claudio Magris gives this a deeper interpretation with his "Utopia and Disillusionment" (Magris 1999, pp. 7-16). He warns us that, despite being

[1] The need to better understand the current situation, and how we have arrived there, is probably also the cause of the renewed interest in his thinking. S. Zamagni hopes that a better knowledge of Caffè can consolidate the return of "critical thought", absent for the last thirty years (Zamagni 2014). His is an original thought that did not find much space in the past in the review of history and economic thought, "also because of his different way being on the left", as reveals R. Faucci (2002). Despite that Guido Carli recognized him as our "greater economist of our time" (Ciocca 1995) and Einaudi wanted him to Quirinale (Amari 2014, pp. 259-266). See also M. Poettinger (2014). Caffè denounced the "trasformismo" of Italian economic policy (Caffè 1976d), and noted as "the reason of the irrelevance of an alternative line of economic policy that has always existed with respect to what had to conduct the persistent secular Italy split among those who have and those who don't have, including false miracles and claim agonies, [was] a historiographical issue still open and controversial"(Caffè 1983d). Among the enormous, growing literature on the crisis, see A. Roncaglia (2010); P. Leon (2014); L. Becchetti, L Bruni, A. Habish, S. Zamagni (2014).

subject to "disenchantment" for the 'hard replicas of history' and a disappointing reality, we cannot part with "utopia".

For Caffè: "utopia is nothing but the affirmation of a possible civilization against the constrictions of the present one." He agrees with Bruno de Finetti, who considers "utopia as a necessary precondition for any significant setup of the economic sciences" (de Finetti 1973).

The *freedom* of utopia for the *courage* of reformism; able to identify and pursue those "requisites for an acceptable economic system in relation to the needs of community" (de Finetti, cit.); and without worrying too much about whether or not these are compatible with the "system in which we live"[2].

Caffè and de Finetti appreciated the Pacem in Terris of John XXIII, and today would be very pleased to read the following passage from the Evangelii Gaudium of Pope Francis:

"People live poised between each individual moment and the greater, brighter horizon of the utopian future as the final cause which draws us to itself. Here we see a first principle for progress in building a people: time is greater than space" (Pope Francis 2013).

The conclusion of the complex debate on "welfare economics", which Caffè followed with great epistemological attention (Caffè 1966, pp. 86-125, 1956a, 1956b; Acocella 2002, 2015, 2014; Becattini 1995; Forte and Mossetto 1972; Mishan 1960; Lombardini 1953), is that we cannot avoid value judgments, starting with the ones about distribution (Little 1949)[3]. It is

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[2] The "requisites" indicated by the reformism of a liberal like Luigi Einaudi are striking, at least before his conservative involution : "The modern society that already provides free elementary education, that already provides the use of many services without charge (public parks, day-care, clinics, medical care, water, sewer system, etc.) must propose higher aims. The boundary between free goods and costly goods must be gradually moved in favour of the former. They are not an absurd ideal, a minimum of free shelter guaranteed for everyone, free education provided throughout university and beyond, the security of life in old age and many other services that today we cannot even imagine" (Einaudi 1948). For interesting relationship between Caffè and Einaudi (Acocella 2010). For writings of Caffe on some great Italian liberals, see (Caffè 1975a)

[3] The "old welfare economics" of Pigou explicitly assumes a value judgment, that of diminishing marginal satisfaction of revenue and therefore *justifies* redistributive policies between different people, from rich persons and poors, whose satisfaction is measured with cardinal numbers, summed and comparable. "Modern welfare economics" assumes the scheme of Pareto that measures the satisfaction with ordinal numbers, and therefore not summed, and also not comparable, so as to avoid value judgments, and remain in the field of mere "efficiency". Then, having reached the so-called "Pareto optimum" (the situation in which it is impossible, because of a redistribution of factors of production or goods, to improve the condition of the members of society without damaging any one person), redistributive policies are justified only in the case of improvement of one or many without hurting anyone. This is equivalent, by the way, to a unanimous decision. But the following complex debate, including the one on possible compensations (from the favourites to the damaged) to get them to accept a

important, as well then, as Caffè agrees with Myrdal (1953), to make them explicit.

It is an invitation not to yield to anti-ideologism, an oxymoron, since it is an ideology in itself, but more insidious, because it is generally regressive[4]. J.A. Schumpeter (1949) states: “And thus, although we proceed slowly because of our ideologies, we cannot continue at all without them”.

Federico Caffè is recognized in our Constitution, “inspired by liberal ideals, supplemented by socialist ideals, corrected by Christian-social ideals”, as Norberto Bobbio (Bobbio and Pierandrei 1982, p. 20), and Giuseppe Dossetti (1995) remind us, with whom Caffè collaborated in the stages of Constituent and the first reconstruction (Pombeni 2014).

An *open* compromise, susceptible to tilt towards one or the other component, but all necessary to avoid the risks inherent to each one, if taken alone[5].

Caffè often recalled constitutional values:

“So today, we toy nominalistically in the search for a ‘new development model’. And it is still ignored that this, in ideal inspirations, is contained in the Constitution, in the technical conditions it is shown by all the studies of the Economic Commission [for the Constituent Assembly]” (Caffè 1978a).

The Constitution that reinforces the belief of the philosopher Guido Calogero, according to whom: “the most solid democracy is born from the plurality of democracies” (Calogero 1945, p. 60)[6].

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redistribution measure and that (from the damaged to the favourites) to avoid it, comes back, in a circle, to the initial distribution, so in fact “privileged”, as Little concludes, expressing however the value judgment that they wanted to avoid.

[4] “[According to Lange] ‘much progress in social sciences are due to the desire and passion for social justice and the improvement of human conditions. The conservative attitude – the desire to maintain certain established institutions and certain canons of civility – tends, in general, to be an obstacle to scientific research. It is instead the desire to change and to improve, both conscious and unconscious, that creates the inquisitive attitude of the mind, that transforms into scientific investigation on human society” (Caffè 1948a). On the relationship between “facts and values ” and “values judgments” according to Caffè (Schiattarella 2015, 2012; Acocella 2015, 2014; Tiberi 2015; Ramazzotti 2012b).

[5] Liberalism slipping into laissez-faire, social Darwinism and into the underestimation of public intervention; in contrast with socialism in its risk of overestimating the latter and sacrificing the individual to the community; the religious component risking integralism and also underestimating State intervention, while in the right defense of social intermediate bodies.

[6] These cultural and political references and the real action next to Ruini, Minister for Public Works and Reconstruction, should dispel any concern about an ‘ethical’ or ‘naïve’ conception of the State by Caffè, advanced by some, and about his alleged contradictions. He was actually one of the few to accept and maintain the constitutional “compromise” in full, while many, after the breaking up of the governmental anti-fascist parties, and especially after the defeat of the Left, in April 1948, had returned to their own

2.

Caffè's analysis is mainly developed in the area of Economic policy, which he considers an intermediary and a *bridge* between pure economics and applied economics, in a *unitary conception* of the discipline. Trying to find "the logic", the "systematic" and the necessary *plurality* of the most useful tools in satisfying the *plurality* of the relevant and compatible objectives. Against the current reductionism, and following, in particular, the planning orientation of J. Tinbergen and Ragnar Firsh (Caffè 1966, pp. 152-193). A planning, which Italy never had, that would avoid perfectionism, that would meet the interest of the people that should defend it, and that would see the largest democratic participation in its elaboration and continual redefinition (Caffè 1945c, 1977).

Hence his great attention to the contemporary theoretical developments on one hand, and to social and economic issues on the other[7]. The choice of the tools with the necessary "eclecticism" (Samuelson), but within the "logic" and "systematic" mentioned above and with a "transdiscliplinary" approach (Myrdal). For the best connection between *values*, *theories*, and *facts*, claimed also by Leontief (1975)[8].

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cultural components, with the "suffocation" of the committed effort of Dossetti in the Catholic field (Caffè 1976h, 1985; La Pira 1945) and the dispersion of the Partito d'Azione in the secular field. A political break that contributed to the maintenance of our lack of participatory and liberal democratic culture, a bad legacy of fascism. Caffè remembered Dossetti's political experiment bitterly: "The testimony of an illusion, to create in Italy the type of acculturation that responded to a participatory and not purely polemical attitude toward labour that society, free from fascism, was living ... [and] the breaking of a scheme that closes the formation of political will within certain restricted areas that intend to call the public subject only to 'enthusiastic support, from the outside, to project already decided'" (Caffè 1976h). Do not forget that the "constitutional compromise" was made easier by the presence of a kind of "veil of ignorance" (J. Rawls 2009, pp. 142-147) on the real balance of power among the parties before the elections. The whole collaboration of Caffè on *Cronache sociali* of Dossetti, is in Amari (2014b, pp. 182-230). Many articles during the Constituent period and on Reconstruction in Amari, Rocchi (2009, pp. 121-205; see also pp. 1043-1070). For Caffè, the State and the institutions, see M. Bovero (1995); M. Cangiani, P. Frigato (2012); V. Valli (1995).

[7] Events, not only economic, punctually and chronologically recorded in his notebooks.

[8] For the prompt of Caffè for more significant social surveys (white deaths, accidents at work, commuting), see the video interview of G. M. Rey in Amari, Rocchi (2007:DVD attached); and Caffè (1983c). A conception of an economy that avoids the gap between theory and policy as in Walras, or even the abandonment of economy for sociology as in Pareto, perhaps for his "impossibilism" (see discussion on welfare economics). Caffè, on the contrary, maintained confidence in (civil) economy (Caffè 1976i).

This conception of Economic policy today should be re-evaluated in the face of heightened abstractness in theoretical research, and fragmentary and often contradictory current policies [9].

In Caffè's Economic policy analysis, there are some crucial relationships, which meet other disciplines. Some of the most significant are mentioned here.

2.1. The flat rejection of the exchange between efficiency and equity

With the latter instead as a sought after condition of the first, which is a feature of his conception of the Welfare State[10].

"But I want to reiterate once again that the state of well-being is an achievement to be realized with difficulty and not a bankruptcy hindrance to shake off. Efficiency without ideals back us to the intellectual climate that allowed to designate the economy as a 'dismal science' "(Caffè 1982).

And also the related rejection of the separation between *moment of production* and *moment of distribution*, the basis, among other things, of industrial democracy and of the role of the union, which Caffè followed with friendship and critical attention.

"Now the misunderstanding is here: there is no problem of distribution that is not at the same time a problem of 'equitable' distribution. The correspondence of the division to what social conscience considers as 'equitable' cannot refer to a 'later time', through the implementation of redistributive processes, but has to be guaranteed at the moment the production is organized and in the same forms in which it is carried out" (Caffè 1945b)[11].

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[9] A well-known text of Economic policy that follows this conception is by Acocella (2006). See also Acocella (2015, 2014), Palmerio (1995). There is a certain analogy with the thought of De Finetti concerning his discipline. Against unnecessary antithesis with regard to mathematics, he writes: "he who appreciates the practical applications of mathematics and sneers at abstract speculations, and vice versa he who exalts one and slights the other, is still far from a full and consistent understanding. Without the sap and the glue application, speculation would fall in aberrant Byzantinism; without the boldness and recklessness of generalizations and abstractions, the most insanely brilliant, mathematics applied would survive, asphyxiated but perhaps not even (De Finetti 1962).

[10] On Caffè's refusal of the *trade-off* between efficiency and equity, see broadly Franzini (1995). On the welfare of Caffè, see also Ciccarone (1995); Rey, Romagnoli (1993); Acocella (1990). His conception of Welfare is well expressed in Caffè (1986a, 2a ed. 2014).

[11] We have seen that Pareto's "optimum" is *relative* to one given initial distribution of resources. And the same for the result of perfect competition, considering its formal correspondence with Pareto's "optimum". But if the distribution is considered *unacceptable*, the "optimum" is "not good", according to

2.2. The relationship between market and democracy

Calogero and the supportive plurality of democracies are mentioned above. Caffè defended the dignity of work, not only proposing full employment in every way, but also defending labour conditions and democracy in companies (so-called industrial democracy)[12]. But today we face a return to hired hands, to the general precariousness of the worker together with the enterprise and whole society. For the "long march" from flexibility to precariousness see Luciano Gallino (2007). Far from the conception of the company as a "common good" that Marco Vitale suggests (2014). On the participation of workers in enterprise management and a different governance, see F. Vella (2014). Caffè did not recognize any "centrality" to the enterprise, but only to the person, above all in the work and into the firm: the conception of Adriano Olivetti and Pietro Onida (1967). For having it forgotten is the major responsibility of the economists and even more - I think - of the labour lawyers, whose elective function is precisely to protect this dignity, instead of consenting to the claims of a wrong conception of enterprise. Claudio Napoleoni (1985, pp. 50-57), after the failure of the labor theory of value, sees the capitalist exploitation in a "same alienation: the subordination to the thing", that involves, albeit in different modes, capitalists and workers and the whole society. So that the liberation of the most exploited also involves the liberation of others. Especially in today's current configuration of capitalism financialized.

De Finetti. And nowadays it is very bad, in "this sad time". Moreover the discussion of "modern welfare economics" has proved that the perfect competition *convalidates* a given distribution; but, if it is considerably "arbitrary and inequitable" (Keynes), contradicts its scientific assumptions on equal conditions between the agents. While, in its historical conditions, the 'free market' increases that "arbitrary and inequitable" distribution, as well known by A. Smith. A similar conclusion of Godel's theorems of incompleteness and inconsistency (see forward the quotation of Le Goff). This confirms the crucial importance of the initial distribution and its causes in economic models. Caffè on Sraffa's scheme, 'opened' to social dialectic with regards to the distribution, wrote: "He provides a compelling demonstration that for any distribution of income, between wages and profits, there is a corresponding set of relative prices. So you cannot say that a set of these prices is better or worse than another, because all are instrumental to the distribution of income, the only thing that can get better or worse. It is not dominated by the price mechanism, but a matter of institutional choice and responsibility of those who may be affected" (Caffè 1983a).

[12] For a collection of writings by Caffè on employment, labour and Trade Unions, see Amari, Rocchi (2007, pp. 129-234) and Amari (2014b). For industrial democracy - a source of major delay for political and Trade Union reformism and no less the owners, compared to other countries - see Caffè (1977c), Amari (2014c).

Multinationals counteract the national sovereignties themselves, with a major democratic involution[13]. "It is policy that must ride the economy and not vice versa" (but carefully not to be unhorsed), and "policy" must act "against the inertia of the crisis"[14], admonishes Caffè. But today there is the phenomenon of "revolving doors" and too many statesmen are "captured" as consultants of the largest economic and financial companies. Thus nullifying, inter alia, the construction of the function of collective preference using that of the politicians to overcome difficulties to build it by adding up the individual preferences ("impossibility of Arrow"). But a such use requires an acceptable democratic system.

Caffè, would agree with the observation of the sociologist and economist, G. Ingham (2010):

"While imperialism of some social sciences, like history and sociology itself, are subjects of sociology of the sciences, the imperialism of (market) economics is more a subject of the sociology of power".

According to Caffè:

"[…] Relevant economic decisions are not the result of unconcerted action by the countless economic units operating on the market, but of the conscious work of restricted strategic groups capable of limiting supply and influencing demand, orienting it at will; the market is so honest in reflecting the decisions of individual operators that it can be an election in which some voters have only one ballot and others more than one. […] The contaminating strength of money and power does not merely create

[13] Caffè recalled the analogy made by Papandreou (1972) between the oligopolistic market and the situation of political power with Big Business, Big Labour and Big Government; nowadays with the dominance of the first over the others. Therefore, making reference to the theory of the "second best", we should work towards downsizing the first and strengthening the others, in a general process of democratization. As is well known, the "theory of 'second best' (one of the developments of 'welfare economics'), states that if a condition is introduced in a system of general equilibrium that prevents satisfaction of one of the 'paretian conditions', then the other conditions, even if feasible, are not generally desirable" (Caffè 1970b, p. 72). To give an example: if, in the market of production factors, capital is highly concentrated, it makes no sense to "liberalize" the labour, even from the point of view of general equilibrium theory. These considerations are also a response to the objections of Coase and those of the theory of "public choice", with respect to public intervention to correct market failures. The first, with the proposal to let the market determine the price of compensation for damage of negative externalities, the second in remembering how politicians often pursue their own selfish interests. But they both forget the severe power asymmetries existing in today's configuration of capitalism. Caffè is drastic in this respect: "The extent of the social costs not paid is still much more important than the obstacles created by forms, albeit cumbersome, of public regulation" (Caffè 1990, p. 50).

[14] It is the title of an article by Caffè dedicated to the 50th anniversary of the F.D. Roosevelt's New Deal (Caffè 1983b).

'imperfections' in the market, it influences the entire operation. Since the market is a human creation, public intervention is a necessary component, not a distortive and oppressive element in itself" (Caffè 1976g).

2.3. The relationship between money and production

According to Caffè, "credit [has] a not only technical task, but a civil one, to be validly performed to [productive] ends, if it is able to escape financial-speculative manipulations, if it is able to dissociate from the unscrupulous manoeuvres that are done in our squalid stock markets, if - in short - it is able to operate in the belief that capital represents a "duty to produce" (Caffè 1976f). And, "because money is transformed into income and income into prompt employment... monetary stability alone is not enough" (Caffè 1979b); and, criticizing those who "suggested promoting community integration through monetary pathways", he continued: "whatever the technical virtuosity of the supporters of such aims, epistemological immaturity surprises and preoccupies, as it should be self-evident that the topic of monetary unification cannot be a premise, but a conclusion. Like the hoopoe of Minerva, which appears at dusk, monetary unification requires a hard day's work in other fields, that cannot be avoided or overridden (Caffè 1976e). Caffè, who considered "financial pollution" no less harmful than environmental pollution, was furthermore convinced that opportune forms of "socialization of financial superstructures" were completely "compatible with a market economy" (Caffè 1971a). It was necessary to resume the Keynesian research program aimed overcoming the dichotomy between money and the real economy of neoclassical theory (Caffè 1981; Minsky 1981). Also remembering that credit is a "relational" good and the credit functioning as described by J. Schumpeter (Vicarelli 1983).

2.4. The relationship between production and employment

According to Caffè: "an economic recovery without lower unemployment is nothing but a pure statistical indication without any valid interest" (Caffè 1983e). He denounced the old tares of "healing deflation" and "liberalization without planning". The problem of employment, of high-quality employment, would be resolved with active policies, even with a conception of the State as "last resort employer". It is the "the tools of production that must go in search of workers", according to Beveridge's setup (1944), and not vice versa (but today they go searching for workers in countries where they are exploited the most). With a democratic planning that considered the "structural change" in economic growth (Sylos Labini 1992; Pasinetti 1984) and disputing the claim of non-productivity of complex service sector. It is full employment that must generate the spending that justifies the consistent level of production (Caffè 1983e)[15]. Referring to the studies of Aldo Visalberghi, Caffè was interested in forms of "compulsory civil service", and not only for young people (Caffè 1973b). Caffè, in the eighties, edited and introduced a book on full employment, contemporary of well known Beveridge book (1944). In it the authors converged on the need of a strong policy, also constrictive, beginning with the capital movements (Burchardt et al., 1979).

2.5. The relationship between public and private and "voluntary action"

The failure of the market for widespread "externalities", increased dramatically following the "privatization of the world" (Ziegler), so much so that the economist W. Kapp, often mentioned by Caffè (1990, p. 50), defined capitalism as "an economy of costs unpaid"[16]; for the pervasive non-competitive forms and the practice of "administered prices" (Caffè 1969a); for the lacking "full employment" and the "arbitrary and inequitable distribution of wealth and incomes" (J.M. Keynes 1953, p. 331), requires continuous public intervention and also includes a "socialization of investment". And the promotion of pluralism of private and public economic

[15] They are firm beliefs of Caffè, starting from the articles written for *Cronache sociali*, the Dossettian magazine. A model, that of the Reconstruction, that sacrificed employment in favour of the internal monetary issues and of the international links taken on as inevitable. An excellent reconstruction of Caffè's thought on that model that conditioned the future policy, is by C. Gnesutta (2014). See also M. De Cecco (1974).

[16] With the so-called "microfoundation of macroeconomics", perhaps related with that "privatization of the world", they have lost the Keynesian concept of "economy as a whole", thus_falling into the "fallacy of composition", and weakening the sense of collectivity. Caffè wrote from London about it by observing the Labour party policy (Caffè 1948b, pp. 25-28). And forgetting also the intimate connection between the activities of the State and the private economy demonstrated by studies of J. O'Connor and C. Olsen (Caffè 1978b). Polemically, P. Leon devoted a chapter of his recent book on "macroeconomic foundation of microeconomics" (Leon 2014, pp. 57-95). For the same global vision of the social security, see De Finetti, in De Finetti e Emanuelli (1967, pp. 311-365).

institutions, of the associationism, cooperation (Caffè 1962, 1964) and volunteering (Caffè 1986b), as provided by the Constitution.

Dangerous commingling of the public with the private should be avoided: this was his original criticism of the system of the PP.SS, while considering their useful potential, Caffè (1970b, pp. 11-34, 1980a; Amoroso, Olsen 1986; Pochini 2012). He responds to the failure of the 'public' not with a return to the private, or with an imitation of privatistic logic, but with the revaluation of public work, democratic control, and with "recaptured sociality" (Caffè 1986c). Moreover, the growth of civil society requires an increase of the spaces for volunteering and non-profit, which is also one of Beveridge's teachings (Beveridge 1948).

3.

Caffè, citing Luigi Einaudi[17], warns us: "[...] the lasting lesson that he gives us, in considering the economic problem as 'an aspect and a consequence of a wider spiritual and moral problem', has nothing in common with the fragile and mechanistic logic of exponential trends in which one might like to include the progress of the universe" (Caffè 1974).

I think he would share the criticism of J. Le Goff (1997), according to which: "The majority of economists, who have acquired, in our society and with governments in Europe and worldwide, an often excessive and sometimes unjustified weight, do not have a good knowledge of economic history and, even worse, they care little about the historical dimension ... This makes the economic discipline inconsistent, whose uncertainties and contradictions would instead need very solid historical references"

Any contribution of Caffè has that historical dimension.

Along with Gustavo del Vecchio, he is convinced that "science must originate from history and return to it without dissolving into it"; and therefore is wary of the various historicisms: that of historical time present in the rather complex thought of Marx and that of general equilibrium theory (Barone included), discounted over logic time, and that of "rational expectations" of agents, *free* into the (dominant) embodied model (the dream

[17] Caffè used to speak "by means" of the great economists (Ciocca 1995).

of Descartes in the social field[18]). Thus, the combination between the liberal Francesco Ferrara and the communist Karl Marx, united in denying space to economic policies (Caffè, 1966, pp. 60-71). He also refused any form of determinism including positivism with its magnificent and progressive fate from scientific progress, without the necessary human intervention (Caffè 1984). And the same for the 'ratios' of balance-sheet of firm or for those of public budget, considered 'absolute truth', what Caffè named "economic pythagorism"[19].

On the contrary, recalling *his* Keynes[20]:

"It is the message of a 'possible civilisation', and not merely of efficient neocapitalism, that emerges from the Keynesian 'vision', with its 'passionate concern' for the ills of the world and its pressing solicitation to dedicate itself to proposing remedies. Among those who believe that the (capitalistic) evils of the world are incurable and those who maintain that they cure themselves, 'for the intrinsic stability of the private sector', over time, there will always be others that share this 'passionate concern' and the commitment it entails to search for the most respondent solutions to the problems as they appear in historical reality, always keeping the lessons of the past in mind," (Caffè 1976c). The same philosophy that he expressed in his well-known article, "The loneliness of the reformist" (Caffè 1982a).

And, as if to confirm this, he translated the volume of the Keynesian, price Nobel, L. Klein, "Economics of Supply and Demand", where there is a need to operate on both sides of the aggregate components, with full and selective use of Keynesian demand and the input-output analysis of W. Leontief (Klein 1986). Maintaining always confidence in Kynesian research program, open to the construction of suitable institutions, the social dynamics and social psychology with its propensities (of consumption, investment, liquidity), in a world uncertain and unstable (Roncaglia 2010, 2005; Leon 2014)[21].

To the unrealistic ambitions of many economists (and others), Caffè responds with his beloved poet, Eugenio Montale, who believes that the

[18] For which – as is known – it was enough to know the position and the speed of every physical element in order to derive the entire past and future of the world. As to 'open' or 'closed' economic model (as to degree of freedom), see Amari (2014d).

[19] For a radical rejection of historicism, see Popper (1981).

[20] Some of his writings on Keynes are in Amari, Rocchi (2009, pp. 275-342). See also Caffè (1979a). As to 'open' or 'closed' economic models (as to degree of freedom), see Amari (2014d).

[20] For a radical rejection of historicism, see Popper (1981).

[21] Once Caffè expressed his preference for the Lakatos' methodology.

search for “the key to the universe” disappointing. Because: “the awareness of the limits of our ability to formulate a coherent and unifying representation of the entire economic world, constitutes an element of strength, not of weakness, of economic inquiry. He places it under the shelter of fragile certainties (the inefficiency of the State, the creative strength of the market, the arrogant parasitism of bureaucracy); but does not lessen the commitment for social improvement intended as effort of mitigation of the many forms of marginalization of human beings” (Caffè, 1986b)[22].

were, and of how few people were dedicated to bringing them justice” (Caffè 1986e)[23]. And, as if to confirm this, he translated the volume of the Keynesian, price Nobel, L. Klein, “Economics of Supply and Demand”, where there is a need to operate on both sides of the aggregate components, with full and selective use of Keynesian demand and the input-output analysis of W. Leontief (Klein 1986). Maintaining always confidence in Kynesian research program, open to the construction of suitable institutions, the social dynamics and social psychology with its propensities (of consumption, investment, liquidity), in a world uncertain and unstable (Roncaglia 2010, 2005; Leon 2014) .

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[22] A direct response of Caffè to some objections about the limits of a lack of overall vision or adherence to a well-defined paradigm (Roggi 2014)

[23] For a brief biographical profile and the bibliography of the writings by Caffè and on Caffè, as well as the initiatives in his honour, without pretence of completeness, refer to Amari (2014a:259-298). See also Acocella, Rey, Tiberi (2009, pp. 11-19, 495-503); Faucci (2014, 2012, 2002); Acocella, Tiberi (2014); Acocella, Franzini (1990, introduction); Tiberi (1997); Ruini (1990); Tarantini (1985); and two interesting books on Caffè, Rea (1992-2000); Amoroso (2012).

improvement intended as effort of mitigation of the many forms of marginalization of human beings" (Caffè, 1986b) .

The demonstrations of Kurt Godel and Bruno de Finetti about the limits and contradictions in our abilities and logical thought in seeking the truth, should not discourage such a commitment, but consider it as an incentive to pursue it jointly and with the knowledge that "everything is built on quicksand, although of course we try to rest the pillars on points relatively less dangerous" (de Finetti 2006, p. 146). It is also a warning against all forms of intellectual arrogance and for greater accountability and tolerance.

4.

Another, and perhaps most important, relationship, considered by Caffè, is the one between the peace of the people, in social justice, and the civil development.

Caffè urged the weakest countries to join forces, while he criticized the hegemonic powers and the arrogance of international and European technocracies (Caffè 1986d)[24]. Criticizing an Italian "mission of peace" abroad, he invited the Italian government not to yield to "others' imperialist designs" with "well known 'greed of servility'"[Cfr. V.E. Orlando], but to try to solve the many internal problems of a "latecomer country". And he fought for the reduction of armaments against the "ancient merchants of guns that are now multinational and institutionalized ... as the pursuit for prosperity lies in the strong arms reduction and not in their multiplication" (Caffè 1983f; see also 1969 e 1973a).

He denounced the "strategy of economic alarmism" of the "vested interests" (Caffè 1976b) and became "adviser of the citizen", for correct economic information; to avoid the "escape from freedom" (E. Fromm) of the citizen facing politics and the politics facing technocracies[25].

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[24] As is well-known he was perhaps the first to denounce the drift of international bodies that, with forced and questionable interpretations of the same statutes, were abandoning the founding spirit, Milone (2012, 2010); Rey, Corsetti, Romagnoli (2001). On Caffè and Europe, see also Tiberi (2007). For several articles by Caffè on international economics, see Amari (2010).

[25] Exemplary was the language of the truth of Roosevelt for an informed democratic participation of citizens to the rebirth of the country (Roosevelt 1933). Bitterly (and uselessly as we see today), Caffè complained: "the way of effective democratic participation is, in truth, yet to be recovered. The

We can recognize him in the memory of a colleague and friend, gone too soon: “[...] He was on many occasions exemplarily critical of the economic policy believed to be inevitable only because it was dictated by hegemonic powers; and also of the paradigms whose explanatory power was to be disproportionately increased. [...] His life was dense, his days extremely laborious. He was aware of how many afflicted and destitute people there were, and of how few people were dedicated to bringing them justice” (Caffè 1986e)[26].

To his students he said: “always stay vigilant; never succumb to the idols of the moment, to those catchphrases and conventional saying, but always exercise your critical evaluation” (Caffè, 1980a)[27].

He once referenced the words of Ferruccio Parri, upon leaving the government: “There is no shadow in life for he who has the light of an ideal”. And he added: “mine does not leave any space for opportunistic moderatism” (Caffè 1980b).

A passionate appeal to the truth as we feel it. Speaking with a language of dangerous sincerity.

“The weight of this sad time we must obey; Speak what we feel, not what we ought to say”[28]

And Rita Levi Montalcini warns us that the greatest tragedies of history were caused by the gregariousness joined to human aggressivity.

We need more and more of "Erasmians", as named them Ralf Dahrendorf (2007): those who agree to undergo isolation and persecution for the defense of their ideas.

Perhaps the “different way of being left” that Faucci (2002) recognized in Caffè was to consider the egalitarian proposal (Bobbio 1995) as a condition

destruction of the achievements that it had found, until fascism taking power, is one of its most serious responsibilities. The negative consequences are still working with us as a tare from which Liberation not redeemed us” (Caffè 1975b). Similar and no less vigorous criticisms will continue from his friend Sylos Labini (2001, 2003). Caffe’s articles on newspapers and magazines, are in Amari (2104b, 2014c, 2013, 2010; Acocella, Franzini 1990; Carlini 2007).

[26] For a brief biographical profile and the bibliography of the writings by Caffè and on Caffè, as well as the initiatives in his honour, without pretence of completeness, refer to Amari (2014a:259-298). See also Acocella, Rey, Tiberi (2009, pp. 11-19, 495-503); Faucci (2014, 2012, 2002); Acocella, Tiberi (2014); Acocella, Franzini (1990, introduction); Tiberi (1997); Ruini (1990); Tarantini (1985); and two interesting books on Caffè, Rea (1992-2000); Amoroso (2012).

[27] On Caffè’s teaching see Leone (2014) and Steve (1995). On university instruction in Italy (Caffè 1984)

[28] The last words of King Lear, Shakespeare’s tragedy.

for expansion of freedom and participation in democratic life. In the utopian goal of building a society in which everyone enriches oneself claiming the duty to contribute according to his growing "capabilities", and receiving according to their own needs. A goal in the actual spirit of the Constitution with its united set of rights and duties.

A condition well clarified by Erickson when remind that a person flourishes when acknowledges to have need of those who need him.

A true "generative" relation when is growing between different generations .

A community to be reached with liberal democratic methods and ethical and cultural growth. Since you cannot force a person to work for his freedom and human growth (an oximoron), also contradicting the Kantian principle to consider the people as an end and not as a means.

Federico Caffè, who "cultivated" the humanity for such a long time [29], when he has retired from teaching, loosed the opportunity to fulfill Erikson's condition of generativity.

However, he left it to us as his own greater legacy.

Acknowledgement

I am grateful to Nicola Acocella for his useful suggestions. The whole responsibility is mine. I wish to thank Rachel Moland for her help in translation.

[29] *Cultivate humanity* is the beautiful title of Martha Nussbaum's book on the education with an cosmopolitan approach.

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G. & L. E. R., Vol. 18 No. 2, 2014

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SECURITIZATION, FRAGILITY, AND REGULATION

Abstract

Drawing on the endogenous character of money and credit supply, an accounting model of three fundamental drivers of fragility (*sudden stops*) in a non-depository financial sector is here presented. Essentially, financial firms adopt a scheme of idiosyncratic liquidity risk management (ILRM): depository institutions (traditional banks) opt for an originate-to-hold approach; non-depository entities (shadow banks) for an originate-to-distribute approach. Building on a sequential accounting model of asset-backed securities (ABSs) distribution, three fragility drivers are singled out: excess issuance of collateralized debt; poor liquidity transformation; collateralized-debt rollover frequency excessive relative to issued ABSs liquidity. Policy implications are eventually sketched out.

JEL CLASSIFICATION: E590; G010; G280.
KEYWORDS: Sudden Stops; Endogenous Money; Liquidity Risk; Originate-To-Hold Vs. Originate-To-Distribute; Impact Evaluation Theory; Securitization; Fragility; Regulation.

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Securitization throws light on the nature of money.

H.P. Minsky, 1987
(Minsky and Wray, 2008, p. 3)

1. Introduction

At the time when Alan Greenspan is appointed as chairman (1987-2006) of its Board of Governors, the US Fed is supposed to upgrade its concern over inflation dynamics. Under the Maestro's reign, however, the Fed displays an expansionary bias. Although motivating such epithets as 'the Greenspan Put' and 'the lender of *first* resort', this bias is not generating inflation and has nothing to do with inflation policy. Rather, Greenspan is concerned with the fact that his attempts at checking inflationary pressures affect a pressure on capital markets potentially leading to swift falls in capital flows, aka *sudden stops*. As it happened, his first tightening culminated in the Black Monday (19 Oct. 1987).

Instituted by Reagan to go into the Black Monday, the Brady Commission (1988) stigmatizes an inappropriate understanding of the actual working of financial markets[1]. At the same time (1987), Hyman Minsky suggests that securitization is the key driver in the evolution of the US financial system[2]. Claessens and Kose (2013, p. 61) record that, while nil in the 1970s, since the 21st century the frequency in sudden stops starts exceeding the sum of frequencies in banking, debt, and currency crises[3]. Against this evolving

[1] 'Institutional and regulatory structures designed for separate marketplaces were incapable of effectively responding to inter-market pressures. The activities of some market participants, such as portfolio insurers, were driven by the misperception that they were trading in separate, not linked, marketplaces. The simple conclusion is that the system grew geometrically with the technological and financial revolution of the 1980s. Many in government, industry and academia failed to understand fully that these separate marketplaces are in fact one market' (Brady Commission, 1988, p. 68).

[2] 'It is necessary to understand what securitization involves and how it might affect the development of the world economy if central bank interventions and the government interventions that guide institutional developments are to be successful' (Minsky and Wray, 2008, p. 2).

[3] Claessens and Kose's data can be usefully interpreted under the light of the growth of four US sectors (households, non-financial corporate, commercial banks, security broker dealers) in the period 1954-2008 (Shin, 2010, p. 169): since 1980, security broker dealers sector grew 45 times more than other sectors.

background, his 'Put' can be regarded as Greenspan's tentative answer to his supreme duty of protecting the US 'exorbitant privilege' from an emerging, yet structural, kind of financial instability[4]. A recent survey of the literature on securitization alludes to a possible answer to Queen Elizabeth's famous question—*Why did nobody see it coming?*:

> *Securitization is not only important because it is quantitatively important. It also challenges theoretical notions of the role of financial intermediation. … Surprisingly, given the importance of securitization, the most basic questions remain open questions. Studying securitization offers an opportunity to examine some basic issues in financial economics and macroeconomics*. (Gorton and Metrick, 2012, pp. 2, 59)

In his recent survey on economists' contributions in *i)* forecasting the sub-prime and the euro-area debt crises, *ii)* providing analytical tools to take them in, and *iii)* advising on how to deal with current and future crises, Pagano (2014) shows that conventional models have proved ineffective[5]. At the same time, a group of researchers at the Bank of England (McLeay et al., 2014) now endorses a non-orthodox perspective on monetary theory[6]: bank *deposits* – by far (97%) the most important type of money held by the public in UK (and virtually everywhere else) – do not create lending but are *created by lending*. In this 'endogenous money' perspective, such a thing as the money multiplier does not even exist because banks are not simple intermediaries lending out the deposits that savers place within them[7]: profitable lending opportunities do determine banks' lending decisions, which in their turn determine the amount of deposits originated, which in its turn influences the amount of base money which banks want to *hold* in

[4] See also Eichengreen, 2011, p. 97ff.

[5] [M]any of the new ideas about systemic risk … have come from researchers working in central banks (especially the NY-Fed and the ECB) and international institutions (chiefly the IMF and the BIS) … Moreover, contributions from academics have not come from researchers in mainstream finance of macroeconomics, but mainly from a small group of researchers in the fields of financial intermediation or economic theory (such as V. Acharya, F. Allen, M. Brunnermeier, M. Hellwig, J.-C. Rochet, H.S. Shin, J. Tirole), who were both prepared and inclined to cross 'received boundaries' between finance and macroeconomics' (Pagano, 2014, p. 6).

[6] See in particular Godley and Lavoie (2007).

[7] '[W]hen households choose to save more money in bank accounts, those deposits come simply at the expense of deposits that would have otherwise gone to companies in payment for goods and services. *Saving does not by itself increase the deposits or 'funds available' for banks to lend'* (McLeay et al., 2014, p. 15, *my it.*).

reserve.

Some time before being appointed (2013) head of research at the Bank for International Settlements, H.S. Shin (2009, 2010) has stressed the role played in the recent turmoil by two misconceptions about securitization: first, before it happened, the belief that *securitization enhances financial stability by dispersing credit risk*; then, after it happened, the notion that securitization allows the 'hot potato' of bad loans to be passed to unsuspecting investors[8]. In Shin's view, both misconceptions stem from overlooking that credit supply does adjust in response to shifts in measured risks: actually, credit supply is endogenous. Adjustments in assets perceived liquidity being a key driver of credit supply, Shin's keynote is that 'sensitive' risk-pricing techniques (in which price adjustments are the sole allowed symptom of changes in fundamentals) – and the corresponding mark-to-market accounting rule – do entail pro-cyclical reactions (sell cheap, buy dear) in credit supply[9]. Further, such perverse reactions are amplified through the *long* intermediation chains associated to securitization procedures[10].

That price-sensitive strategies do play a key role in fostering financial fragility has been argued in the wake of both the Great Depression[11] and the 1906-07 global liquidity crisis. Pantaleoni (1912) came to consider fragility as a consequence of individual risk-pricing strategies inspired by short-term incentives[12]: such strategies induce individuals to interpret all variation in assets prices as a variation in fundamentals (assets liquidity). Inspired by Pantaleoni's account of pro-cyclicality (essentially based on 'excessive' trading frequencies[13]), the present article aims at singling out high-frequency debt rollover as a by-product of securitization procedures and a key driver of

[8] The hot potato is not leaving the seller's balance sheet at all. Cf. Sections 3 and 4.

[9] Sensitive traders interpret an appreciation of a risky asset as a decline in the risk premium, i.e., this asset is deemed worth buying (to the extent allowed by leverage policies) as fast as possible, before others push its price further up by doing the same (buy dear). Conversely, depreciations induce selling reactions (sell cheap). In a nutshell: 'the more weight is given to prices in making decisions, the greater are the spillover effects that ultimately undermine the integrity of those prices' (Shin, 2010, p. 4).

[10] Long chains 'carry costs in terms of greater amplitude of fluctuations in the boom-bust cycle of leverage and balance-sheet size' (Shin, 2010, p. 167).

[11] E.g., Myrdal 1931[1939], Hicks 1935, Keynes 1936.

[12] 'In short time-periods … it is always supposed that the depreciation or appreciation is due to a qualitative variation of the commodity; this is admittedly possible with securities that can easily experience qualitative variations in a few hours' time lag; this is not possible with the commodities of other markets' (Pantaleoni, 1912, p. 198).

[13] I.e., on the 'shortness' of decisional periods.

financial fragility.

More in general, these pages take up the crying need for a sounder theory of securitization. Indeed, securitization is a stone guest in current policy debates (and the JEL classification system, too). The remainder of the paper is thus organized as follows. Building on the endogenous character of credit and money supply, Sec. 2 claims that financial firms do essentially adopt a scheme of idiosyncratic liquidity risk management (ILRM): depository institutions (traditional banks) opt for an originate-to-hold (OTH) scheme, while non-depository entities (shadow banks) an originate-to-distribute (OTD) approach. Sec. 3 proves that interim balance sheets of OTD-ILRM procedures open a convenient perspective for evaluating the impact of securitization procedures. By means of a sequential accounting model, Sec. 4 highlights a first fragility driver in a non-depository financial sector: 'excess' issuance of collateralized debt. In Sec. 5, poor liquidity transformation (structured claims being perceived not enough more liquid than their collateral) is identified as a second driver of fragility; this, in its turn, can be considered as a special case of a more general fragility driver: debt rollover frequency being excessive relatively to the liquidity of issuances. Sec. 6 sketches regulatory implications and Sec. 7 concludes by hinting at the ways ahead.

2. OTH and OTD schemes of ILRM

The conventional account of banking activity is one of pre-existing liquidity being channelled into new ventures. Banking intermediation can be elucidated by means of transactions accounts (flow of funds), where outflows during the period $(0,T)$ are *uses* and inflows *resources*. The balancing item is thus a net inflow. Be $(0,T)$ the life span of a business plan requiring external finance; L the average value of the stock of deposits held by the bank during the period $(0,T)$; λL the amount of interest a bank pays to depositors over $(0,T)$; W the total cost of the business plan; ρ its internal rate of return; ϕ the fraction of W externally financed; $\beta\phi W$ the amount of interest a bank receives from borrowers over $(0,T)$. Of course, λ and β are parameters connected to the interest rates a bank applies to deposits and loans, respectively. The conventional view of banking intermediation can thus be depicted as follows:

final creditor		*bank*		*final debtor*	
uses	resources	uses	resources	uses	resources
L	(1+λ)L	(1+λ) L	L		
		ϕW	(1+β) ϕW	(1+β) ϕW	(1+ρ)W
λL		βϕW − λL		(1+ρ−ϕ(1+β))W	

For the intermediation sequence (final creditor; bank; final debtor) to be viable, all parties must realize non-negative net inflows, i.e.,

$$\begin{cases} \lambda L \geq 0 \\ \beta\phi W - \lambda L \geq 0 \\ \left(1+\rho-(1+\beta)\phi\right) W \geq 0 \end{cases}$$

That is, if:

$$\begin{cases} \lambda \geq 0 \\ \beta \geq \dfrac{\lambda L}{\phi W} \\ \rho \geq (1+\beta)\phi - 1 \end{cases}$$

In such conventional perspective, banks come across as originators of loans (assets) they hold until maturity in order to monitor borrowers and thus manage *credit risk*. However common sense that may seem, a growing literature avows that representations as these trivialize the precise reason why banks originate-to-hold deposits, i.e., why banks are *depository* institutions. Actually, banks (just like any other financial entity) can only generate liabilities[14]. Banks are willing to originate-to-*hold* deposits as these

[14] This may be regarded as a modern version of King Midas' myth.

entail liquid assets (e.g., currency) being available to manage (reduce) idiosyncratic *liquidity risk*. In this perspective, the sequence of transaction accounts looks as this:

final debtor		*bank*		*final creditor*	
uses	resources	uses	resources	uses	resources
$(1+\beta)\,\phi W$	$(1+\rho)W$	ϕW	$(1+\beta)\,\phi W$		
		$(1+\lambda)\,L$	L	L	$(1+\lambda)L$
$(1+\rho-\phi(1+\beta))W$		$\beta\phi W-\lambda L$		λL	

The viability conditions are the same in both perspectives on OTH intermediation. Yet, a final debtor[15] now starts the sequence. In a dynamic perspective over a dynamic environment, liquidity is not a prerequisite for *lending*[16] – as it is in the conventional 'exogenous money' view of banking and the resulting 'capital scarcity' view of financial regulation – but a prerequisite for *solvency*. The resulting perspective on new bank deposits – not the essential raw material for new loans but, more essentially, an instrument apt to insure the realization of financial plans against upswings in liquidity risk – has a number of upshots: among them, a fresh perspective on securitization as a procedure of ILRM.

Assume a non-depository financial institution, a so-called shadow bank. As a rule, this is a branch of a 'sunlight' bank. A shadow bank is 'created to hold securitized assets or other assets that have been securitized by the original holder, and issue debt securities collateralized by those assets' (Eurostat, 2013, 5.107). Therefore, a shadow bank is no more than a 'financial vehicle corporation engaged in securitization transactions (FVC)' (*ib.*, 2.88)[17]. Being backed by the cash inflow associated to a *given* pool of assets, debt securities issued by FVCs are called asset-backed securities

[15] '[T]he fundamental paper emitter and source of the cash flows from income that validate the securities [loans]' (Minsky and Wray, 2008, p. 4).
[16] See footnote n. 7.
[17] Even governments set up shadow banks for financial convenience. The ESA 2010 aims at enhancing information about FVCs. Yet, as for *public* vehicles, especially resident in Europe, whether approved arrangements pave the way for an understanding of FVCs impact on such issues as the sovereign debt crisis, financial stability, or economic growth, is an open question.

(ABSs): 'An ABS is a debt security whose principal and/or interest is solely payable from the cash flows produced by a specified pool of financial or non-financial assets' (*ib.*, 5.110).

Typically, a FVC is a robot corporation (Gorton and Souleles, 2007, p. 550) interacting with its sponsor via non-requited[18] transactions. A FVC is thus expected to contribute in reducing its sponsor liquidity risk by getting anticipations of its sponsor future cash inflows by way of ABSs issuances. In short, a FVC does enforce an originate-to-distribute (OTD) strategy of ILRM. In originating-to-distribute ABSs, just like in selling whichever debt security, there is a liquidity risk transfer from someone who can bear it best to another who can bear it less. Yet, in OTD-ILRM there is no transfer of collateral and hence *no credit risk transfer* (Shin, 2010, pp. 152ff). The ABS containing in itself a duplication of the credit risk on underlying assets, OTD-ILRM rather implies a *multiplication* of idiosyncratic credit risk[19] and thereby an increase in *systemic* credit risk.

An ABS states 'I owe you X tomorrow for $\sigma^{-1}X$ you give me today, X being backed by such and such given assets'. The ABS is distributed *if* its buyer does expect an *eventual* (tomorrow) positive net inflow: $\sigma > 1$. Being σ^{-1} the discount factor the market applies on an ABS face value X, σ is a measure of an ABS illiquidity (i.e., an index of the market scepticism over this ABS *credit* risk). At the end of the day (tomorrow), the following transactions accounts enter into force:

ABS issuer		*ABS buyer*	
uses	resources	uses	resources
X	$\sigma^{-1} X$	$\sigma^{-1} X$	X
$-(1-\sigma^{-1}) X$		$(1-\sigma^{-1}) X$	

Now, be γ defined as $\gamma \equiv \sigma(\sigma - 1)^{-1}$. Being $\gamma'(\sigma) < 0$, γ can be regarded

[18] Eurostat, 2013, 1.71.

[19] A *credit risk multiplier* may be conjured up.

as an ABS *liquidity* measure (i.e., an index of market trust in a securitization service: good packaging of good assets). Our accounts can thus be rewritten as follows:

ABS issuer		*ABS buyer*	
uses	resources	uses	resources
X	$(1 - \gamma^{-1})\,X$	$(1 - \gamma^{-1})\,X$	X
$-\gamma^{-1}X$		$\gamma^{-1}X$	

It is here critical to notice that ‘today’, when the ABS is *only distributed*, the issuer succeeds in reducing liquidity risk by cashing an anticipation of $(1-\gamma^{-1})X$ on his future cash flow X. A *liquidity risk transfer* is thus realized, for which the ABS buyer will be more than compensated at a later date (‘tomorrow’): for the time being, however, the ABS buyer (issuer) shall experience a rise (decline) in his/her idiosyncratic liquidity risk.

3. The interim accounts in OTD procedures

The effects of securitization procedures can be more conveniently approached via the sequence of accounts implied by securitization procedures. Applied codes are drawn from the ESA2010: be LS an opening balance sheet, LE a closing one, linked through an account LX of aggregate changes[20]. To our ends, the LX account can be split into two sub-accounts, the former (LX.a) accounting for changes due to ABS *distribution*, the latter (LX.b) to ABS *clearing*:

[20] In LX accounts, the quadruple entry principle applies.

ABS ISSUER		**ABS BUYER**

LS Opening balance sheet

ABS issuer: Assets		ABS issuer: Liab. & n.w.	
AF.3	D		
		B.90	D

ABS buyer: Assets	ABS buyer: Liab. & n.w.
(unaltered)	

ABS distribution

LX.a Changes in balance sheet

ABS issuer: Assets		ABS issuer: Liab. & n.w.		ABS buyer: Assets		ABS buyer: Liab. & n.w.	
Total changes		*Total changes*		*Total changes*		*Total changes*	
F.2	$(1-\gamma^{-1})$ D					F.2	$(1-\gamma^{-1})$ D
		F.3	D	F.3	D		
		B.10	$-\gamma^{-1}$ D			B.10	γ^{-1} D

ABS clearing

LX.b Changes in balance sheet

ABS issuer: Assets		ABS issuer: Liab. & n.w.		ABS buyer: Assets		ABS buyer: Liab. & n.w.	
Total changes		*Total changes*		*Total changes*		*Total changes*	
		F.2	D	F.2	D		
		F.3	− D	F.3	− D		
		B.10	Ø			B.10	Ø

Net changes (LX.a + LX.b)

LX Changes in balance sheet

ABS issuer: Assets		ABS issuer: Liab. & n.w.		ABS buyer: Assets		ABS buyer: Liab. & n.w.	
Total changes		*Total changes*		*Total changes*		*Total changes*	
F.2	$(1-\gamma^{-1})$ D	F.2	D	F.2	D	F.2	$(1-\gamma^{-1})$ D
		F.3	Ø	F.3	Ø		
		B.10	$-\gamma^{-1}$ D			B.10	γ^{-1} D

LE Closing balance sheet

ABS issuer: Assets		ABS issuer: Liab. & n.w.		ABS buyer: Assets		ABS buyer: Liab. & n.w.	
AF.2	$(1-\gamma^{-1})$ D	AF.2	D	AF.2	D	AF.2	$(1-\gamma^{-1})$ D
AF.3	D	AF.3	Ø	AF.3	Ø		
		B.90	$(1-\gamma^{-1})$ D			B.90	γ^{-1} D

The LS row certifies the existence of a pool of illiquid assets (AF.3). The LX.a account deals with variations ascribable to ABS origination and distribution: the issuer (left column) originates-to-distribute a collateralized debt obligation – by hypothesis equivalent to securitized cash flow (D) – so to cash a fraction $(1-\gamma^{-1})$ of D in liquid assets (AF.2)[21]; on the other side, the buyer (right column) records an increase in his/her illiquid assets and a decrease in his/her stock of liquid assets. As soon as the ABS comes to maturity (LX.b), the issuer (buyer) cancels his/her debt (credit) position while recording a decrease (increase) in his/her stock of liquid assets (principal plus interest). The LX account being the sum of LX.a and LX.b, the balance sheet LE resulting at the end of the securitization procedure is obtained out of the sum LS + LX, where LX = LX.a + LX.b.

The sequence as a whole makes clear that a securitization procedure leads to a final situation where an ABS issuer is more illiquid and an ABS buyer more liquid than they were before; *meantime, however, the opposite applies: the ABS issuer is more liquid, the buyer less liquid*. ABS clearing not affecting net worth, we can focus on *interim* balance sheets, i.e., on balance sheets as they appear as a consequence of ABS distribution only (LI = LS + LX.a):

ABS ISSUER

LI Interim balance sheet

Assets		Liab. & n.w.	
AF.2	$(1-\gamma^{-1})$ D		
AF.3	D	**AF.3**	**D**
		B.90	$(1-\gamma^{-1})$ D

ABS BUYER

LI Interim balance sheet

Assets		Liab. & n.w.	
		AF.2	$(1-\gamma^{-1})$ D
AF.3	**D**		
		B.90	γ^{-1} D

The information contained in interim relevant to the whole sequence: the collateral (AF.3), ABS origination and distribution (boldfaced AF.3), the liquidity risk transfer (AF.2) and, crucially, net worth (B.90) equivalent to

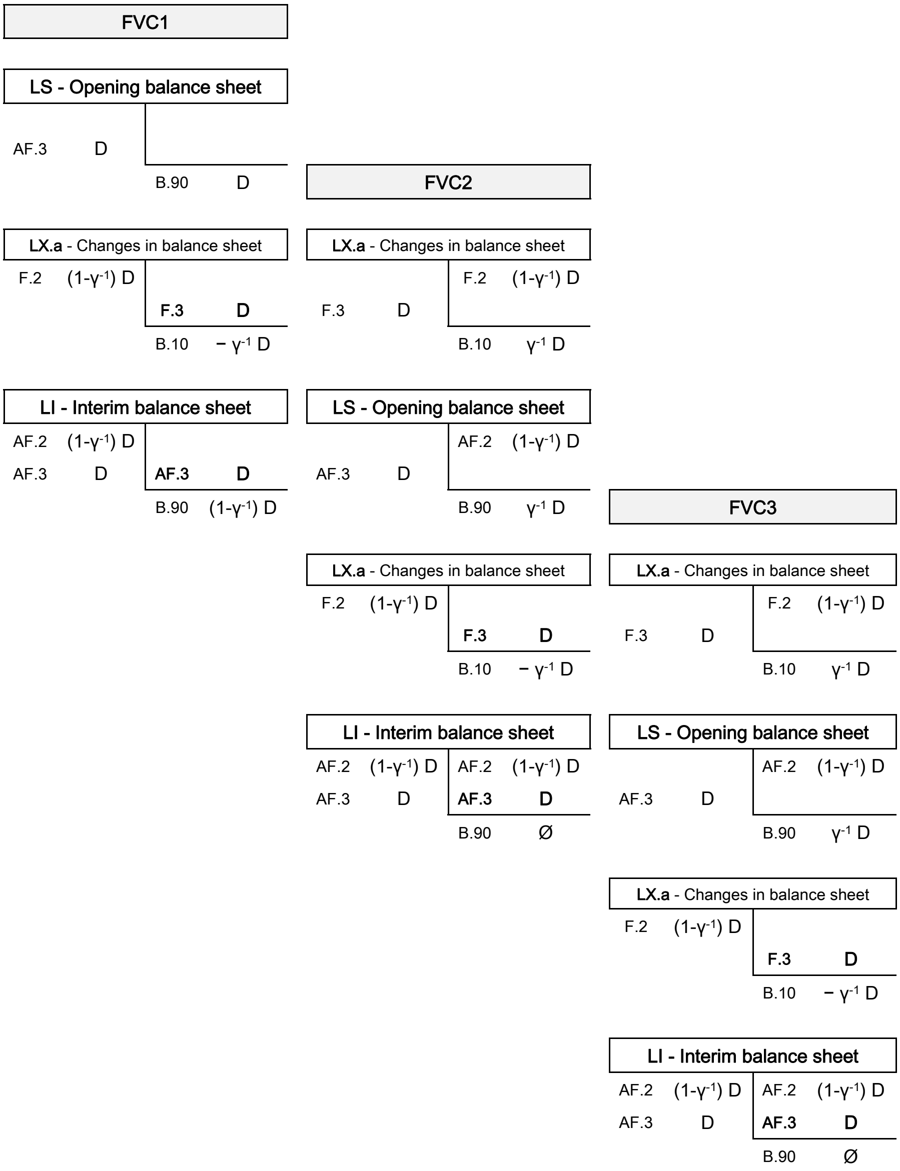
[21] As for the ESA codes, AF is for financial assets, AF.2 when in form of currency of deposits, AF.3 are debt securities, AF.4 loans; F is for transactions in financial assets and liabilities, F.2 when in form of currency and deposits, F.3 in case of debt securities, F.4 of loans.

closing ones (see LE). Since interim accounts describe the actual situation when an operation of OTD-ILRM is under way, *interim balance sheets open a convenient perspective for evaluating the impact of securitization procedures*. Likely impacts will essentially depend on ABS buyers' operations.

4. The 'creative wave' viability condition: a special case

Exercises in impact evaluation on the non-depository financial sector itself (the shadow banking system) need be based on the assumption that an ABS buyer is another vehicle (FVC2) employing his asset-backed security as a collateral to originate and distribute another ABS, i.e., an ABS-backed-security (ABS-squared)—also known as collateralized debt obligation (CDO). In its time, the CDO buyer (FVC3) issues a CDO-squared (ABS-cubed) … and so on, with *n*-powered-ABS (ABS^n or CDO^{n-1}). Let us tag such a sequence of issuances (ultimately backed by D) a *'creative wave'*.

Under the hypotheses that *i)* γ is constant throughout the n layers, and *ii)* FVCs securitize the whole of their assets value, a creative wave can be captured through this sequence of accounts:


FVC1
LS - Opening balance sheet
AF.3 D
B.90 D
LX.a - Changes in balance sheet
F.2 (1-γ-1) D
F.3 D
B.10 − γ-1 D
LI - Interim balance sheet
AF.2 (1-γ-1) D
AF.3 D
AF.3 D
B.90 (1-γ-1) D
FVC2
LX.a - Changes in balance sheet
F.2 (1-γ-1) D
F.3 D
B.10 γ-1 D
LS - Opening balance sheet
AF.2 (1-γ-1) D
AF.3 D
B.90 γ-1 D
LX.a - Changes in balance sheet
F.2 (1-γ-1) D
F.3 D
B.10 − γ-1 D
LI - Interim balance sheet
AF.2 (1-γ-1) D
AF.2 (1-γ-1) D
AF.3 D
AF.3 D
B.90 Ø
FVC3
LX.a - Changes in balance sheet
F.2 (1-γ-1) D
F.3 D
B.10 γ-1 D
LS - Opening balance sheet
AF.2 (1-γ-1) D
AF.3 D
B.90 γ-1 D
LX.a - Changes in balance sheet
F.2 (1-γ-1) D
F.3 D
B.10 − γ-1 D
LI - Interim balance sheet
AF.2 (1-γ-1) D
AF.2 (1-γ-1) D
AF.3 D
AF.3 D
B.90 Ø

As considered in the previous section, these accounts can be conveniently reduced to a set of interim balance sheets (LI) providing a no less accurate précis of a creative wave build-up out of a given volume D of final debt[22]:

Final debtor			
AF.3/4		AF.3	D
		B.90	− D

FVC1 LI - Interim balance sheet			
AF.2	$(1-\gamma^{-1})$ D		
AF.3	D	AF.3	D
		B.90	$(1-\gamma^{-1})$ D

FVC2 LI - Interim balance sheet			
AF.2	$(1-\gamma^{-1})$ D	AF.2	$(1-\gamma^{-1})$ D
AF.3	D	AF.3	D
		B.90	Ø

FVC3 LI - Interim balance sheet			
AF.2	$(1-\gamma^{-1})$ D	AF.2	$(1-\gamma^{-1})$ D
AF.3	D	AF.3	D
		B.90	Ø

…

FVCn (n>1) LI - Interim balance sheet			
AF.2	$(1-\gamma^{-1})$ D	AF.2	$(1-\gamma^{-1})$ D
AF.3	D	AF.3	D
		B.90	Ø

Under the hypotheses *i)* and *ii)*, there is no reason why a creative wave should develop: vehicles other than a FVC1 have no rational incentive to originate and distribute CDOs: such operations must not result in any net improvement in their situation—neither in terms of net worth nor liquidity risk. Having a FVC2 no rational incentive to buy an ABS, it is of course also unlikely for a FVC1 to have (in the model) a rational incentive to issue ABSs[23]: 'rationally' (under the above-referred hypotheses), ABSs and CDOs being non-distributable, neither a full-fledged non-depository financial sector, nor a creative wave, should develop.

The moral of this story is that FVCs should resist the temptation to securitize too great a part of their assets. Excess *collateralized* debt, i.e., excess ABS and CDO issuance, must be an elementary cause of market fragility: the more assets are 'securitized', the greater the risk for a sudden

[22] For reasons considered in Sec. 2, someone's financial asset is ultimately someone else's financial liability.

[23] Post-crisis experience shows that when CDOs markets are frozen ABS markets suffer from a severe contraction in 'depth'. This is due to the fact that an ABS buyer can either hold it, or sell it, or issue a CDO. When CDO issuers disappear, demand for ABSs is severely reduced.

stop to happen is. Such a risk can somehow be reduced to the extent that the liquidity of an ABS^n relative to its underlying ABS^{n-1} (namely γ_n) is greater than the liquidity (γ_{n-1}) of the ABS^{n-1} relative to its underlying ABS^{n-2}, and so on[24]. In any case, the non-depository financial system is more resilient the smaller the share of securitized assets is.

As it happens, if we assume that FVCs reduce liquidity risk by securitizing *net* assets only (LS net worth), the accounting model yields viable outcomes:

[24] In other words, fragility is reduced when $\gamma_n > \gamma_{n-1} > \ldots > \gamma_2 > \gamma_1$.

FVC1

LS - Opening balance sheet

AF.3	D		
		B.90	D

LX.a - Changes in balance sheet

F.2	$(\gamma-1)\gamma^{-1} D$		
		F.3	$\mathbf{D}$
		B.10	$-\gamma^{-1} D$

LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-1} D$		
AF.3	D	**AF.3**	$\mathbf{D}$
		B.90	$(\gamma-1)\gamma^{-1} D$

FVC2

LX.a - Changes in balance sheet

		F.2	$(\gamma-1)\gamma^{-1} D$
F.3	D		
		B.10	$\gamma^{-1} D$

LS - Opening balance sheet

		AF.2	$(\gamma-1)\gamma^{-1} D$
AF.3	D		
		B.90	$\gamma^{-1} D$

LX.a - Changes in balance sheet

F.2	$(\gamma-1)\gamma^{-2} D$		
		F.3	$\boldsymbol{\gamma^{-1} D}$
		B.10	$-\gamma^{-2} D$

LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-2} D$	AF.2	$(\gamma-1)\gamma^{-1} D$
AF.3	D	**AF.3**	$\boldsymbol{\gamma^{-1} D}$
		B.90	$(\gamma-1)\gamma^{-2} D$

FVC3

LX.a - Changes in balance sheet

		F.2	$(\gamma-1)\gamma^{-2} D$
F.3	$\gamma^{-1} D$		
		B.10	$\gamma^{-2} D$

LS - Opening balance sheet

		AF.2	$(\gamma-1)\gamma^{-2} D$
AF.3	$\gamma^{-1} D$		
		B.90	$\gamma^{-2} D$

LX.a - Changes in balance sheet

F.2	$(\gamma-1)\gamma^{-3} D$		
		F.3	$\boldsymbol{\gamma^{-2} D}$
		B.10	$-\gamma^{-3} D$

LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-3} D$	AF.2	$(\gamma-1)\gamma^{-2} D$
AF.3	$\gamma^{-1} D$	**AF.3**	$\boldsymbol{\gamma^{-2} D}$
		B.90	$(\gamma-1)\gamma^{-3} D$

Once again, interim balance sheets let us get straight to the point:

Final debtor

AF.3/4		**AF.3**	**D**
		B.90	− D

FVC1
LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-1}$ D		
AF.3	D	**AF.3**	**D**
		B.90	$(\gamma-1)\gamma^{-1}$ D

FVC2
LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-2}$ D	AF.2	$(\gamma-1)\gamma^{-1}$D
AF.3	D	**AF.3**	**γ^{-1} D**
		B.90	$(\gamma-1)\gamma^{-2}$ D

FVC3
LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-3}$ D	AF.2	$(\gamma-1)\gamma^{-2}$ D
AF.3	γ^{-1} D	**AF.3**	**γ^{-2} D**
		B.90	$(\gamma-1)\gamma^{-3}$ D

…

FVCn (n>1)
LI - Interim balance sheet

AF.2	$(\gamma-1)\gamma^{-n}$ D	AF.2	$(\gamma-1)\gamma^{1-n}$ D
AF.3	γ^{2-n} D	**AF.3**	**γ^{1-n} D**
		B.90	$(\gamma-1)\gamma^{-n}$ D

When FVCs securitize net cash flows, each and every vehicle can reduce idiosyncratic liquidity risk while preserving a positive net worth. This is possible when:

$$\gamma > 1 \tag{1}$$

i.e., when the perceived liquidity of a structured claim is greater than its collateral perceived liquidity. With effective liquidity transformation and net assets securitization, FVCs have a rational incentive to follow a OTD strategy of ILRM: a full-fledged non-banking financial sector (and a creative wave) can develop.

5. The ‘creative wave’ viability condition: a less special case

Under the hypothesis that FVCs securitize net cash flows, a generic FVC_i gets optimal outcomes when:

$$\frac{\partial\left((\gamma-1)\gamma^{-i}\right)}{\partial\gamma} = \frac{i+\gamma(1-i)}{\gamma^{i+1}} = 0$$

i.e., when:

$$\gamma = \frac{i}{i-1}.$$

Unfortunately, there is no range of γ that is best for *all* vehicles: high-gammas requite low-*i* vehicles, and vice versa. The false best, however, is manifest as soon as one is considering that low-gammas, unlike high-gammas, not only can bring a creative wave to a halt but also prevent this from getting under way. Therefore, low-gammas must be our second driver of fundamental fragility in a non-depository financial sector.

This argument is corroborated by an interesting implication in the cost minimization problem. Net expenditure in securitization procedures is recorded as change in net worth (B.10) occurring between the opening (LS) and the interim (LI) situations. To a generic FVC$_i$, net expenditure amounts to $-\gamma^{-i}D$: the higher γ, the less costly a OTD-ILRM strategy is. The implication is that high-gammas (AAA ratings) result in a win-win game: FVCs reduce liquidity risk at the least cost, and rating agencies face a greater demand for their services. Since a FVC can upgrade its collateral low-gamma by using instruments of credit risk transfer[25] (credit default swaps, interest rate swaps, etcetera), such a general interest in high-gammas can be regarded as a key factor in the huge diffusion in credit risk transfer tools.

Credit risk transfer, however, is not the sole possible strategy to enhance gammas: alternatively, more and more sensitive risk-pricing techniques, essentially based on Black-Scholes approach to option pricing, can be adopted. The rationale is that liquidity transformation can be improved through maturity transformation: one can induce high-gammas by abating ABSs maturities, i.e., by intensifying rollover frequencies. The underlying principle in this second strategy is that the longer a security maturity, the greater its associated risks, the higher the costs of a OTD-ILRM strategy: and vice versa. Intelligibly, maturity transformation was a key driver in the geometrical growth in financial volumes that has characterized last decades.

Is such a strategy a fragility driver, too? However complex, it can enter our picture in a pretty simple way. Let us assume α be the ratio of the maturity of an ABS maturity to the maturity of its collateral. It is $0 < \alpha < 1$

[25] In which case the operation is named 'synthetic securitization' (Eurostat, 2013, 5.106.b).

because, for the ABS to be demanded, it must be more liquid, and thus 'shorter', than its collateral: the lower a debt α, the higher its γ. For sake of simplicity let us also assume that α and γ keep constant throughout the *n* layers of a creative wave.

Apparently, allowing for rollover frequencies may irremediably complicate the construction of a sequence of accounts. Yet, ABS clearing does not affect net worth (Sec. 3), fictitious[26] interim balance sheets which still contain all critical information about the role played by maturity transformation in the fragility of a non-depository financial sector can be conjured up. Being debt rollover frequency τ defined as:

$$\tau \equiv \alpha^{-1},$$

the construction of such a fictitious set of accounts, starting once more with gross assets securitization, can take place following the same procedure as before:

[26] Fictitious because, due to the overlap of distribution and clearing operations, there is no point of time in $(0,T)$ when FVCs balance sheets assume that peculiar configuration.

FVC1

LS - Opening balance sheet			
AF.3	D		
		B.90	D

LX.a - Changes in balance sheet			
F.2	$\tau(1-\gamma^{-1})D$		
		F.3	$\boldsymbol{\tau D}$
		B.10	$-\tau\gamma^{-1}D$

LI - Interim balance sheet			
AF.2	$\tau(1-\gamma^{-1})D$		
AF.3	D	**AF.3**	$\boldsymbol{\tau D}$
		B.90	$(1-\tau\gamma^{-1})D$

FVC2

LX.a - Changes in balance sheet			
		F.2	$\tau(1-\gamma^{-1})D$
F.3	τD		
		B.10	$\tau\gamma^{-1}D$

LS - Opening balance sheet			
		AF.2	$\tau(1-\gamma^{-1})D$
AF.3	τD		
		B.90	$\tau\gamma^{-1}D$

LX.a - Changes in balance sheet			
F.2	$\tau^2(1-\gamma^{-1})D$		
		F.3	$\boldsymbol{\tau^2 D}$
		B.10	$-\tau^2\gamma^{-1}D$

LI - Interim balance sheet			
AF.2	$\tau^2(1-\gamma^{-1})D$	AF.2	$\tau(1-\gamma^{-1})D$
AF.3	τD	**AF.3**	$\boldsymbol{\tau^2 D}$
		B.90	$-\tau\gamma^{-1}(\tau-1)D$

FVC3

LX.a - Changes in balance sheet			
		F.2	$\tau^2(1-\gamma^{-1})D$
F.3	$\tau^2 D$		
		B.10	$\tau^2\gamma^{-1}D$

LS - Opening balance sheet			
		AF.2	$\tau^2(1-\gamma^{-1})D$
AF.3	$\tau^2 D$		
		B.90	$\tau^2\gamma^{-1}D$

LX.a - Changes in balance sheet			
F.2	$\tau^3(1-\gamma^{-1})D$		
		F.3	$\boldsymbol{\tau^3 D}$
		B.10	$-\tau^3\gamma^{-1}D$

LI - Interim balance sheet			
AF.2	$\tau^3(1-\gamma^{-1})D$	AF.2	$\tau^2(1-\gamma^{-1})D$
AF.3	$\tau^2 D$	**AF.3**	$\boldsymbol{\tau^3 D}$
		B.90	$-\tau^2\gamma^{-1}(\tau-1)D$

No need to recall the interim set because, under the hypothesis of gross assets securitization, unless maturity transformation is *not* aimed at enhancing liquidity transformation – i.e., unless $\tau < 1$ – the creative wave is manifestly not viable (all interim B.90 being negative).

Let us thus consider *net* assets securitization:

FVC1

LS - Opening balance sheet

AF.3	D		
		B.90	D

LX.a - Changes in balance sheet

F.2	$\tau(1-\gamma^{-1})D$		
		F.3	$\boldsymbol{\tau D}$
		B.10	$-\tau\gamma^{-1}D$

LI - Interim balance sheet

AF.2	$\tau(1-\gamma^{-1})D$		
AF.3	D	**AF.3**	$\boldsymbol{\tau D}$
		B.90	$(1-\tau\gamma^{-1})D$

FVC2

LX.a - Changes in balance sheet

		F.2	$\tau(1-\gamma^{-1})D$
F.3	τD		
		B.10	$\tau\gamma^{-1}D$

LS - Opening balance sheet

		AF.2	$\tau(1-\gamma^{-1})D$
AF.3	τD		
		B.90	$\tau\gamma^{-1}D$

LX.a - Changes in balance sheet

F.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$		
		F.3	$\boldsymbol{\tau^2\gamma^{-1}D}$
		B.10	$-\tau^2\gamma^{-2}D$

LI - Interim balance sheet

AF.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$	AF.2	$\tau(1-\gamma^{-1})D$
AF.3	τD	**AF.3**	$\boldsymbol{\tau^2\gamma^{-1}D}$
		B.90	$\tau\gamma^{-1}(1-\tau\gamma^{-1})D$

FVC3

LX.a - Changes in balance sheet

		F.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$
F.3	$\tau^2\gamma^{-1}D$		
		B.10	$\tau^2\gamma^{-2}D$

LS - Opening balance sheet

		AF.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$
AF.3	$\tau^2\gamma^{-1}D$		
		B.90	$\tau^2\gamma^{-2}D$

LX.a - Changes in balance sheet

F.2	$\tau^3\gamma^{-2}(1-\gamma^{-1})D$		
		F.3	$\tau^3\gamma^{-2}D$
		B.10	$-\tau^3\gamma^{-3}D$

LI - Interim balance sheet

AF.2	$\tau^3\gamma^{-2}(1-\gamma^{-1})D$	AF.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$
AF.3	$\tau^2\gamma^{-1}D$	**AF.3**	$\tau^3\gamma^{-2}D$
		B.90	$(\tau\gamma^{-1})^2(1-\tau\gamma^{-1})D$

This time, the interim set is quite instructive:

Final debtor			
AF.3/4		**AF.3**	**D**
		B.90	− D

FVC1 **LI - Interim balance sheet**			
AF.2	$\tau(1-\gamma^{-1})D$		
AF.3	D	**AF.3**	τ **D**
		B.90	$(1-\tau\gamma^{-1})D$

FVC2 **LI - Interim balance sheet**			
AF.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$	AF.2	$\tau(1-\gamma^{-1})D$
AF.3	τ D	**AF.3**	$\tau^2\gamma^{-1}D$
		B.90	$\tau\gamma^{-1}(1-\tau\gamma^{-1})D$

FVC3 **LI - Interim balance sheet**			
AF.2	$\tau^3\gamma^{-2}(1-\gamma^{-1})D$	AF.2	$\tau^2\gamma^{-1}(1-\gamma^{-1})D$
AF.3	$\tau^2\gamma^{-1}$ D	**AF.3**	$\tau^3\gamma^{-2}$ D
		B.90	$(\tau\gamma^{-1})^2(1-\tau\gamma^{-1})D$

•••

FVCn (n>1) **LI - Interim balance sheet**			
AF.2	$\tau^n\gamma^{1-n}(1-\gamma^{-1})D$	AF.2	$\tau^{n-1}\gamma^{2-n}(1-\gamma^{-1})D$
AF.3	$\tau^{n-1}\gamma^{2-n}$ D	**AF.3**	$\tau^n\gamma^{1-n}$ **D**
		B.90	$(\tau\gamma^{-1})^{n-1}(1-\tau\gamma^{-1})D$

With net assets securitization, the creative wave can be viable: provided that $\tau\gamma^{-1}<1$, no endogenous impulse to instability in a non-depository financial sector is produced. Being γ a positive function of debt rollover frequency τ, the viability condition $\tau\gamma^{-1}<1$ can be conveniently rewritten as follows:

$$\gamma(\tau)>\tau\,, \tag{2}$$

Condition (2) implies that the higher τ is, the higher γ must be. Manifestly, (1) consists in a special case of (2), i.e., the case with no maturity transformation ($\tau=1$). Although increasing debt rollover frequencies (τ) play a positive role in sustaining gammas, they also play a negative role in elevating the floor below which low-gammas bring the flow of funds in a non-depository financial system to a halt. Therefore, the fragility of a non-depository financial system eventually relies on the *sensitivity* of γ to τ. This depends on actual historical, institutional, technological, and psychological factors. Something unconditional about such sensitivity, however, can be inferred. Since the liquidity judgement is inherently psychological, it can hardly be assumed that $\gamma(\tau)$ is linear or explosive. Admitting $\gamma''(\tau) < 0$, there is a certain $\hat{\tau}$ s.t.:

$$\forall \tau > \hat{\tau}, \gamma(\tau) < \tau\,,$$

i.e., beyond which a non-depository financial sector is liable to experience a 'sudden stop'. Consequently, excess debt rollover frequency (τ) is a third driver of fragility in a non-depository financial sector.

6. Fragility and Regulation

With the help of our simple accounting model based on interim balance sheets it is possible to draw light on three basic drivers of fragility in a non-depository financial sector: first, 'excess' issuance of collateralized debt; second, poor liquidity transformation; third, excess recourse to maturity transformation, i.e., excess rollover frequency τ (relative to the liquidity of issuances γ). The second and the third driver (the former being a special case of the latter) were derived under the favourable hypothesis of net assets securitization. As a matter of fact, once ξ is defined as:

$$\xi \equiv \frac{\tau}{\gamma(\tau)},$$

condition (2) can be rewritten as follows:

$$\xi < 1. \tag{3}$$

Being ξ a ratio of 'speed' (τ) to 'confidence' (γ), i.e., a measure of maturity transformation ($0 < \tau^{-1} < 1$) adjusted to associated liquidity transformation $\gamma(\tau)$, the policy moral implied by (3) sounds like 'speed is nothing without control'. The case for active regulation is once again reflected in a FVC_{i+1} interim net worth, which amounts to a fraction $\xi^i(1-\xi)$ of D. Being:

$$\frac{\partial}{\partial\xi}\left(\xi^i(1-\xi)D\right)=\left(i-(1+i)\xi\right)\xi^{i-1}D,$$

the root of which, for all FVC_{i+1}, is:

$$\xi=\frac{i}{1+i},$$

it can be inferred that the greater *i* (ABS/CDO layering), the closer to 1 is, to a FVC_i, the optimal ξ. Such an endogenous incentive to converge on the stability limit $\xi=1$ (where $B.90=0$) provides the rationale for exogenous counteracting incentives, i.e., for regulatory measures aimed at preventing actual ξ from exceeding unity.

In our model, regulatory measures must act on either of the two sides of condition (2). When downward regulations of τ are ruled out, the only method to exert a downward pressure on ξ is an *upward manipulation of* $\gamma(\tau)$. Such a manipulation can be induced in at least three, not exhaustive and non-mutually exclusive, ways:

a) trusting someone (i.e., rating agencies) the authority to effectively manipulate the level of γ. Being a high-gamma in the common interest of ABS issuers, ABS holders, and the same rating agencies, this results in the institutionalization of a conflict of interest;

b) a Ponzi-type scheme: the same originators sustain γ by breaking the moorings of net assets securitization. Albeit temporarily, this strategy reveals successful in sustaining the liquidity of *old* issuances. That is how sub-prime lending arose, and consumption credit was so actively sought out;

c) an expansionary bias in monetary policy (e.g., the 'Greenspan Put') so that the central bank reaction function does essentially aim at keeping the shadow banking system liquid (lending of *first* resort).

Our accounting model consists in a possible framework for unitary interpretations of such major facts in recent financial history. At the same time, once appropriately extended to other methods of liquidity transformation, it can be exploited for evaluating the impact of different amendments to financial regulation on the non-depository financial sector resiliency.

In its present version, we can hint at strategies to implement more sustainable policies through *downward manipulations of* τ. In this regard, a most obvious instrument would of course be a financial transactions tax affecting, in particular, operations on ABSs and CDOs primary markets. Such a levy, by making liquidity transformation by means of maturity transformation more costly, generates an obvious triple disciplining effect making for:

a) lower collateralized debt rollover frequencies (driver n. 3);

b) decreased ABSs issuance (driver n. 1);

c) higher underwriting standards (driver n. 2).

Such a disciplining impact addresses at once the three fragility drivers our accounting model has shed light on. Of course, considering a wider array of (even mixed) regulatory hypotheses can result in more sophisticated policy implications.

7. Conclusion

The present article puts forward a simple method to handle the complexity of modern financial systems. Although in its present version the model is especially devoted to financial regulation issues, its accounting character makes it suitable to shadow banking monitoring and oversight purposes, too. Also, one can find out other fragility drivers by considering further liquidity transformation enhancement strategies. Additional refinements may be of service to statisticians in their efforts on improving the availability of relevant credit data (e.g., BOE 2014).

Moreira and Savov (2014) claim that the conventional (Basel) capital scarcity view (fragility arising out of a shortfall in capital) conceals the actual role of intermediaries' *liabilities* as the essential link between the financial system and the macro-economy. Accordingly, they insist on interpreting shadow banking as a liquidity transformation process. Yet, the 'liquidity view' they profess to adopt cannot avoid assuming a liquidity motive exogenous to the financial sector: this is rooted in households concerned with potential idiosyncratic liquidity events. In the 'liquidity view' here advocated, the liquidity motive (and *hence* liquidity transformation) is inherent to financial firms, instead.

While adopting the same perspective on shadow banking, the present model only deals with drivers of sudden stops arising out of OTD-ILRM activities. However, the model can be given a macro-financial substance by assuming a simple economy with two sectors—non-financial firms and non-depository financial firms, where the construction of new productive capacity (real investment) and its associated internal rate of return (ρ) and corresponding claims are the fundamental source of the cash flows from income that validate asset-backed securities. The interplay of these two sectors is conceivable as a co-ordination problem of liquidity transformation operations: production activities carried out by non-financial firms can be properly considered through the lenses of liquidity transformation, too[27].

For such a crude macro-financial model to produce truly sensitive policy implications, possible channels for the funds to flow out of the non-depository financial sector (OTD) into a (third) depository sector (OTH) should be considered. Such channels are particularly relevant because, with its *short* intermediation chains, all transactions in an OTH-ILRM procedure do typically involve non-financial counterparts, namely a final debtor and a final creditor. In case of emergency, the liquidity crisis goes on until debtors and creditors' positions are re-harmonized. This is where distributive issues come to the fore. A forth sector to aggregate the distributive functions of general government and households (not to mention non-profit institutions serving households) ought eventually be allowed for. In the liquidity view here advocated, this sector current account surplus is likely destined to lose the prominent role it plays in Ricardian-equivalent, 'virtuist' approaches to

[27] This is possible building on role of the time-to-build in the analysis of the processes of change. This role is given paramount attention in Hicks (1973) and Amendola and Gaffard (1998).

policy making under current circumstances.

Acknowledgements

I thank Massimo Cingolani, Ian Crowther, Marco Dardi and Paolo Piacentini for comments and suggestions.

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G. & L. E. R., Vol. 18 No. 2, 2014

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PUBLIC POLICY MANAGEMENT: ISSUES AND CHALLENGES

Abstract

The world today is facing extraordinary challenges. Policymakers are grappling with the challenge of establishing institutions to cope with rapid changes in demography, the environment and the economy. Policymakers are part of the system in which governments must operate. This system has no shortage of external and internal forces that are constantly challenging it. Policies have been reversed or changed more frequently than warranted by exogenous changes or new information. Policymakers in India are facing an increasing number of challenges that are caused by certain types of complexity. In this complex environment the demand for good policy making development is steadily increasing. In this paper, some of the core issues like Fiscal deficit, Corruption, Governance and Infrastructure development have been discussed. The findings of the study conclude that a systematic analysis and integration prior to policy-making, i.e., cost-benefit analysis should be done and there should be greater emphasis on policy design which helps to ensure that the planned action represent a realistic and viable means of achieving the policy goals. Further, systematic means should be developed for obtaining outside inputs and strengthening relations with citizens which is a sound investment in better policy making and a core element of good governance. The present study is based on secondary data which have been collected from different sources which include Reports and Publications of Govt., annual reports of RBI and reports of various international organisations.

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JEL CLASSIFICATION: D78; G30; G39; J18.
KEYWORDS: PUBLIC-POLICY; GOVERNANCE; POLICY FORMULATION; POLICY IMPLEMENTATION.

1. Introduction

Over the past decades, many reforms in government have been aimed at increasing efficiency, effectiveness and value for money with very little focus on the actual policy process and the way it affects the ability of policy makers to meet the needs of constituents in an increasingly complex, uncertain and unpredictable world. However, if this core process were to be modernized, it would yield considerable economic and social benefits, including enhanced productivity, openness, transparency and participation, as well as actionable and interoperable policy intelligence (Geurts 2011).

The public policy making structure refers to the various branches of government and the individuals and entities within each branch that play a role in making and implementing policy decisions. The making of public policy for a country as large, populous and diverse as India is intrinsically a more complex task than in a smaller political unit. This makes a study of the institutions which make policy all the more important (Agarwal, Somanathan 2005).

Policy making is not, by and large, simply a matter of problem solving, of taking some common goal and seeking the "best" or most cost effective "solution". It is rather a matter of choice in which resources are limited and in which goals and objectives differ and cannot easily be weighed against each other. Hence policy making is a matter of conflict (Simeon 1976).

Policies can be regarded as political, management, financial and administrative mechanisms that are arranged to achieve explicit goals. Policies may apply to government, to private sector organisations and groups, and to individuals (Guerts 2011).

Public policy is what government's do, why they do it, and what difference it makes on society. David Easton defines public policy as "the authoritative allocation of values for the whole society." The agency which can authoritatively act on the whole society is government. Study of the public policy, the way it is formulated, implemented and the impact of the policy is important because its role is increasing in both developed and developing countries. Its role is significant in the context of developing countries where it is expected to perform numerous functions through its executive agency – government.

Public policy decision is one of the most important functions of the government. For a proper administration in the society, a perfect policy is absolutely essential. If the track of public policy is wrong, it leaves far reaching consequences on the society at large. Public policy making is a very complex and dynamic process. Policy making comprises various components. It involves various substructures and the degree of their involvement depends on the circumstances and societal values. Public policy making is a continuous process and requires a continuous output of resources and motivation. Gerston (1997) suggests that an issue will appear and remain on the public policy agenda when it meets one or more of three criteria. It must have sufficient scope (a significant number of people or communities are affected), intensity (the magnitude of the impact is high) and/or time (it has been an issue over a long period).

A public policy may be either positive or negative. Some form of overt governmental action may deal with a problem on which action is demanded (positive), or governmental official may decide to do nothing on some matter on which government involvement was sought (negative." Public policies are designed to accomplish specified goals or produce definite result, although these are not always achieved.

2. Who is involved?

Institutions involved in public policy making range from agencies in all branches of Government, the executive, the legislative, and the judiciary to a host of non-governmental institutions, associations, interest groups, political parties, academic bodies and individuals. In the executive branch of Government, the policies are given concrete shape and direction by the Prime Minister and his/her Cabinet. They are assisted in this function by the various Standing Committees of the Cabinet, and the Prime Minister's Secretariat composed of personal advisers. Although the Prime Minister's Secretariat does not make any original proposals in policy matters, it exercises a great deal of influence in moulding them through the preparation of briefs and analysis and shifting the information for the decisions of the Prime Minister. The interplay between the Prime Minister and Cabinet colleagues, the use of Committee structure in the Cabinet, and the interaction between the staff of the Cabinet Secretariat, Prime Minister's Secretariat and the Secretariat of the different ministries determines the final outcomes of public policies through the executive branch of the Government.

3. The policy maker

Policy makers are actively involved either in making policy or in influencing policy. The policy maker is a person who has the power to influence or determine policies and practices at an international, national, regional or local level. Public policy making is characterized by a large set of actors. Actors can be politicians, civil servants, lobbyists, advisors, domain experts, auditors, etc. They can design policies, codify and formalize policies, and assess or approve policies.

4. Policy making process

The main process of policy making consists of four phases; initiation, formulation, implementation and evaluation. The process starts by setting an agenda based on an issue or previous decision and ends by handing over the implemented policy to an execution and enforcement layer. It includes indentifying the problem, formulating a solution, identifying different alternatives, selecting from those alternatives on the basis of their impact and laying them down in some type of statement.

Formulated policy objectives may be expressed and formulized as policy statements, programs or projects aimed at solving a problem. Policy implementations may be expressed and formulized as laws, procedures, protocols, directives or budgetary actions.

Evaluation and verification are an integral part of the policy making process. Many of the consultation activities are intended not only to obtain political support, but also to obtain feedback on the expected impact and effects.

4.1. Review of Literature

Social science and the task of improving policy making were at the heart of the work of Herold Lasswell, a founding father of public policy as a field of study. Lasswell believed that the policy science movement from its very beginning was concerned about the relationship between knowledge, policy making and power. Laswell also believed that democratisation was an ongoing process and that the particular challenge facing modern democracies was how to ensure that policy making could be informed by a new kind of interaction between knowledge producers and users (Torgerson 1985). There is very little and not enough evidence that policy making has, in Britain, America or elsewhere, been informed by the kind of relationship envisaged by Lasswell (Fischer 1998). "A policy is a powerful course of action designed and implemented with the objective of shaping future outcomes in ways that will be more desirable than would otherwise be expected (Anderson 1979). One way of describing a "good" policy making process is one that "is committed to producing a high quality decision- not any particular decision" and that "invests any decision made with a high degree of legitimacy, power and accuracy" (Moore 1998).

Rein and Schon in their paper defines public policy as, the study of how societies learn (fail to learn) about those problems they define as being public and how they seek to solve (fail to solve) their problems. The aim of government should not be to control and direct, but to facilitate the growth of individuals, organisations and communities that are capable of managing their own continuing transformations (Rein, Schon 1996). Policy making therefore, nearly always means trade-offs, the giving of something to get something else, losses to one group or section in exchange for (hopefully larger) gains for another (Agarwal, Somnathan 2005). The period from 1997 has been repeated efforts to define and rationalise policy making. These efforts to improve policy making have varied in scale and focus, and have frequently overlapped or seemed to merge with one another (Hallsworth et al. 2011).

Infrastructure segment is vital for the development of the nation, as it is a stepping stone of a stable and productive society and represents a unique challenge and hence demands intense attention from top-grade policy makers of the country (Rai, Ghavate, 2013). As has been said by Narayan Murthy in an interview, "For Indian to make sustained progress, we have to build better roads, we have to build ports; we have to enhance our power capacity; and we have improve access to coal and other raw materials. These are all very important requirements" (PWC 2013).

The need for fiscal consolidation and sustainability is one of the key macroeconomic issues confronting Indian economy (Kumar, Soumya 2010). Sundararajan in his paper questioned the efficacy of fiscal expansion given the large fiscal deficits and the accumulation of a high debt to GDP ratio (Sundararajan, Thakur 1980). The economic condition in india is really very critical. Besides, fiscal deficit, the flight of dollar based investments has caused the Indian rupee to plummet (Shrivastav 2013). Heller, et al., in their paper focused on the well designed fiscal policy which would help to move an economy like india towards a higher growth path without high inflation or international transfers of the burden of public debt (Heller, Govinda 2006).

Good governance ensures that the poor and other disadvantaged groups are included in decision-making about providing services that affect their lives and about the objectives of the resulting policies and programmes (Sheng, Carillo, et al. 2007). Haldea in his paper addresses the challenges like structured transparency, politician – engineer – contractor nexus, etc., which are embedded in governance and raise questions of political economy (Haldea 2008). Strengthening relations with citizens contributes to building public trust in government, raising the quality of democracy and strengthening civic capacity (OECD 2001).

4.2. Objectives of the Study

The following are the objectives of the study:

- To study how public policy is formulated and implemented in India.
- To study the current issues and challenges which India's policy-making structures have been facing in formulating right kind of policies.
- To suggest the appropriate measures for improving public policy making in India.

5. Governance

Policy Governance refers to processes – how things are done, not just what is done. Governance refers to the nature of rules that regulate the public realm – the space where state and economic and societal actors interact to make decisions.

Governance refers to the systems and practices that governments use to set policy priorities and agenda implement policies and obtain knowledge about their impacts and effectiveness (Hjelt et. al 2008). Good governance ensures that the poor and other disadvantaged groups are included in decision-making about providing services that affect their lives and about the objectives of the resulting policies and programmes. Their inclusion and involvement also empowers them to become agents of their own development and to participate in other relevant areas (Sheng, Carrillo, et al. 2007). Given the state of India's economic development, good governance is absolutely critical to give us a competitive edge and sustain growth. It is becoming increasingly evident that it is impossible to separate good governance and sustainable development.

Public policy is an attempt to bridge the gap between a situation and a norm. There is no right answer to the challenges they face, there is only a right answer in a given period of time and in a given context.

The choice made by policy makers and the answers they give should be founded on a set of guiding principles: the principles of good governance. Good governance is a concept that describes the principles, approaches and guidelines adopted by public administrations to promote the interaction and formation of political will in relation to societal and technological changes. According to the United Nations (UN), good governance is based on eight qualities. Governments must be:

- Transparent
- Responsive
- Consensus oriented
- Equitable and inclusive
- Effective and efficient
- Follow the rule of law
- Participatory
- accountable

These UN principles of good governance have an impact on every manifestation of public sector policy making and execution, regardless of the domain or target group. They require consistency and coherence in policy making and implementation. And at the same time, they require participation, involvement and transparent decision-making in order to bring government closer to citizens and to realize clear and applicable laws and regulations.

Good governance helps create an environment in which sustained economic growth becomes achievable. Conditions of good governance allow citizens to maximize their returns on investment. (Singh 2008) Good governance does not occur by chance. It must be demanded by citizens and nourished explicitly and consciously by the nation state. In the words of Pt. Jawaharlal Nehru, “Good governance must aim at expansion in social opportunities and removal of poverty.” It is, therefore, necessary that the citizens are allowed to participate freely, openly and fully in the political process. The citizens must have the right to compete for office, form political party and enjoy fundamental rights and civil liberty. Good

Governance has always been associated with political leadership, enlightened policy making along with the concept of transparency and accountability. It aims in expanding the social opportunities and envisages the removal of poverty (Singh 2008). It assures that corruption is minimized and there arises a situation where the society participates in the decision making process along with the marginalized sections of the society. It is envisaged that an ideal good governance has eight major characteristics i.e., participatory, consensus oriented, accountable transparent, responsive, effective and efficient, equitable and inclusive and which follows the rule of law. It assures that corruption is minimized and it is open to future changes and challenges of the society.

The challenges to such governance are many folds and are diverse in nature. They arise from changed allocation of public funds, delay in production of records, noncompliance with regulatory provisions, limited database facility and instances of irregularities and fraud. All such challenges point us to the problem of the lack of effectiveness and accountability in the delivery of services which hampers the sustainable growth of human kind.

5.1. Major Challenges to Governance

5.1.1. Administrative Responses

The Indian administrative scene is marked by few successful innovations and practices in public service delivery and a large number of pathetic performances. The general weakness of accountability mechanisms is an impediment to improving services across the board. Bureaucratic complexities and procedures make it difficult for a citizen as well as the civil society to navigate the system for timely and quality delivery of services. The frequent transfer of key civil servants has enormously contributed to failures in delivery of services. In some states, the average tenure of a District Magistrate is less than one year. Development projects have also suffered as a result of frequent changes in project directors.

5.1.2. Capacity Building

Capacity building at all levels of an organization is widely perceived as the most important approach to achieve quality of services and customer's satisfaction. Capacity building in public administration heavily relies upon professionalism of the civil service. There is increasing awareness about the low level of professional quality of public servants employed in districts and in rural areas. Resistance to the capacity building programme comes from the staff as well as from the supervisor. People normally do not like change. There is also a myth that capacity building means bigger work-loads. Resistance also comes from supervisors and managers who often perceive that staff capacity building would lead to reduction of their own powers.

The most crucial element in capacity building is leadership. Good leadership aimed at improvement of organizational culture is integral to capacity building. Capacity building demands staff to behave responsibly and produce desired and agreed upon results. It means a collegiate effort in which an individual or an organization could be made accountable and responsible for any action that they take.

Access to information, participation, innovation and accountability are needed to build an environment for capacity building. In traditional organizations, information is the preserve of higher level bureaucracy. This system needs to be broken to allow people to get whatever information they need to perform their task. The staff should be encouraged to actively participate in the task of the group.

5.1.3. Criminalisation of Politics

The Criminalisation of the political process and the unholy nexus between politicians, civil servants, and business houses are having a baneful influence on public policy formulation and governance. Political class as such is losing respect. The more insidious threat to India's democratic governance is from criminals and musclemen who are entering into state legislative assemblies and national Parliament in sizeable numbers. A political culture seems to be taking roots in which membership of state legislatures and Parliament are viewed as offices for seeking private gain and for making money. Such elements have also found place in Council of Ministers and a Prime Minister or a Chief Minister in an era of coalition. (Singh 2008) The dictum that 'howsoever high, the law is above you' is sought to be replaced by rule of men.

5.1.4. Corruption

The high level of corruption in India has been widely perceived as a major obstacle in improving the quality of governance. While human greed is obviously a driver of corruption, it is the structural incentives and poor enforcement system to punish the corrupt that have contributed to the rising curve of graft in India. The complex and non-transparent system of command and control, monopoly of the government as a service provider, underdeveloped legal framework, and lack of information and weak notion of citizens' rights have provided incentives for corruption in India.

5.2. Elements of reform:

There has to be greater accountability of Politicians to the citizen, autonomy for service providers, and greater ability of citizens to hold service providers to account for the services they deliver. The elements of reform should comprise:

- ❖ Allowing the private sector to provide public services in wide-ranging areas such as health, primary education, building infrastructure, water supply and inner-city transport would solve several important problems. It would enable the government to fulfil its obligations to supply core services, which are badly served.
- ❖ By decentralising provision of public services, the government can unbundle responsibilities across tiers of government to create checks and balances. Decentralisation also strengthens the demand side, as citizens from the bottom-up demand better performance and has scope for voice and choice.
- ❖ Strengthening relations with citizens is a sound investment in better policy making and a core element of good governance. It allows government to tap new sources of policy – relevant ideas, information and resources when making decisions.
- ❖ Create and adapt basic legislation and institutions that guarantee political and economic freedoms as well as strive to meet a broader range of basic human needs (food, housing, health and Medicare, education, etc.).
- ❖ Relax regulations in order to remove obstacles to economic participation.
- ❖ Improve financial management.

- ❖ Build infrastructure to ensure that organizational capacity is available to handle the growing needs for services, increasing demands for better and more responsive services, and creating conditions for economic progress and social cohesion.
- ❖ Train public officers, business people and entrepreneurs. With the improvements in access to education brings the challenge of rapid changes in many knowledge areas therefore government must institute an ongoing development programme for its human resources to ensure that they are equipped with the necessary skills.
- ❖ Reform public management practices to address issues such as budget deficits, external pressures on competitiveness (globalization), antiquated work procedures, excessive centralization, inflexibility, lack of efficiency and perceived lack of public confidence in government.
- ❖ Accountability of politicians and civil servants to ensure that the power given to them through the laws and regulations they implement, resources they control and the organizations they manage is used appropriately and in accordance with the public interest.

The path breaking Right to Information Act (2005) which has come into effect recently has been heralded as the most significant reform in public administration in India in the last 60 years. This far reaching law is the light of hope which can dispel the darkness of secrecy and storms of corruption, and ensure transparency and accountability which are hallmarks of efficient governance. It can act as a catalyst to facilitate the onset of a new value system, rejuvenation of hope to establish a better society. Access to information requires sound legislation, clear institutional mechanisms for its application and independent oversight institutions and judiciary for enforcement. Finally, it requires citizens to know and understand their rights and to be willing and able to act upon them. The initiatives to move government services online—e-governance—can also enhance transparency and reduce transaction costs. However, these initiatives have to be widely used in order to be effective. Further, there is a need for 'reform champions' in the administration who can successfully lead and manage governance reforms.

6. Corruption

"Corruption threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law" (G-20 Summit, Seoul). In many developing countries, public sector corruption is a key barrier to effective service delivery. Corruption can prevent the equitable allocation of goods and services to its citizens by sweeping into all aspects of life, from starting a new business to getting a passport or seeing a doctor. It can take many forms, from bureaucrats asking citizens for bribes to perform basic services, to hospital employees stealing medicines that were meant to be distributed to the poor, to bureaucrats receiving salaries for jobs that they carry out inadequately or do not complete (Hanna et al. 2011).

Fighting corruption has emerged as a key development issue in India in recent years. More and more policymakers, businesses and civil society organisations have began to confront the issue openly. At the same time the general level of understanding about corruption has risen markedly. Until recently, it was not uncommon to hear someone discuss anti-corruption strictly in law enforcement terms. By contrast, most people working in the field today acknowledge that public education and prevention are equally important. The field has also come to appreciate how critical the role of civil society is far effective and sustained reform (Abdulraheem 2009).

N. Nittal, former central vigilance commissioner (CVC), wrote: "nearly half of those who avail services of most often visited public departments of government in the country had the first hand experience of giving bribe at one time or the other. In fact, as high as two thirds of people think that corruption in these offices is real. However, one third think corruption is more exaggerated. And yet, 80 per cent of people are passive and hardly 20 per cent had ever complained about such corruption to any. It is interesting that while 50 per cent of people reported that they had bribed, only 20 per cent took the trouble of complaining. This also highlights the need for sensitizing the public about the danger of corruption."

Empirical evidence suggests that high levels of corruption are associated with lower levels of investment. Corruption invariably increases transaction costs and uncertainty entrepreneurs to divert their scarce time and money to bribery rather than production. It inhibits the development of a healthy marketplace and imbalances economic and social development by distorting the rule of law and weakening the institutional foundation on which economic growth depends. Corruption is a double jeopardy for the poor, who are hardest hit by economic decline, are most reliant on the provision of public services and are least capable of paying the extra costs associated with bribery, fraud and the misappropriation of economic privilege.

In 2013, India ranked 94 out of 177 countries in the Corruption Perception Index of Transparency International (See Table 1). Other recent surveys also reveal that, globally, corruption has worsened in the last two years. Furthermore, if corruption is not contained, it will grow exponentially, and we need to arrest this inimical growth that is tearing into the social fabric of our economy. (EY's 2013)

Table 1. Corruption perception index 2013

Rank	Country	Score
1	Denmark	91
1	New Zeeland	91
3	Finland	89
3	Sweden	89
5	Norway	86
5	Singapore	86
18	Japan	74
26	USA	69
80	China	40
94	India	36

Source: Corruption Perception Index, 2013. Transparency International (TI).
Note :(i) 177 countries/territories were represented across the world.
(ii):0-9 Represents high corruption and 91-100 Represents zero corruption.

The state of economy also plays an important role in corruption. Inequality of wealth distribution, exploitation by employers, and low wages and salaries provide ideal breeding ground for corruption. A license-permit regime or scarcity of basic commodities adds fuel to the fire. India is a textbook example of how license-permit Raj can vitiate political as well as economic atmosphere of the nation.

Broadly speaking, there are two forms of corruption:

Administrative Corruption: Corruption that alters the implementation of policies, such as getting a license even if you don't qualify for it.

Political Corruption: Corruption that influences the formulation of laws, regulations, and policies, such as revoking all licenses, and gaining the sole right to operate some public utility with monopoly.

According to World Bank estimates, between $1 trillion and $1.6 trillion dollars are lost globally to illegal activities each year and 0.5 percent of India's gross domestic product (GDP) is lost due to corruption every year. Corruption decreases the amount of wealth in a country and lowers the standard of living. Corruption affects a person even if he doesn't come into direct contact with it. Furthermore, it makes the business environment less attractive to foreign investment.

The major scams that have been committed in last five decades seem to be a direct result of deficit in governance by our corrupt politicians and bureaucrats. Following is a list of recent financial scandals committed in India since 2008. The total monetary worth of scams committed since 1992 in India is worth one lakh billion. There must have also taken place other scandals probably of smaller magnitude but have gone unnoticed.

Table 2. Latest financial scams (INR in Crores)

Year	Scam	Quantum of money involved
2008	Satyam Scam	10,000
2008	2G Spectrum Scam	60,000
2008	State Bank of Saurashtra Scam	95
2008	Illegal Money in Swiss Bank	71,00,000
2009	Jharkhand Medical Equipment Scam	130
2009	Rice Export Scam	2500
2009	Orissa Mine Scam	7,000
2009	Madhu Koda Scam	4,000
2010	IPL Scam	Quantum yet to be fixed
2010	Commonwealth Games Scam	Quantum yet to be fixed
2011	Reddy Brothers Illegal Mining Scam	Quantum yet to be fixed

Source: http://www.dnaindia.com
http://www.finance.yahoo.com

7. Problems and challenges

Despite adequate laws to fight corruption in the public sector, it is still one of the biggest menaces Indian society must deal with. The Indian criminal justice system has been facing many problems and challenges in its fight against corruption, some of which are highlighted below.

- **No Law to tackle Corruption in the Private Sector**

In India the Prevention of Corruption Act 1988 is the existing law which deals with offences relating to corruption. The law was essentially enacted to take care of corruption cases in the public sector and by public servants, whereas in fact, there is widespread corruption in the private sector also which seriously hampers the overall growth and development of the country. The private sector has expanded greatly after the Liberalisation of the Indian economy in the early 1990s. The problem of corruption in the private sector is increasing with the expansion of the private sector. Today it has assumed alarming proportions. It has become the single biggest menace to Indian society. Efforts are underway to enact laws to deal with corruption in the private sector as envisaged in the UNCAC.

- **Inherent Delays in the Criminal Justice System**

The system is painfully slow and punishments are not swift. As explained earlier, sec. 19 of the Corruption Act requires prior permission of the authority competent to remove a public servant from his or her post before launching prosecution against him or her in court. This often delays the launch of a prosecution. Upon receiving reports from the investigating agencies seeking approval for a prosecution, the concerned authorities often take considerable time to grant such permission. Also, permission is sometimes denied on political and other grounds.

- **Hostile Witnesses**

In order to convict a corrupt public servant, the prosecution has to prove its case beyond doubt. This is a strict legal requirement as per the Indian Evidence Act, the general law on evidence in India. There is no exception to this requirement even for corruption cases. Prosecution has to depend heavily on the testimony of witnesses to prove its case beyond doubt. However, witnesses often do not support the prosecution case because of influence, allurement and intimidation from the other side. There is no witness protection scheme, nor are there provisions for quick and effective action against witnesses who become hostile. As a result, witnesses frequently become un co-operative and spoil the prosecution case.

- **Ineffective Asset Recovery**

Though there are legal provisions for confiscation and recovery of property acquired as proceeds of crime, such recovery is not easy. Quite often properties are acquired with the proceeds of crime by the corrupt public servants in the names of their friends, relatives, family members and other acquaintances. Therefore, it is not easy to prove in court that such properties are the proceeds of crime. Such properties are quite often held offshore under strict privacy laws and it is not easy to trace and recover them, especially in the absence of desired international co-operation.

Despite all these measures and laws, the country is still not free from the scourge of corruption. Corruption is still one of the biggest impediments to extending the benefits of development and progress to the poorest of the poor. The Indian criminal justice system is facing many problems and challenges in its fight against corruption. At present, there is no law to deal with corruption in the private sector, which has grown in leaps and bounds in last two decades, as envisaged in the UNCAC. Offenders take advantage of the very strict requirements of Indian courts to prove every point beyond doubt. The system suffers from inherent delays; as a result punishment is not swift. Corruption is considered a 'high profit-low risk' activity by corrupt public servants. Recoveries of assets, which are proceeds of crime, remain a big challenge. Such assets are often held offshore and getting them back is a Herculean task, especially in the absence of desired international co-operation.

The fight against corruption is, therefore, not an easy one. We need to join forces against this enemy, with all resources at our disposal to achieve better and more effective results. The United Nations Convention against Corruption can be seen as a watershed in the resolve of the international community to fight corruption.

7.1. How to eliminate corruption in India

Many people think that only government has responsibility for eliminating corruption and often blames government, however in view of the level of corruption and the existing framework that we have in India, it is very clear that government alone cannot stop corruption. If the people of India and civil society institutions remain unconcerned and hopeless in fighting against corruption then it can never be eliminated or even can't be reduced. Thus, it is the responsibility and duty of every Indian to fight against corruption and take some action to promote honesty and integrity and contribute in the motion of honesty in India. The people in India need to promote excellence and teach their young generation the actual meaning of success. In this 21st century people have knowledge and proven mechanism to fight corruption. They also have the power of media and technology to spread the message to millions of people within a fraction of second.

In addition to the ongoing initiatives such as Citizens charters, RTI act, social audit, e-governance, lokayukta, etc. which needs some improvement and harmonised approach across all states. Weak governance appears to be at the root of all problems discussed above. The following steps will go a long way in strengthening governance and building confidence of ordinary people in the system:

- ❖ A strong Lokpal Bill on the line of Anna Hazare's demands that gives autonomy of functioning and control over the anti-corruption wing of the CBI and merging various teeth-less agencies such as CVC with Lokpal is urgently required. Poor people face harassment at the hands of lower bureaucracy; thus, covering the lower bureaucracy and appointing Lokayukta's in all states is the need of ordinary people of the country.
- ❖ Money stashed in the Swiss banks is enormous – of the size of USD 19 – 20 trillion. Not taking immediate steps to bring this money back into the country is unpardonable. If used properly, this money can provide tremendous relief to the poor Indian community and speed up infrastructural and other developments in the country.
- ❖ A separate law is needed to curb corruption in the private sector. Countries like the US and UK have laws that forbid firms from bribing even outside the country.
- ❖ Another way to fight against corruption is reforms in the Police department which will provide tremendous relief to the common man which no longer treats the police as his friend or protector.
- ❖ With the help of the Right to Information Act, citizens should be empowered to ask for information related to public services, etc. And this information should be made available to general public as and when required. Such stringent actions against corrupt officials will certainly have a deterrent impact.
- ❖ Laws have "teeth" when they seen to be implemented. Judicial reform is needed to speed up and process the thousands of cases pending in courts at all levels.
- ❖ Corruption needs to be nailed at the bottom level every day. New leadership against corruption needs to be built. Experience with e-governance in the state of Bihar, which has helped achieve

impressive improvements in the delivery of public services is a great example of how things can be done correctly.

- ❖ One possible solution could be voluntary disclosure to law enforcement bodies in exchange for assurances of leniency, or even amnesty. This would expose wrongdoers and help break the circle of bribe seeking and giving.
- ❖ Education from early childhood is needed to help people and society unshackle them from the mindset that accepts and feeds corruption.
- ❖ Government officials across the entire public service sector should be better paid to reduce the incidences of bribe taking.

8. Infrastructure

Across the globe, infrastructure is the life blood of prosperity and economic confidence in the 21st century. Well planned and well executed investments offer developing economies a hope of basic facilities for all and a chance to compete in a global marketplace. (Ernst, Young 2012) Infrastructure – the structure or the underlying foundation on which the continued growth of a community depends – is critical for countries in all stages of development. But adverse economic and political conditions can make effective investment in infrastructure difficult to achieve, and affect how efficient countries are in realizing anticipated benefits.

Infrastructure segment is vital for the development of the nation and hence demands intense attention from top grade policy makers of the country. Infrastructure growth is a stepping stone of a stable and productive society; it represents unique challenges but also brings opportunities for private and public sectors in the field of construction (Rai, Ghavate 2013).

Infrastructure deficit in India is widely recognised as a constraint on growth. Be it airports or rural roads, a mega power station or a rural supply line, the wheels of growth require well-oiled infrastructure in every segment of the economy. It is also a critical input for broad-based and inclusive growth aimed at improving the quality of life, generating employment and reducing poverty across regions (Standard 2008). Inadequate investment has been responsible for the inability of the infrastructure sector to keep pace with the enhanced requirements of accelerating growth. As a result, congestion on highways, ports, airports and railways has increased, as have power shortages. This infrastructure deficit imposes additional costs and constraints, which in turn compromise the competitiveness of the agriculture, manufacturing and service sectors in the domestic as well as global markets. As a result, growth and employment suffer. If we look at the quality of the transportation, telecommunications and energy infrastructure – an assessment did by business executives recently, India's performance looks very dismal with getting 87th rank out of 144 countries that were represented in the survey (See Table 3).

Table 3. Business Executives Rate the Quality of Infrastructure on a scale of 1 to 7.

Country	Rank	Score
Switzerland	1	6.6
Singapore	2	6.5
Finland	3	6.5
Hong Kong Sar	4	6.5
France	5	6.4
U.A.E	6	6.4
Germany	9	6.2
Japan	16	5.9
U.K	24	5.6
U.S.A	25	5.6
China	69	4.3
India	87	3.8

Source: World Economic Forum, the Global Competitiveness Report, 2012.
Note: 144 Countries were represented in the survey

Addressing the nation's infrastructure needs, especially with today's intense economic pressures, will require government and industry stakeholders to find more efficient and effective ways to finance and deliver capital projects while controlling costs. The problems of clogged airports, poor roads, inadequate power, and delays in ports have been well-recognised as impeding growth. Indian companies on average lose 30 days in obtaining an electricity connection, 15 days in clearing exports through customs, and lose 7% of the value of their sales due to power shortages (Deolitte 2013).

Incremental demand for infrastructure will continue to increase due to economic growth and urbanisation. Thus, there is both a stock and a flow problem. If India needs to sustain its economic growth story, it will have to fuel demand for energy, transport, logistics and communication. Additionally, India is in a phase of increasing urbanisation. Current estimates show that only 30 per cent of India is urbanised and estimates reveal that this may increase to just above 60 per cent by 2050 thus leading to an additional 700mn people living in cities The impact on infrastructure demand will be enormous, from demand for inner-city transport, water and sewerage to low-income housing. The Planning Commission estimates that India needs almost to double its ports, roads, power, airports and telecom in the next five years to sustain growth. The large infrastructure spend program as envisaged by the twelfth five year plan emphasizes the need for timely and appropriate means of financing when addressing infrastructure development with finite funding resources.

8.1. Issues in Infrastructure Development

The importance of infrastructure for sustained economic development is well recognised. As per planning commission mid – term review of eleventh five year plan estimates, India has been adversely impacted on an average by 1 to 2 percentage points due to infrastructure bottlenecks. The country is not able to realize its full growth potential due to high transaction costs, which arises from inadequate and inefficient infrastructure. The planned targets are hardly achievable as has been the case with previous five year plans. Various inter-related reasons like time overruns, cost overruns, etc., have been the cause for this slippage. In this context, some of the challenges faced by infrastructure sector, in general are summarised as under:

- Speedy implementation of projects: The infrastructure developers in India continue to remain concerned about land acquisition and environmental issues. Both these issues have been prevalent since a long period of time and are the prime reasons for infrastructure projects to get delayed. To overcome from this situation, land acquisition process should be done by the government prior to the project bidding stage and the project commences only after land acquisition. To over-see the task of land management, a national level congruent state-centre institution staffed with high integrity personnel needs to be set up in collaboration with the state and central governments. Once needs have been identified, and data is available, associated infrastructure should be promptly set up. The ambitious target of $ 1 trillion plus investment is achievable only, when these two issues are addressed proactively to balance the interests of all stakeholders.

- Financing: Financing infrastructure projects has always been a problem in India. The Planning Commission estimates that India needs an additional $500bn over the next five years itself to finance infrastructure which means a large percentage of this will have to come from the government. However, government finances are currently not in good shape, which does not augur well for increasing investment rates dramatically.
- Short tender process: To reduce the projects costs and expedite implementation, time lag between the bid for a project and the commencement of construction work should be reduced to the minimum possible extent. Due to this, the rise in material costs can be controlled which arises due to inflation. Frequent changes in implementation agreements such as model concession agreement; Request for Proposal (RPF), norms should be avoided as it makes the project implementation task very difficult.
- Institutional constraints: There are capacity constraints in managing and executing infrastructure, especially at the state level. At the state level, there is very little capacity for also a shortage of skilled engineers and technicians, which severely constrains rapid infra roll-out.
- Regulatory issues: Till very recently, the government dominated the infrastructure space, and private investment was negligible. Still, there are significant areas of infrastructure that are not open to private investment. There is no unified approach governing any aspect of regulation, be it powers and functions of the regulator, extent of regulation, appointments and accountability of regulators. User charges on water, road and power are not yet commensurate with marginal costs, as they are politically

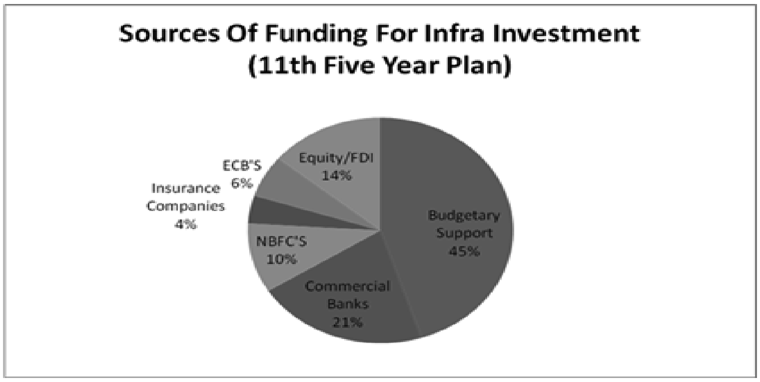
sensitive, thus impeding private investment. There are significant barriers to entry for firms, especially foreign firms, and FDI limits are still in place. Further, there are frequent changes in regulatory policy in all areas of infrastructure, including telecom, roads and power, which increase uncertainty and impede private investment.

- Limited capacity of Indian bond market for long term debts: Budgetary support and bank credit have been the two main sources of infrastructure funding in India, where as in other countries the picture is quite different. Long term debt in the form of corporate/sovereign or municipal bonds forms a major source of infrastructure finance in many developing countries across the world. In India infrastructure developers are facing difficulties in getting finance due to lack of depth and breadth of the secondary debt market. Having long term pay – back period, infrastructure projects require long term financing in order to be sustainable and cost effective. Therefore, depth and liquidity of corporate bond market needs to be improved to provide additional sources of funding for infrastructure projects.

8.2. The Way Forward

The Eleventh Plan recognised the importance of investing more in infrastructure sectors such as power, roads, ports, airports, and railways, and sought to raise investment in these sectors from about 5.6% of GDP in the base year of the Eleventh Plan 2006-07 to around 9% by the last year, i.e. 2011-12. The actual achievement is likely to be around 8.5%, with some sectors, e g, telecommunications, achieving higher levels of investment than projected, while others achieved significantly less. The major source of infra investment in Eleventh plan was budgetary support contributing 45 per cent followed by commercial banks with 21 per cent and the contribution from Equity/FDI was just only 14 per cent. (See Chart) The policy makers need to build consensus and attract more FDI inflows in infrastructure segment which is currently facing a lot of problems especially financial problems. The task begun in the Eleventh Plan has to continue in the Twelfth Plan, which should aim at increasing the rate of investment in infrastructure to around 10.5% by 2017-18. If India is to maintain the growth path established in recent years, infrastructure development must remain a core concern even beyond the 11th plan period.

Figure 1.



Source: Working Sub group on Infrastructure, Planning Commission, GOI.

Projections for the 12th plan have been made by the Planning Commission, assuming that GCF in infrastructure as percentage of GDP would rise from 9 per cent in the terminal year of the 11th plan (2011-12) to 10.25 per cent by the terminal year of the 12th plan (2016-17), and that GDP would continue to grow at an average of 9 per cent per annum during this entire period. On the basis of this assumption, the projected GCF in infrastructure during the 12th plan would be about Rs 40, 99,240 crore ($1,024 billion) **(See Table 4)**. As an aggregate of the two plan periods, the 10-year projection for investment in infrastructure would be Rs 61, 01,016 crore ($1,525 billion). This implies that investment in infrastructure, which was targeted at $500 billion in the Eleventh Plan period, would have to increase to about $1 trillion over the Twelfth Plan period 2012-13 to 2017-18. This poses two major challenges. One is how to finance the investment needed, and the second is how to overcome implementation hurdles, which currently delay project completion.

Table 4. Projected investment in infrastructure in the 12th Five Year Plan (INR billion at 2006-07 prices)

	2012-13	2013-14	2014-15	2015-16	2016-17	12th PLAN
GDP	68.825.49	75.019.78	81771.56	89131.00	97152.80	411960.64
Rate of growth of GDP	9.00	9.00	9.00	9.00	9.00	9.00
Infrastructure investment as a % of GDP	9.00	9.50	9.90	10.30	10.70	9.95
Infrastructure investment	6194.29	7126.88	8095.38	9180.49	10350.35	40992.40

Source: (i) Mid-Term appraisal eleventh five year plan, Planning Commission, GOI.
(ii) Working Sub-Group on infrastructure, working group on Savings Formulation of the Twelfth Five Year Plan, GOI.

As far as financing is concerned, it is clear that public sector resources will be scarce and, as noted above, the first priority for these resources must be education and health, which are crucial for inclusiveness and are currently underfunded. Critical infrastructure in rural areas and backward areas is another priority.

Both the central and state governments must therefore follow an infrastructure strategy which consists of a combination of public investment and public-private partnership (PPP). Public investment would have to be directed to areas where the private sector is unlikely to come, with the rest of infrastructure being developed as far as possible through PPP. Valuable experience has been gained in this area and many of the teething problems related to procedures for structuring PPP projects have been overcome. India need to build on this experience and launch a renewed effort in which the role of PPP in infrastructure investment may have to increase from around 30% in the Eleventh Plan to as much as 50% in the Twelfth Plan.

The second major challenge in infrastructure development relates to implementation. Infrastructure projects are often delayed due to difficulties in land acquisition, and where land has been acquired, due to other difficulties such as dealing with encroachments and lack of coordination with other utilities. Projects are also held back by difficulties in obtaining forest and environmental clearances. However, project developers are not without blame. They have got used to laxity in application of environmental regulations and there is a tendency to ignore environmental regulations or act in anticipation of clearances in the belief that such actions can be regularised later.

To conclude India needs to immediately bridge the infrastructure gap that industry and people face every day. The slow pace of infrastructure development is quite obvious from non achievement of eleventh plan targets. The creation of a deep and robust capital market is a key to making available long term debt instruments for infrastructure. The domestic bond market continues to be dominated by public borrowings and does not address the needs of the corporate sector as in the case of other emerging markets. A robust philosophy for infrastructure regulation is needed to make the regulatory authorities more accountable and independent. Further, tariffs in the power sector needs to be revised annually. Ta attract large chunk of investment in power sector, iron-tariffs should not be imposed and flexible pricing needs to be adopted. To make PPPs success, full-fledged PPP departments should be established by state governments mandated with developing core competencies and public discourse. We need to move to a system with much greater transparency, predictability and also tighter enforcement in future. In the process we may need to find ways of dealing with the problems of ongoing projects in a reasonable manner while establishing better systems for the future. Both the central government and the state governments have to give serious attention to resolving these problems in the years ahead.

9. Fiscal deficit

India's gross fiscal deficit remains one of the highest in the world and, recently, government liabilities have been increasing at an alarming rate. Given India's long history of running huge fiscal deficits, the sharp increase in its fiscal deficit over the last two years is a major concern for both academicians and policy- makers in India. According to budget estimates for the fiscal year 2011-12, the ratio of fiscal deficit to gross domestic product (GDP) (for the central and state governments but excluding off-budget bonds) in India is 8.1 per cent. This follows a sharp rise in the fiscal deficit ratio from 4.2 per cent in 2007–2008 to 9.3 per cent in 2009–2010. This increase reverses all the fiscal gains made since 2003–2004.

The fiscal deficit, as the name suggests, is the difference between the government's total expenditure and its total receipts (excluding borrowing). The elements of the fiscal deficit are the revenue deficit, which is the difference between the government's current (or revenue) expenditure and total current receipts (excluding borrowing) and capital expenditure. The fiscal deficit can be financed by borrowing from the Reserve Bank of India (which is also called deficit financing or money creation) and market borrowing (from the money market, which is mainly from banks).

Fiscal policy deals with the taxation and expenditure decisions of the government. In most modern economies, the government deals with fiscal policy while the central bank is responsible for monetary policy. Fiscal policy is an important constituent of the overall economic framework of a country and is therefore intimately linked with its general economic policy strategy (De 2012). The impact of fiscal deficit on economic growth is one of the highly debated issues in all world economies. The target of achieving sustained growth and maintaining macroeconomic stability is the dream among many developed, developing and underdeveloped economies. The economic growth and stability of developing countries in recent times has brought the issue of fiscal deficit in sharp focus. Continuing high levels of fiscal deficit, even if adoption of fiscal responsibility and budget management act (FRBM), pose a serious danger to macroeconomic stability in India. The gross fiscal deficit has been increasing at an alarming rate with more than two-fold increase in 2008-09 over its previous year figures (See Table 5). The excessive fiscal deficits seem to be the major concern of academicians and policy makers in India. The government has to incur deficits to finance its revenue and expenditure mismatches and also to finance investments. The problem arises when the deficit level becomes too high and chronic. The ill effects of high deficit are linked to the way they are financed and how it is used. The fiscal deficit can be financed through domestic borrowings, foreign borrowing or by printing money. Excess use of any particular mode of financing of the fiscal deficit has adverse macroeconomic consequences.

Table 5. Combined Deficits of the central and state governments (As a percentage of GDP)

Year	Gross fiscal deficit	Revenue deficit
2007-08	4.0	0.2
2008-09	8.3	4.3
2009-10	9.3	5.7
2010-11	6.9	3.2
2011-12	7.6	4.3
2012-13	7.5	3.7
2013-14	6.9	2.9

Note: Data for 2012-13 are revised estimates and data for 2013-14 are budget estimates.
Source: Handbook of statistics on the Indian economy, Reserve Bank of India. Time series publications.

A higher fiscal deficit implies high government borrowing and high debt servicing which forces the government to cut back in spending on relevant sectors like health, education and infrastructure. This reduces growth in human and physical capital, both of which have a long term impact on economic growth. Fiscal deficit used for creating infrastructure and human capital will have a different impact than if it is used for financing ill – targeted subsidies and wasteful recurrent expenditure. Therefore, the fear of about high fiscal deficit is justified if the government incur deficit to finance its current expenditure rather than capital expenditure.

Appropriate and timely fiscal policy measures can promote growth by setting efficient and effective use of scarce resources and by creating the right incentive signals. The well designed fiscal policy would help to move an economy like India towards a higher growth path without high inflation or international transfers of the burden of public debt. (Heller et. al, 2006) As per the statement by Chidambaram P. Union Finance Minister on August 12, 2013 since the world economy is challenged; India's economy also faces challenges. One of the main challenges is the Current Account Deficit (CAD). In 2011-12, while financing the CAD, we had to draw upon reserves to the extent of USD 12.8 billion. Last year, we had a larger CAD at USD 88.2 billion. Nevertheless, we were able to fully and safely finance the CAD, and do even better. We added USD 3.8 billion to the reserves. We contained the CAD at 4.8 percent of the GDP.

Financing of fiscal deficits has two significant negative impacts like inflation and rise in interest rates. A high fiscal deficit is generally linked to inflation. This is because that part of the fiscal deficit which is financed by borrowing from the RBI leads to an increase in the money stock and a higher money stock automatically leads to inflation since "more money chases the same goods". Another fiscal deficit financing effect is rise in interest rates. To reduce the Fiscal Deficit government borrows from the money market. Large amount of borrowings by government results in higher interest rates and the same rise crowds out the private investment and impacts sectors like realty. Also, higher borrowings by Govt. suck out liquidity, leaving less scope for banks to lend to private players.

The challenging aspect of fiscal deficit which policymakers have been facing is the reduction in fiscal deficit. There are two ways in which the fiscal deficit can be reduced, by raising revenues or by reducing expenditure or both. To increase the revenue Government has to increase the taxes or sell off the PSUs (disinvestment). However the government always finds it difficult to increase revenues through taxation. In fact, in every year's budget, the government has actually given away tax cuts. So, only option left with government to raise revenues is through means like disinvestment. Even disinvestment of PSUs has not been fully implemented. Thus, the main impact of the policy of reduced fiscal deficits has to be on the government's expenditure. This policy has a number of effects. For example, government investment in sectors such as agriculture goes down. Besides that, expenditure on social sectors like education, health and poverty alleviation also gets reduced leading to greater hardship for the poor.

As far as revenues are concerned, the aim should be to achieve higher tax ratios without resorting to distortionary taxation. The most important initiative in this context is the Goods and Services Tax (GST), for which a Constitution Amendment Bill has been introduced. The GST, once implemented, will convert the present regime in which the central and state governments levy multiple indirect taxes separately on different tax bases, into a more rational system with separate central and state taxes. Some reduction in non-Plan expenditure as a ratio of GDP will happen automatically if there is high growth, because government employment is not expected to increase significantly, and no new pay commission impact is expected in the Twelfth Plan period. Food subsidies, which amount to about 0.7% of GDP, will be difficult to contain in view of the commitments on National Food Security. The focus of attention for subsidy control by the centre should therefore be on the subsidy on fuel and fertilisers.

9.1. Remedial Fiscal Measures

- India’s fiscal situation requires immediate attention: high growth and low interest rates will not take care of the problem of long run sustainability of the debt, nor the risks of a crisis in the short or medium run
- Institutional reforms such as improvements in the intergovernmental transfer system, borrowing mechanisms for State governments, and budgeting practices and norms are all technically possible and may well be politically feasible
- Revenue-enhancing tax reform is critical at all levels, including Centre, States and local governments. While there exists ample room for improving the structure of indirect taxes in particular improved tax administration and enforcement remains one of the most critical areas for internal government reform. Tax reform is an essential step toward increasing government revenue, as well as reducing microeconomic distortions.
- Financial sector reform needs to be broader and deeper than it has been so far, and reduction in the direct and indirect influence of the government in this sector must continue.
- Coordination of fiscal policy with monetary and exchange rate policies would be better than letting the latter adjust to fiscal looseness, as seems to have been happening recently.
- The quality of expenditures at the Centre and the States overall has deteriorated, and the solution to this has to be a rationalization of government, both internally and through privatization. Thus expenditure restructuring must accompany expenditure control.

A medium-term strategy for fiscal consolidation is eminently feasible in India. Since 2002, the government has had in place the FRBMA, which mandated a reduction in the central fiscal deficit by 0.3 per cent per year. Over the past several years, the FRBMA has been adhered to and India has brought its central deficit down from 6.2 per cent of GDP in 2001/02 to 3.4 per cent in 2007/08, and state deficits down from 3.2 per cent of GDP to 2.3 per cent over the same period.

10. Suggestion

In India there have been seen major efforts to improve policy making, from a variety of angles: process, structures, and politics. These attempts have, however, suffered from a pervasive gap between theory and practice. Either they have presented unrealistic models of policy making, or have failed to provide the support to turn desired practices into reality. Although policymaking is inherently complex and messy, but the key to improve policy making is to construct a resilient process that can handle such challenges and pressures. Such a process would be realistic enough to have a chance of being followed in practice. The below mentioned points can be seen as remedial measures to improve public policy making in India:

- ❖ Strengthening relations with citizens is a sound investment in better policy making and a core element of good governance. It allows government to tap new sources of policy – relevant ideas, information and resources when making decisions. Equally important, it contributes to building public trust in government, raising the quality of democracy and strengthening civic capacity.
- ❖ Government must invest adequate time, resources and commitment in building robust legal, policy and institutional frameworks, developing appropriate tools and evaluating their own performance in engaging citizens in policy making. Poorly designed and inadequate measures for information, consultation and active participation in policy-making can narrow down government – citizen relationship.
- ❖ Policymakers need to evaluate new approaches to policy making and public management, to identify and promote best practices, wherever it may be found.
- ❖ There should be effective and functional partnerships between civil servants and ministers which are critical to making policy successful.
- ❖ Policies should not be poorly designed because they ultimately fail. A good policy-making process should produce policies which can be executed swiftly and successfully. There should be greater emphasis on policy design which helps to ensure that the planned actions represent a realistic and viable means of achieving the policy goals.
- ❖ In order to enhance the knowledge base used in policy-making

and promoting integration and synthesis, ensure that only those with the requisite knowledge and intelligence make it to the top policy levels.

- There should be systematic analysis and integration prior to policy-making, i.e., adequate analysis of costs, benefits and consequences and adequate time should be spent on policy-making.
- Systematic means should be developed for obtaining outside inputs and for involving those affected by policies or for debating alternatives and their impacts on different groups. For example, the US has a system of widespread public debate before a policy is approved. The new policy initiative is put to extensive debate not only in committees but also in the Senate and House.

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G. & L. E. R., Vol. 18 No. 2, 2014

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CIVILIZATION AS THE DIFFUSION OF ECLECTICISM IN ECONOMIC THOUGHT FEDERICO CAFFE' (1914-1987)

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1. Introduction

"Expressing an ideal is to project a society jet to be built, not merely diagnose the functioning of an existing social structure" (Caffè 1979a, in Caffè 2014, pp. 342-43).

Federico Caffè chose, of all possible specialisation in economics, political economy (Rea 2000; Caffè 2013, pp. 275-280; Amoroso 2012). He himself defined political economy as the systematic analysis of logical alternatives and thusly concerned with past experiences, present facts and particularly future possibilities (Caffè 1964, p. 14). The past, though, was the realm of historians of economic thought, in search of guidelines to understand better the present, while economic theoreticians studied current economic relations, valid in a given economic and social system. Political economists, instead, should *"use all available instruments and analysing techniques, to outline an entire constellation of possible economic situations"*, building *"simplified models of feasible systems"* (Caffè 1964, p. 15). By adopting this methodology of analysis, Caffè affirmed that ideas, and so human will, prevailed over material life and history. Contrary to other economists, hoping for a future palingenesis (Caffè 1970a, in Amari and Rocchi 2009, p. 348) or passively accepting some natural laws (Caffè 1982a, in Amari and Rocchi 2009, pp. 633-634), Caffè believed in a future yet to be construed and, before that, a future to be thought. When he looked into the past, he did so to retrieve possible alternative visions, in order to fragment the cultural monopoly of the political and theoretical winners of his time. For the present, his intent was to offer to reflection the widest possible array of economic policies and economic institutions, as means to the ends of society. On the future Caffè directed the sight of an intellectual. *"My task as an intellectual* – he wrote on "Sinistra '77" – *is to point out an alternative model and prove that it is a feasible model"* (Caffè 1977a, in Caffè 2014, p. 36). Federico Caffè retrieved such models from a mature rereading of Italy's historical past, from an attentive study of the most recent theories of political economy and from the rediscovering of past and defeated ideologies, as the centrality of work in social life. These models, though, would not automatically become reality, even awaiting twenty or thirty years, as Keynes considered necessary. Ideas could easily turn into a fanciful failing. *"No other epoch, as ours,* - wrote Caffè in the 1980s in defence of the welfare state - *has ever had such need for a stimulus to act, as is implied by this social philosophy. As Keynes underlined in the 1930s: there is no reason why we shouldn't feel free to be audacious and wilful, to experiment, to act and to research all possibilities"* (Caffè 1986a, in Amari and Rocchi 2009, p. 330). He so dedicated his whole scholarly life to spread theories, models of a possible future, in academia, among economic elites in big business, big labour and big government (Caffè 1964, p. 5), down to the readers of independent newspapers and journals.

In the following paragraphs, this diffusing effort of the Abruzzese economist will be detailed and analysed, alighting its consistency and motivations. His host of publications could be too easily attributed to the Italian tradition of economists like Francesco Ferrara, who did not constrain their efforts to theoretical analysis or teaching, but also contributed to spread economics through newspapers and participated to the political arena when circumstances demanded it (Caffè 1978a, in Caffè 2013, p. 158). In the case of Federico Caffè, though, as argued in the first part of this essay, the diffusion of economic thought, pursued as a veritable vocation, had more profound sources in the epistemological, philosophical and theoretical foundations of his thought. The second part of this essay will be dedicated to reconstruct and summarize past and contemporary influences on Caffè's philosophy of history, starting from the most evident to the less obvious ones. The last part of the essay will then relate the diverse channels of diffusion used by Caffè to spread eclecticism and a multifaceted knowledge of economics, resuming also their effectiveness. The Appendix to the essay contains an accounting of economists, political economists and economic historians quoted by Caffè in the host of his writings, a last proof of his ceaseless activity as propagator of economic thought.

2. Economics: a dialog between facts and ideas

"I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil" (Keynes 2006, p. 348; Caffè 1982b, in Caffè 2007, p. 82).

The extraordinary diffusing effort that Federico Caffè exerted in economics over thirty years is clearly retraceable from the tables published in appendix to this essay. An encyclopaedic overview of the economic science emerges by simply scrolling the list of economists, political economists and economic historians quoted by Caffè in his many writings, academic or not. The economic science, in the view of Caffè, included history, analysis and political economy. He so reviewed and analysed works of economic historians and historians *tout court* and referred to essays and books of economists who acted outside of academia, in institutions like IMF, central banks, organisations of international trade and big research centres. He obviously quoted all big economists of the past, Smith and Ricardo as Marx and Walras: overwhelmingly Keynes (Table 1). His writings also refer to all new ramifications of economics, all those recent researches derived from the slow agony of the neoclassical paradigm in the 1930s and from the loosing impetus of Keynesism in the 1970s (Caffè 1977b, in Amari and Rocchi 2007, p. 84; Caffè 1962a; Caffè 1968-1969). Caffè, though, also cited and reviewed an infinite number of young Italian economists (Tables 3 and 4): a clear demonstration that his was not just a show of erudition or a sterile love for quotations. He patiently and passionately dedicated to their researches and studies long and serious analyses, diffusing their theories and results as those of major national and international economists. He so vindicated the existence of an Italian school of thought that was not in any way declining as many asserted. In a note, preserved among his papers in the archives of the Bank of Italy, he wrote: "Italy has not yet realized that there is an extremely flourishing bloom of young scholars of economics and finance among the generation 30 and 40 years old" (Amari and Rocchi 2009, p. 312). Caffè's diffusion of economic thought was ecumenical: vertically in respect to time, from Quesnay to Patinkin, and horizontally, comprising all contemporary schools of thought: neo-keynesian, post-keynesian, neo-ricardian, neo-institutionalist and so on. Caffè lent his voice to all this argumentative chaos, to all disparate research lines, to the growing eclecticism, with the conscience of being witness to the proliferation of possible alternatives, of ideas and ideals for the future. He reaffirmed in one of his lessons: "Orthodoxy means that we are content with the present state of things, that we accept it. In times when the critical approach prevails, we should not feel unsettled: this critical reappraisal, in the long run, bears fruit and brings good results" (Caffè 1979b, in Caffè 2014, p. 122). His publishing and teaching activity were so devoted to the diffusion of this variety of ideas. "For this variety – Caffè asserted, quoting a "dazzling page" of Keynes (Keynes 2006, p. 348) - preserves the traditions which embody the most secure and successful choices of former generations; it colours the present with the diversification of its fancy; and being the handmaid of experiment as well as of tradition and of fancy, it is the most powerful instrument to better the future" (Caffè 1974, p. 546). Another quotation, from Paul Samuelson, among the most loved and repeated by Caffè, confirms his preference for eclecticism over orthodoxy. "Experience – he cited -taught us severely that eclecticism in economics is not something that is desired, as much as a necessity" (Amari and Rocchi 2009, p. 312). A call for eclecticism that was repeated times and times again in his textbook (Caffè 2008, p. 17) as in his essays (Caffè 1986a, in Amari and Rocchi 2009, p. 312; Caffè 1977b, in Amari and Rocchi 2007, p. 85) and even on a newspaper like "il manifesto" (Caffè 1984a, in Caffè 2007, p. 105). The so defined value of variety, which Caffè strenuously defended, did not derive from a pretended heterodoxy or disaffection to current prevailing economic models, as the ecumenism of his publishing and teaching activity proves. The necessity, more than the pleasure, of variety derived from Caffè's very definition of economic science and its relationship with historical change. As seen, in his view, economic theory should be the systematic explanation of the present state of things, while political economy would look at how things should be: both captured in a continuous evolution, because linked to an ever-changing reality. Quoting D. H. Robertson, Caffè used to say: "Madame History and Madame Nature always hold in store some surprise for us. History never ends" (Caffè 1979c, in Caffè 2007, p. 130). Economic theory had so to answer to the historical moment in which it had been devised, even if it was connected with the past; a theory of political economy even more so, given that it had to be "floor and ceiling" (Caffè 1948, in Amari and Rocchi 2009, p. 180) of public and civil action, guiding future changes of a country. Both had to be constantly connected with "the present as history" of Paul Sweezy (Sweezy 1953; Caffè 2008, p. 15). "It is discouraging – wrote Caffè on "Il Messaggero" – to witness the inability to comprehend that human aims change and that, as Gunnar Myrdal cautions, nothing is more illusory than to face the present with past theories" (Caffè 1978b, in Caffè 2013, p. 163). Everything changed and so should a science that did not wish to become sterile. Federico Caffè considered two types of changes, brought about by the passing of time, which should have influenced the economic science. Firstly, the instruments that men used to manage available resources: technology but also institutions. One example Caffè quoted many times was the turn of capitalism toward monopolies and oligopolies at the end of the nineteenth century. Economic theory and political economy had to take these changes in consideration (Caffè 1978c, in Caffè 2014, p. 57), analysing capitalism in its historical contingency, not in view of an idealistic market economy (Esposto and Tiberi 1995). In 1985, writing on the journal "L'Ora", Caffè recalled the lesson of Luigi Einaudi (Amari and Rocchi 2007, pp. 97-126) and underlined that the enlightened action of intellectuals should have been directed to this concrete historical capitalism, open to reform and substantial changes, not to an ideal and invariable economic system (Caffè 1985a, in Caffè 2013, p. 224). When economic analysis and historical reality diverged, theory lost its explicative power and economic policy its ability to direct change (Caffè 1979b, in Caffè 2014, p. 122). Eclecticism had the purpose to bridge this gap, re-establishing the significance of analysis and restoring its ability to fulfil its aims. In consequence, eclecticism was not to be blamed or negatively judged, being the solution, not the symptom, of a crisis of the economic science (Caffè 2008, p. 15; Caffè 1975a, in Amari and Rocchi 2009, pp. 429-435). The second change related, instead, to ideas. Caffè defined ideas as the complex construction that at any time comprised the ends that man established for her/his actions and the theoretical instruments through which she/he justified reality and created instruments to modify the same reality according to her/his ends. Caffè scattered across his writings testimonies of his belief, of Keynesian heritage, that in the end ideas would prevail over facts (Caffè 1982b, in Caffè 2007, p. 82; Caffè 1983a, in Caffè 2014, p. 368; Caffè 1985b, in Caffè 2007, p. 141). He left no space for the materialist determinism of certain Marxian traditions, nor admitted the existence of theories or laws of nature, valid over time and space, to which reality should abide. "To count on automatic tendencies (dictated by modern "industrial systems" substituting central planning to market (Caffè 1970a, in Amari and Rocchi 2009, p. 393), or by the traditional market mechanism subject to the sovereignty of consumers), instead of counting on the conscious effort of human action, would only generate disappointment" (Caffè 1970a, in Amari and Rocchi 2009, p. 397). It would simply not do to ascribe to a mythical or mystical "convergence of systems" what definitely was a responsibility of men (Caffè 1970a, in Amari and Rocchi 2009, p. 397): this the ideal premise of all theoretical reasoning of Federico Caffè (Caffè 2008, p. 17). In synthesis, Caffè considered economic analysis to be part of the ideals of humanity, of the *Weltanschauung*, historically determined in its theoretical part, but historically determining in its political part. In consequence, an economist "had to admit the historical conditioning in every contribution that would not be limited to an exercise of formal logic" (Caffè 1983b, in Caffè 2013, p. 174), but at the same time an economist should also "examine the capacity of effective functioning of systems imagined as utopian mental schemes" (Rea 2000, p. 178). What others would scorn as utopian and unrealistic, Caffè defined as ideas that could and should change the future of humanity. Exactly this determining capacity of ideas founded what he called, after John Stuart Mill, his social philosophy (Caffè 1962b, p. 324) and was the main rationale behind his activity as diffusing agent of economic thought.

3. Ideas for civilization and history's bottlenecks

"For a scientist what others define as utopia is only anticipation of results that still have to master the resistances of present times" (Rea 2000, p. 177).

Federico Caffè loved citations, references and quotes, as apparent reading his writings and retracing the memories of his students. He dressed his innermost thoughts with the wordings and phrasings of others, with ecumenical completeness. To this rather external and formalistic influence of many Italian and foreign economists, however, corresponded a much more profound inspiration by some specific authors who intensely influenced his philosophy of history and the epistemological foundation of his thought. Some sources of inspiration have already been hinted at and clearly emerge by simply counting the most numerous references contained in his writings (Tables 1-4); others are more subtle and have to be retraced from Caffè's own methodological discourse. A measure of influence must be recognized to the characteristic trait of Italian economic thought, uniting economists as Francesco Ferrara and Luigi Einaudi, that defined economics as a science based on a "dialogue of facts and theories", or more specifically: "an iterative process between questions raised by theoretical formulations and answers given by empirical analyses" (Caffè 1975b, in Amari and Rocchi 2007, p. 91). It has already been underlined how much Caffè relied on this tradition to develop his own vision of the evolution of history. His belief in an economic analysis grounded in contemporary reality, but, at the same time, capable of changing the future, found its innermost origin here. An interview, granted by Federico Caffè to the renowned journalist and writer

Ermanno Rea, reveals some more influences. In the dialogue, Caffè affirmed once again that: "utopia is nothing else than a possible civilization against the bottlenecks of present times" (Rea 2000, pp. 178-79), as seen a recurring argument of his reasoning. This sentence, in just a few words, hints at three references of his thought. Two are apparent: Bruno de Finetti's utopian view of economics (De Finetti 1973, pp. 13-87) and the John M. Keynes who toasted "to the Royal Economic Society, of economics and economists, who are the trustees not of civilization, but of the possibility of civilization" (Harrod 1951, pp. 193-194). The third, instead, is retraceable in the expression: "bottlenecks". Bottlenecks were obstacles, in Caffe's view, that impeded the easy realization of ideas and ideals, confining them to a utopian Neverland: a clear reference to the philosophy of Amintore Fanfani. Fanfani opened his courses and textbooks of economic history with the clear vindication of the pre-eminence of ideas over material conditions in determining the path of history. He also envisaged that such evolution might be hampered by resistances that could be of material nature and needed to be overcome by technological change, or of ideal kind: past ideas crystallized in obsolete institutions, norms and laws that called for changes in theorization, scientific paradigms, social and political settings (Fanfani 2014). The relationship between Caffè and Fanfani, colleagues at the University of Rome, is complex and particularly difficult to analyse, given the silence of both on the issue and the scarcity of archival material. On the said question, though, there is no doubt. Caffè's description of ideas as the *telos* of a future society, expression of man's will to perfect herself/himself; ideas that, surpassed by a change of reality, became resistances to history's evolution toward a release from material needs and the implementation of ethical aims (Fanfani 1960, pp. 68-72), is surely a legacy of Fanfani's lesson. Both Fanfani and Caffè can so be considered adherents to some form of historical personalism (Galeazzi 1998, p. 21). Both surely represented the new humanism, particularly evident in the vindication of work as a mean to realize human dignity that in the aftermath of WWII gathered in Italy a wide consensus: the starting point of the Republican constitution (Pizzolato 1999). In his writings, Caffè often returned to the period of thriving vitality that transformed the resistance movement into constituency will, posing the institutional and legal foundations of the new Italian state (Amari and Rocchi 2009, pp. 121-205). He had to register, though, the futility of such ideal pressures and their inability to become concrete measures of change. At the time, change had unsuccessfully faced vested interests and the opposition of ideas sclerotized into ideologies. "However – pondered Caffè in an essay of 1983 – for someone believing that, in the long run, ideas prevail on vested interests, this cannot be a satisfying explanation. It is perhaps more approximate to truth to recall the improvisation, fancifulness and limited effectiveness of the intellectual efforts under discussion, efforts that neither have nor will become the object of history (if not for some meticulous archivist in due time). It has been an extremely generous intellectual exertion, but whimsical. In vain Antonio Gramsci admonished "to react to fancifulness": this phrase, like many others, was destined to be manifold quoted, but to have little influence on national habits" (Caffè 1983a, in Caffè 2014, p. 368). Ideas had not been absent in Italy after WWII. There had been, for example, the fleeting experience of the "corsair" press: a varied collection of publications in which Italy's structural problems and the necessary solutions had been correctly identified (Caffè 1983a, in Caffè 2014, p. 366). What had been missing was the effort to implement those ideals: they had remained unrealized and had even vanished from historiography. The winning liberal ideology slowly and inexorably deleted even the remembrance of a possible theoretical alternative. Caffè considered this historiographic reductionism particularly dangerous because it removed from the consciousness of Italians part of the variety of possible systems among which to choose their future. "This winner's history – wrote Caffè – makes us neglect the positions of the losers, which were not necessarily wrong. This way, as said, we lose that greater understanding of present problems that would follow from the recurrence, in different circumstances, of similar conditionings and preclusions. Surely reacting to such forms of historical simplification is not easy, because it involves personalities and the evaluation of their actions, be it positive or negative" (Caffè 1984b, in Caffè 2014, pp. 76-77). The history of Italy's reconstruction was still to be written, particularly one that described "the prejudice caused to the process of economic reconstruction of our country by the inspiring principle that "free markets solved all problems that law's wisdom cannot" (…) an influence so penetrating, deforming and persisting that even the attempts of planning were severely conditioned by it" (Caffè 1977c, in Caffè 2013, pp. 138-39). The historical revisionism invoked by Caffè was not an end in itself, but had a precise scope: saving Italy from a new season of fanciful and fruitless ideas. His unceasing diffusion of economic thought was born out of the personal experience that he had lived at the end of WWII in Italy. Spreading economic theories and cultivating eclecticism was the solution that Federico

Caffè offered to the problem of Gramsci. The longer inadequate ideas prevailed in Italy, the more the civilization process would be impaired, not only in the form of a growing impoverishment of theoretical thought, but of an increasing incapacity to manage efficaciously and equitably material conditions through technology and institutions. Errors in the economic policy of Italy, usually criticized on technical ground, were so the result of an erroneous *Weltanschauung*, still relying on old ideals (Caffè 1977d, in Caffè 2013, p. 144). Given these premises, an intellectual, as Caffè defined himself, had two main tasks to fulfil in the process of theorization: "to remain faithful to systematic doubt, as an antidote to the uncompromising reassertion of formulas that became a constraining cage" (Caffè 1984c, in Caffè 2014, p. 80); and "to reason without bonds and boundaries, even ignoring possible resistances and oppositions", practicing "the just theoretical refusal of existing bottlenecks, affirming a possible civilization" (Caffè 1985b, in Caffè 2007, pp. 142-43). To develop new ideas, to theorize new social and economic systems, though, would not be enough. Ideas needed to transform into a diffused *Weltanschauung*, to become effective and transform reality. To do so, ideas had to be imbibed into a local, national or international culture, through a complex process of education and civilization. To be active part of such a process was, in Caffè's view, the most important duty of an intellectual. Along with traces of historical personalism, Caffè's thought contained so a great measure of enlightenment, as he was very much aware. "Intellectuals – he wrote on the journal "L'Ora" – practice an enlightening action on which relies the survival not of an ideal market economy, but of an historical capitalism, based on important reforms and long-lasting improvements" (Caffè 1985a, in Caffè 2013, p. 224). Lamps to be alighted, light to be thrown, mist to be dispersed became so frequent metaphors in the writings of Federico Caffè. "It might be enlightenment, - affirmed Caffè in an interview by Valentino Parlato – but there is nothing to be ashamed of in being an enlightened scholar" (Caffè 1985b, in Caffè 2007, pp. 144-145).

4. Federico Caffè's enlightenment

"Surely, it is important to constantly and mercilessly demystify all that is smuggled as undisputable conventional wisdom (…). Beyond polemics, a correct economic information is the most necessary action to call attention toward the possibilities of political economy (…)" (Caffè 1980, in Caffè 2007, p. 24).

Caffè, as an intellectual, considered the enlightening diffusion of knowledge of primary importance in the civilizing process. The first and privileged scenario of this diffusion was academia. There, among colleagues and students, Caffè fought his main battle in favour of eclecticism. Not without opposition. In one of his first articles, published on "Cronache Sociali" in 1949, he already affirmed: "in academia innovations, of whatever nature, are received with diffidence, a consequence mayhap of the attempt to defend the received patrimony of ideas, considered intangible. This attitude is wrong, because the real preservation of a scientific patrimony implies a constant activity of renewal and critical revision" (Caffè 1949, in Caffè 2014, p. 213). He considered wrong also the opposite approach. It made no sense to wipe out completely the past of a discipline, raptured by revolutionary intent. In "Note Economiche" Caffè warned that: "a satisfying exploration of the 'closet of ideas' can help to comprehend that the closet isn't void at all and to prevent that it be crowded with illusory novelties or imitative garbage" (Caffè 1979d, in Amari and Rocchi 2009, pp. 574-575). Caffè did not believe the evolution of economic analysis to proceed through Kuhnian revolutions or Schumpeterian evolution (Caffè 2008, p. 17; Caffè 1977b, in Amari and Rocchi 2007, p. 86). He subscribed, instead, the incremental vision of his teacher, Gustavo del Vecchio. The economic science, in this sense, was like a building to which the passing of time added story to story, without endangering its general harmony (Caffè 2008, p. 17): Pantaleoni's snowball that, rolling toward the plain, thickened by strata upon strata of snow (Pantaleoni 1925, p. 159). This somewhat natural path of economic analysis, though, became rough and bumpy in consequence of the persistent opposition of old theories, transformed into myths and ideologies, of the obstruction of vested interests, and due to problems caused by the internal structure of academia. Impeding the continuous process of theoretical creative destruction, such resistances allowed sclerotized paradigms and conventional wisdom to continue guiding economic policies long after their expiry date (Caffè 1983b, in Caffè 2013, p. 173). In Caffè's thought, academia was the cradle of ideas, where future possibilities could be nurtured and encouraged or suffocated at birth. In Italy, since the end of WWII, this pivotal role of universities had been further augmented by the circumstance that many professors of economics actively participated to the political decision process, assuming leading roles in parliamentary life. "The professorial factor – lamented Caffè – has been much more intrusive and decisive in determining the orientation of Italy's economic policy than the political one. In reality, politicians often just repeat formulas dictated by such economists, whose influence, both if they are part of the government or create public opinion movements through the press, is excessively relevant" (Caffè 1949, in Caffè 2014, p. 214). To simplify the emerging of new ideas, to foster eclecticism and to fight common wisdom, Caffè proposed a complete reforming of Italy's university. "The concept of university as an ivory tower strictly serving science and in so doing fulfilling best its task of social progress – he wrote in 1979 - seems completely inadequate in respect to present times" (Querini 1979, in Amari and Rocchi 2009, p. 562). University should have been a laboratory were science served practice and research never was an end to itself. The new *telos* of universities and scholarly life should have become to nurture the betterment of future societies, becoming a project centre for economic and social development. Economics also had to be reformed in this sense. Economic analysis had to expand its subject from the classical "study of human behaviour in regard to the use of limited means to achieve given ends", to "the comparative analysis of various systems and different economic institutions in respect to their efficiency in using scares resources" (Caffè 1955, in Amari and Rocchi 2009, p. 360). Here Caffè registered his main success: the redefinition of political economy that became an independent discipline, with an improved methodology and a precise scientific statute. As designed by Caffè, political economy grew into a science at service of economic practice, with the aim of discovering the ideas for the present and future progress of society. Nonetheless, a new aim to academic life and a new definition of economic analysis might not be enough to transform Italian universities into the desired laboratory of the future. There were always resistances and bottlenecks to take into account. Caffè clearly envisaged the institutional problems afflicting Italy's universities and the perils of a growing interference of politics into academic life. To these problems, he dedicated many reflections (Amari and Rocchi 2009, pp. 312-313) and an illuminating essay in 1984 (Caffè 1984c, in Amari and Rocchi 2009, p. 222). As in Italy in general, also in university the problem was not the lack of ideas or young talents, but excessive bureaucratization, centralization and the ever-threatening doctrinarian homogenization. To the task of being the cradle of ideas, then, universities added the one to transform such ideas in competences at disposition of society. Not always an easy endeavour. In the aftermath of WWII, for example, Italy lacked an adequate number of economists to fill all positions required in central, commercial and private banking, in large holdings and state-owned enterprises, in the financial sector and in the public administration. Exactly in those years, Caffè decided to dedicate his scholarly life to educate entire generations of economists through his academic work. This he considered to have been his more lasting contribution to the future development of Italy. He wrote down in a notebook notices and names concerning all those students, more than one thousand and two hundred, who had done their graduation thesis under his personal supervision. He used to say that the notebook was worth many a manual or monograph he had not written. The influence exerted, in Keynes' opinion, by dead economists over future generations through their writings, Caffè attributed to his teaching and tutoring activity in university (Amari and Rocchi 2009, p. 786). In fact, many of his students became journalists, a great number entered public service, some worked in big companies or labor unions, and certain embraced the academic career. All had been educated to eclecticism and became in time a veritable multiplier of the diffusion of economic thought, of every kind of economic thought, in Italy. Federico Caffè dedicated to academia the greatest part of his life. He was very much aware, though, that research and teaching were not enough to transform successfully ideas into a renewal of civil life. Ideas had to become widely accepted culture and this needed time, as in Keynes' admonishment, but also a diffusive effort that extended beyond the walls of universities and came to encompass institutions and decision makers. Three iron pots, big government, big business and big labour, threatened the fragile vase of free market and composed what Caffè defined Italy's injudicious oligopolistic capitalism (Caffè 1977e, in Caffè 2014, p. 88). Changing the economic culture dominating the action of these iron pots was necessary for new ideas to prevail in Italy. Following the methodological lesson of Morgenstern, Meade e Tinbergen, Caffè refused, though, to become the counsellor of the prince, as many other economists did. The influence so gained paid a high price. Instead of setting new aims to social life, researching new ideas and elaborating new theories, economists in service of politicians could only suggest the most efficient means to ends chosen by others, becoming veritable minions to past ideologies and surpassed thinking (Caffè 1985c, in Amari and Rocchi 2009, p. 702). Caffè was also aware that the cleft between his ideas, the centrality of man and work in society and the defence of the welfare state, and those governing big government and big business, had grown to such proportion that an insisted effort of diffusion of eclectic economic thought in those circles would have proved useless. Right wing or left wing parties (Caffè 1970a, in Amari and Rocchi 2007, p. 332), big state owned companies and private oligopolistic enterprises were driven by vested interests or sclerotized ideologies. The fruitful relationship between political and cultural discussion had long been interrupted in Italy (Caffè 1976a, in Amari and Rocchi 2007, p. 328). New theories, as those on monopolistic competition and neo-Keynesism, had never made it outside universities (Caffè 1984d, in Amari and Rocchi 2009, p. 212). In consequence, Caffè decided to dedicate his efforts outside academia to the spreading of eclectic economic thinking in labour unions and particularly Cgil. His activity comprised lectures and seminars (Caffè 1979a, in Caffè 2014, pp. 116-150), but also regular contributions to journals like "Sinistra '77", "Sinistra '78", "Lettere Sinistra '80", "Quaderni di Fabbrica e Stato", "Quaderni di Rassegna Sindacale", "Lettere di Fabbrica e Stato", "I consigli", "Rassegna Sindacale" and "Conquiste del lavoro" (Tables 1-4) (Caffè 2014, pp. 17-150). Caffè hoped that, through the political influence of trade unions, new theories and ideas could be forced upon government and business circles. Big labour could perhaps win the hand of innovation against big government and big business; but to do so, trade unions should have abandoned old Marxian ideological positions and embraced neo-keynesian thought. By refusing the old ideal that industry was at the centre of society and union action, Cgil would also have gained a wider association base, made of independent workers, temporary employees and even unemployed people. Trade unions could then have used this new representativeness and political influence to ask for those policies, varying in time and space, that decidedly aimed at full employment (Caffè 1987, in Caffè 2014, pp. 84-86). Caffè dedicated a similar diffusing activity also to Italian public opinion. His popularizing and educational writings were published as articles and essays in a wide variety of journals and newspapers. He also maintained long-lasting collaborations with the newspapers "Il Messaggero" and "il manifesto". He believed that this channel to diffuse economic thought would be of primary importance. Enlightening Italians on economic matters would serve to transform them from "passive subjects" to "conscious participants to the decision process regarding economic policies" (Ibid). A full quarter of all his quotations, registered in the Tables in appendix, was in pieces directed to trade union members and to Italian population at large (Tables 1-4). Caffè was conscious, though, that this was the most difficult task he posed to himself. Public opinion was easily influenced by propaganda and disinformation (Caffè 1976b, in Caffè 2013, p. 122). He openly expressed his doubts on the "Giornale degli Economisti": "The public often seeks excuses to be deceived, more than demystifying information" (Caffè 1971, p. 669). He studied with attention the condescending attitude of Italy's public opinion towards the stereotypes divulged by powerful èlites. To this purpose, he analysed the hypotheses of Offe (Offe 1977), O'Connor (Caffè 1979a, in Caffè 2014, p. 139) and Habermas (O'Connor 1977; Offe 1977; Habermas 1975) on mature capitalism in an essay (Caffè 1982c, in Amari and Rocchi 2007, pp. 368-376) and a newspaper article (Caffè 1978d, in Caffè 2014, pp. 45-46). "In this picture – he wrote – the problem of consensus translates into its acquisition through the extension of privileges or through its imposition by force"(Caffè 1978d, in Caffè 2014, pp. 45-46). Exactly to hinder the use of void formulas in economic publications, the spreading of ideologies and common wisdom in the economic discourse, against vested interests, the indifference of politics and the deafness of trade unions, Federico Caffè exerted his continuous diffusing activity in favour of public opinion. He wrote articles upon articles to popularize a revised historical lecture of Italy's past, particularly the period of reconstruction after WWII, to demystify the simplified interpretation commonly circulating that magnified liberalism (Caffè 1986b, in Caffè 2013, p. 244). He refereed, explained and spread all possible economic theories, as shown by his ecumenical quotations, while being particularly interested in bringing the political interest on two major line of reasoning, still largely ignored: Keynesism and monopolistic markets (Caffè 1970a, in Amari and Rocchi 2009, p. 346). He already knew he would not succeed. His contemporaries had been educated to Einaudi an liberalism, a tradition of thought that in Italy dated back to Unity and the theorizations of Francesco Ferrara. Formulas like "market" and "competition" had lost every intrinsic significance but maintained, in popular culture, a negative moral judgement of their opposite. Against such myths, sound reasoning was not enough: the more so, given that behind such formulas, Caffè envisaged the influence of élites having a personal interest in the liberalization of the financial system, the deregulation of particular sectors and, in the 1980's, privatizations, in order to maintain monopolistic profits whose social costs would be borne by population at large. If changing the ends of Italian economic policies would be impossible, Caffè still hoped to set the public opinion free from its pernicious conformism and to silence the siren's call of a state continuously in search of consensus and legitimation. Through the resulting publishing activity, three decades long, he became the critical conscience of the Italian economy. In this self-imposed role, Caffè felt alone, like a marathon runner who "has the boring task of reiterating the reasons of rationality" (Caffè 1985d, in Caffè 2014, p. 83). Even if "against human stupidity Gods also are powerless" (Caffè 1975a, in Amari and Rocchi 2009, p. 433), he did not believe his lifelong effort without significance. In the quoted interview to Valentino Parlato, he affirmed: "the economist is the trustee of possible civilizations and if vested interests prevail upon ideas, he must still pay attention to ideas" (Caffè 1985b, in Caffè 2007, p. 141). He so continued to write, publish and diffuse, against whatever disillusion, about alternative theories, possible scenarios and a variegated interpretation of the past, in order to maintain to future generations the knowledge that a different way had been thought of and was possible. If, again, Italian politics, Italian public opinion, Italian academia condemned all alternatives to liberalism and all reforms to fanciful utopias, Caffè tried to avoid, at least, the *damnatio memoriae* that would have doomed the country to repeat its errors to infinity.

5. Conclusions

"History of economic thought teaches us that, independently from an immediate adhesion of politicians, it is the task of economists to examine the range of future possibilities" (Caffè 1983, in Caffè 2013, p. 199).

Federico Caffè has been an extraordinary agent of diffusion of economic thought. His publishing activity, academic as dedicated to a wider public, is characterized by the variety of themes treated, by the number of economists quoted and refereed, by equilibrium of judgement. Caffè might so be defined as a fine political economist, with a penchant for bibliophilia and compulsive scribbling, but it would be a rushed and superficial judgement. At the base of Caffè's diffusing effort lied his personal historicism and his philosophy of history. In his thought, ideas and facts interacted in a continuous dialectic evolution. At times ideas were late in interpreting changes in facts, at times facts became obstacles to the realization of ideas. There was no doubt, for Caffè, though, that it was ideas that in the end would prevail over material conditions. Choosing some kind of determinism would mean escaping responsibility: a grave fault, particularly for political economist whose task was to propose new possible structures for the future of society, but also counter the material and cultural obstacles posed to their realization. In Italy, the Gramscian problem had only become more pressing with the evolution of Italian capitalism from competitive to oligopolistic, from oligopolistic to mature. In this scenario, studying how ideas spread and grew into institutions, common wisdom and economic actions was essential. Diffusing and defending the variety of economic ideas became so, for Caffè, a vocational call. These the profound motivations of his activity as a propagator of economic thought. His effort proceeded over three channels: academia, trade unions and newspapers. He registered his main success in teaching. An entire generation of economists, public servants, journalists and managers absorbed his lesson of eclecticism transferring it in their own activities and workplaces. Among the economic actors of big business, big labour and big government, instead, Caffè could only testimony the permanence of old ideas, transformed in ideologies or cloak to material interests. Substituting Keynes to Einaudi or Marx in the economic policies and decisions of contemporaries appeared impossible. His articles, published by independent newspapers over decades, obtained a better receiving. Through them Caffè became, in the eyes of Italians, the critical conscience of Italy' economic and political life from reconstruction to the 1980s. He preached times and times again against a simplified and ideological lecture of Italy's past and present. He tried to imagine an alternative future, diffusing eclecticism and a critical knowledge of economic theory. As Jiminy Cricket his preaching remained largely unheeded, but the scarce results of his diffusing efforts did not discourage him. His writings would be part of future historiography, pointing at those possible civilizations that, ignored at present, could become reality in future.

6. Tables

Table 1. Non Italian economists quoted by Federico Caffè in academic and generic publications[1]

Quoted Author	*Generic writings published on:*	*Academic writings published on:*	*Sum*
	Il Messaggero (1974-1986) [2]; L'Ora (1983-1987)[3]; Il Manifesto (1978-1985)[4] trade-union journals[5]; Cronache Sociali (1947-1949) [6]; Others[7]	journals[8]; essays[9]; edited monographs and collective works[10]	
	TOTAL	TOTAL	
Keynes John M.	32	34	66
Hicks John R.	7	15	22
Schumpeter Joseph A.	3	15	18
Myrdal Gunnar	7	9	16
Robertson Dennis H.	5	11	16
Robinson Joan	6	10	16

[1] Every author has been counted once for every essay, even if quoted many times inside it. Every author has been counted once even if quoted only in adjective form (Keynesian, Schumpeterian, etc.).
[2] Data are taken from the collection of essays published as Caffè (2013).
[3] Data are taken from the collection of essays published as: Caffè (2013).
[4] Data are taken from articles republished in Caffè, 2007; Caffè, 2013; Amari and Rocchi (eds.), 2009.
[5] Data are taken from the articles published in "Sinistra '77", "Sinistra '78", "Lettere Sinistra '80", "Quaderni di Fabbrica e Stato", "Quaderni di Rassegna Sindacale", "Lettere di Fabbrica e Stato", "I consigli", "Rassegna Sindacale" and "Conquiste del lavoro" republished in Caffè, 2014.
[6] Data are taken from articles republished in Caffè, 2014.
[7] Articles, excluding the preceding, republished in Caffè, 2014; Amari and Rocchi (eds.), 2009.
[8] Articles published in "Economia Pubblica", "Economia Internazionale", "Rivista Internazionale di Scienze Economiche e Commerciali", republished in Caffè, 2014; and various articles republished in Amari and Rocchi (eds.), 2009.
[9] Essays republished in Caffè, 2014; Amari and Rocchi (eds.), 2009; and esaays published in "Giornale degli Economisti e Annali di Economia" between 1956 and 1983.
[10] In the case of collections of essays, the authors have been counted when quoted in the introduction by Federico Caffè and selected by Caffè to be part of the publication. The collections analysed have been: Caffè (ed.), 1979a; Caffè (ed.), 1968-1969; Caffè, 1962a; Caffè (ed.), 1975b; Caffè (ed.), 1970a; Caffè (ed.), 1956; Caffè (ed.) (1983d); Caffè (ed.) (1986a); Caffè (ed.) 1978d); Caffè (eds) (1970b). In cases of monographs introducted/translated by Federico Caffè the author has been counted.

Galbraith John K.	2	13	15
Samuelson Paul	4	11	15
Hayek Friedrich von	3	9	12
Tobin James	7	5	12
Kaldor Nicholas	1	10	11
Marshall Alfred	4	7	11
Meade James E.	4	7	11
Smith Adam	6	5	11
Tinbergen Jan	2	9	11
Marx Karl	4	6	10
Pigou Arthur C.	2	8	10
Kindleberger Charles P.	6	3	9
Ricardo David	5	4	9
Wicksell Knut	2	7	9
Friedman Milton	1	7	8
Harrod Roy	4	3	7
Leontief Wassily	2	5	7
Minsky Hyman P.	3	4	7
Robbins Lionel	1	6	7
Sweezy Paul	1	6	7
Baumol William J.	2	4	6
Frisch Ragnar		6	6
Volker Paul A.	5	1	6
Walras Léon	2	4	6
Balogh Thomas	2	3	5
Fisher Irving	1	4	5
Hansen Alvin H.	1	4	5
Kahn Richard	1	5	5
Kalecki Michael	1	5	5
Mill John S.	2	3	5
Scitovsky Tibor		5	5
Stigler George J.	2	3	5
Beveridge William H.	1	3	4
Haberler Gottfried	1	3	4
Klein Lawrence R.	2	2	4
Knight Frank		4	4
Lange Oskar		4	4
Malthus Thomas R.	2	2	4
Means Gardiner C.	1	3	4
Morgenstern Oskar		4	4
Ohlin Bertil	2	2	4
Patinkin Don		4	4

Schackle George L. S.	2	2	4
Triffin Robert	2	2	4
Wallich Henry C.	2	2	4
Arrow Kenneth J.		3	3
Baran Paul A.		3	3
Böhm-Bawerk Eugen von		3	3
Clark John M.		3	3
Dobb Maurice		3	3
Fellner William J.	1	2	3
Hotelling Harold		3	3
Johnson Harry G.	2	1	3
Lerner Abba P.		3	3
Little J. M. D.		3	3
Marchal André		3	3
Mitchell Wesley C.		3	3
Myint Hla		3	3
Robinson Austin	1	2	3
Rosenstein Rodan P. N.	1	2	3
Rothschild Kurt W.	1	2	3
Thurow Lester		3	3
Weintraub Sidney	1	2	3
Zeuthen Frederik		3	3
Bagehot Walter		2	2
Berle Adolf A.	1	1	2
Bergson Abram	1	1	2
Boulding Kenneth E.		2	2
Brunner Karl	2		2
Burchardt Fritz A.		2	2
Cairncross Alec		2	2
Cannan Edwin	1	1	2
Chamberlin Edward H.		2	2
Chenery Hollis B.	1	1	2
Clower Robert W.	2		2
Dorfman Robert		2	2
Greenspan Alan	2		2
Guitton Henri	1	1	2
Hahn Frank H.		2	2
Kapp Karl W.	1	1	2
Koopmans Tjalling C.		2	2
Kurihara Kenneth K.	2		2
Lekachman Robert		2	2

Leijonhufvud Axel		2	2
Lindbeck Assar		2	2
Machlup Fritz		2	2
Marris Robin L.	1	1	2
Marget A. W.		2	2
Martin Preston	2		2
Mises Ludwig von		2	2
O'Connor James		2	2
Offe Claus	1	1	2
Okun Arthur	1	1	2
Perroux Francois	1	1	2
Phelps Brown E. H.		2	2
Robson W. A.	2		2
Röpke Wilhelm		2	2
Say Jean B.		2	2
Sidgwick Henry		2	2
Sismondi Jean C. L.		2	2
Sombart Werner		2	2
Toynbee Arnold J.		2	2
Witteveen Hendrikus J.	2		2
Worswick Georg D. N.		2	2
Young Allyn	1	1	2

Table 2. Non Italian economists quoted once time by Federico Caffè in academic and generic publications[11]

Generic writings	Academic writings
Alchian Armen A.; Bartlett Bruce; Bastiat Frederic; Bonfenbrenner Martin; Burns Arthur; Child Josiah; Colander David C.; Corner Paul; Dantzig George B.; Davidson Paul; Dornbusch Rudiger; Fisher Stanley; Guthrie R. S.; Heller Wolfgang; Higgins Benjamin ; Hirsch Fred; Holland D.; Klein John J.; Kregel Jan A.; Kuenne Robert E.; Larosière Jacques De; Lundberg Erik; Luxemburg Rosa; Menger Carl; Meyers S.; Mueller Dennis C.; Olsen Ole J.; Pöhl Karl; Preiser Erich; Quandt Richard F.; Quesnay Francois; Ramey F. R.; Richardson Gordon; Rueff Jacques; Sayers Richard S.; Schove Gerald F.; Sen Amartya; Shubik Martin; Skidelsky Robert; Södersten Bo; Stone Richard; Swann Dennis; *Wieser Friedrich von; Wilkinson Frank;* Green David G.	Ayres Clarence E.; Bacon Robert; Bhagwati Jagdish N.; Balfour Campbell; Barre Raymond; Beckerman Wilfred; Begg David; Bergson Abram; Black J.; Blair J. M.; Bodenhorn Diran; Bousquet Georges H.; Bronfenbrenner Martin; Brown A. J.; Buchanan Norman; Cassel Gustav; Champernowne David G.; Clark John B.; Cole George D. H.; Colm Gerhard; Commons John R.; Crick F. W.; Cripps Francis; Debreu Gérard; Dewey John; Douglas Paul; Dupuit Jules; Eatwell John; Edgeworth F. Ysidro; Eltis Walter; Feiwel George R; Ferber Robert; Fraser Lindley M.; Frey Bruno S.; Gold Joseph; Gruchy Allan G.; Gurley John J.; Guyot Yves; Hawtrey Ralph G.; Hobson John A.; Holzman Franklyn D.; Hume David; Hunt Emery K.; James Emile; Johansen Leif; Juglar Clement; Kantorovič Leonid V.; Kaufmann Henry; Kornai Jànos; Quesnay Francois; Kuznets Simon; Lanzillotti Robert F.; Lavington Frederick; Maillet Pierre; Malinvaud Edmond; Mandelbaum Kurt; Marschak Jacob; Matthews Robin C.O.; McChesney Martin William; Meyer John R.; Miller Merton H.; Mishan Ezra J.; Moore Henry L.; Neumann John von; Noyes G. E.; Papandreu Andreas; Phillips J. D.; Prest A. R.; Reuther Walter; Robinson Derek; Rogin Leo; Ruggles Richard F.; Sampaio Alde; Scherman Howard J.; Schlesinger Karl; Schneider Erich; Schultz Henry; Schulze-Delitzsch Franz H.; Seligman Ben; Simon Henry; Simon Herbert A.; Steindl Josef; Stringher Bonaldo; Turvey Ralph; Vagemann Ernst; Veblen Thorstein; Viner Jacob; Vries F. de; *Wicksteed Philip H.;* Wolf Charles; Wojnilower A. M.; Wright Keneth M.; Schumacher Ernst F.

[11] Criteria of accounting correspond to those of Table 1.

Table 3. Italian economists quoted by Federico Caffè in academic and generic publications[12]

Quoted Author	Generic writings published on: Il Messaggero (1974-1986) [13]; L'Ora (1983-1987) [14]; Il Manifesto (1978-1985)[15] Trade-union journals[16]; Cronache Sociali (1947-1949) [17]; Others[18]	Academic writings published on: journals[19]; essays[20]; edited monographs and collective works[21]	Sum
Einaudi Luigi	19	18	37
Del Vecchio Gustavo	7	14	21
Ferrara Francesco	7	13	20
Demaria Giovanni	4	11	15
Sraffa Piero	7	6	13
Bresciani Turroni Costantino	6	5	11
Pareto Vilfredo	1	7	8
Sylos Labini Paolo	3	5	8
Nitti Francesco Saverio	4	3	7
Pantaleoni Maffeo		7	7

[12] Every author has been counted once for every essay, even if quoted many times inside it. Every author has been counted once even if quoted only in adjective form (Keynesian, Schumpeterian, etc.).
[13] Data are taken from the collection of essays published as Caffè (2013).
[14] Data are taken from the collection of essays published as Caffè (2013).
[15] Data are taken from articles republished in Caffè (2007; Caffè (2013); Amari and Rocchi (eds.) (2009).
[16] Data are taken from the articles published in "Sinistra '77", "Sinistra '78", "Lettere Sinistra '80", "Quaderni di Fabbrica e Stato", "Quaderni di Rassegna Sindacale", "Lettere di Fabbrica e Stato", "I consigli", "Rassegna Sindacale" and "Conquiste del lavoro" republished in Caffè (2014).
[17] Data are taken from articles republished in Caffè (2014).
[18] Articles, excluding the preceding, republished in Caffè (2014); Amari and Rocchi (eds.) (2009).
[19] Articles published in: "Economia Pubblica", "Economia Internazionale", "Rivista Internazionale di Scienze Economiche e Commerciali", republished in Caffè (2014); and various articles republished in Amari and Rocchi (eds.) (2009).
[20] Essays republished in Caffè (2017); Amari and Rocchi (eds.) (2009); and essays published in "Giornale degli Economisti e Annali di Economia" between 1956 and 1983.
[21] In the case of collections of essays, the authors have been counted when quoted in the introduction by Federico Caffè and selected by Caffè to be part of the publication. The collections analysed have been: Caffè (ed.) (1979a); Caffè (ed.) (1968-1969); Caffè (1962a); Caffè (ed.) (1975b); Caffè (ed.) (1970a); Caffè (ed.) (1956); Caffè (ed.) (1983d); Caffè (ed.) (1986a); Caffè (ed.) (1978e); Caffè (eds) (1970b). In cases of monographs introducted/translated by Federico Caffè the author has been counted.

Ciocca Pierluigi	5	1	6
Fuà Giorgio	3	3	6
Baffi Paolo	2	3	5
Breglia Alberto	2	3	5
Modigliani Franco	4	1	5
Tarantelli Ezio	4	1	5
Toniolo Gianni	4	1	5
Fanno Marco	1	3	4
Pesenti Antonio	2	2	4
Bachi Riccardo		3	3
Barone Enrico		3	3
De Cecco Marcello	1	2	3
Di Fenizio Ferdinando	3		3
La Malfa Giorgio	1	2	3
Lombardini Siro	1	2	3
Luzzatti Luigi	1	2	3
Masci Guglielmo		3	3
Ricci Umberto		3	3
Saraceno Pasquale	2	1	3
Amoroso Luigi		2	2
Amoroso Bruno	1	1	2
Barucci Piero	2		2
Bertolino Alberto	1	1	2
Damascelli Ester Fano	2		2
De Viti De Marco Antonio		2	2
Di Nardi Giuseppe		2	2
Ercolani Paolo	1	1	2
Filosa Renato	2		2
Foa Vittorio	2		2
Lunghini Giorgio	1	1	2
Menichella Donato	1	1	2
Milone Ferdinando		2	2
Mori Giorgio		2	2
Mortara Alberto	1	1	2
Papi Giuseppe Ugo		2	2
Pasinetti Luigi	1	1	2
Spaventa Luigi	1	1	2
Rossi Ragazzi Bruno	1	1	2
Vicarelli Fausto	1	1	2

Table 4. Italian economists quoted once by Federico Caffè in academic and generic publications[22]

Generic writings	Academic writings
Acocella Nicola; Beneduce Alberto; Biagiotti Tullio; Bordini Massimo; Cadeddu Alberto; Camapanella Francesco; Campilli Pietro; Campolongo Alberto; Carabelli Anna; Castellino Onorato; Cecchi Claudio; Ceriani Vieri; Cesarini Francesco; Corbino Epicarmo; Crivellini Marco; De Vecchi Nicolò; De Rita Giuseppe; Faucci Riccardo; Foriero Elsa; Galiani Ferdinando; Germano Giuseppe; Giavazzi Francesco; Graziani Augusto; Lepre Stefano; Maggi Bruno; Mantovani Enrico; Monti Mario; Niccoli Alberto; Onado Marco; Orlando Giuseppe; Osio Artuso; Parrinello Sergio; Pettenati Paolo; Proni Giovanni; Rampa Lorenzo; Ricciardelli Marina; Ricossa Sergio; Rienzi Emanuele; Sabbatucci Severini Patrizia; Sarcinelli Mario; Sella Quintino; Serpieri Arrigo; Sitzia Bruno; Socrate Francesca; Sori Ercole; Tattara Giuseppe; Trento Angelo; Tucci Gianrocco; Vaciago Giacomo; Valli Vittorio; Zamagni Stefano; Zamagni Vera	Andreatta Nino; Arena Celestino; Bagiotti Tullio; Baili Martiri Neil; Barbieri Gino; Boccardo Gerolamo; Castronovo Valerio; Cosciani Cesare; Cossa Luigi; D'Addario Raffaele; Dal Pane Luigi; D'Antonio Mariano; De Finetti Bruno; Demarco Domenico; Dominedò Valentino; Donati Antigono; Ellena Vittorio; Fasiani Mauro; Fontana Russo Luigi; Franco Giampiero; Fubini Guido; Gambino Amedeo; Gangemi Lello; Garino-Canina Attilo; Gera Giovanni; Gola Guglielmo; Jannacone Pasquale; Izzo Lucio; Lampertico Fedele; Lasorsa Giovanni; Livi Livio; Loria Achille; Luzzatto-Fegiz Pierpaolo; Martello Tullio; Mattioli Raffaele; Miraglia Luigi; Momigliano Franco; Montemartini Giovanni; Napoleoni Claudio; Occhiuto Antonino; Romani Franco; Romano Ruggiero; Rossi Alessandro; Rossi Lionello; Rota Giorgio; Salvati Mariuccia; Scialoja Antonio; Steve Sergio; Stringher Bonaldo; Villani Felice; Vito Francesco M.

[22] Criteria of accounting correspond to those of Table 3.

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G. & L. E. R., Vol. 18 No. 2, 2014

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FEDERICO CAFFE' AND THE THEORY-POLICY NEXUS IN A COMPLEX ENVIRONMENT

Abstract

The paper aims to assess Federico Caffè's contribution to economic thought in the light of developments that occurred after he left us. It focuses on economic policy in a complex environment. The first section discusses the dimensions of complexity: synchronic and diachronic complexity, and knowledge, i.e. the attempt to make sense of such forms of complexity.

The second section focuses on coordination. Relative prices are the typical coordinating instance in a capitalist market economy but institutions, whether spontaneous or purposively established, are just as important. While conventional economists view institutions as regulators of a predefined set of economic relations – typically, the market – an alternative view, which is more consistent with the above themes, is that institutions provide the framework and the background for the co-existence and co-evolution of sectional and collective interests. In so doing, institutions determine the relation between the economy and society.

The final section of the paper deals with the implications that this framework has for a proper understanding of how economic theory and economic policy relate. Any policy perspective must deal with two issues. First, how institutions are expected to frame the operation of relative prices. Second, which – economic and societal - institutions should be maintained and which should be made to change, and over what time range. Only through the interaction between moral value judgments –

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what we believe should be – and cognitive value judgments - what we believe can be – can we provide a means to adequately deal with complexity.
The concluding remarks link the above discussion to Federico Caffè. They point out that his attempt to found a theory of economic policy reflected a view of the economy that is consistent with complexity approaches.

JEL CLASSIFICATION: B4; B5; H1; K1
KEYWORDS: CAFFE'; COMPLEXITY; KNOWLEDGE; ECONOMIC POLICY; VALUE JUDGMENTS; COORDINATION; INSTITUTIONS.

1. Introduction

Federico Caffè was an important economist for many reasons. He was one of the scholars who introduced Keynesian thought in Italy. He actively took part in all major discussions concerning the evolution of international economic relations, the pattern of economic development in Italy and day by day issues in Italian economic policy from the end of WWII to the day he left us. He tutored a great many economists, some of whom eventually became influential scholars or major actors in the country's economic policy. Finally, he was a personal of extremely high moral standards.

While the above features suggest that he definitely was an important figure in Italy's recent history, they do not provide evidence that we still have something to learn from his work as a scholar, especially if we move away from Italian (academic) boundaries. Indeed, this view seems to be confirmed by a great deal of papers that remember him as a great scholar and a great man but do not provide a critical assessment of his approach[1].

This paper takes issue with these possible conclusions. It contends that Caffè significantly contributed to the establishment of a theory of economic policy. It does not aim to summarize the key tenets of Caffè's thought[2]. What it does aim to do is to show how his approach is consistent with a complexity-theoretic view of the economy. More specifically, it argues that his emphasis on Myrdal's methodological approach – whereby value judgments underlie all economic analysis – is consistent with a more general – ontological – view of the economy. This same view, the paper argues, accounts for a theory of economic policy that is at least to some extent scientifically autonomous from political economy. Finally, this ontological and methodological approach provides a solid explanation for his constant claim that no economic theory could ever be discarded and that an eclectic stance was inevitable.

Many of the issues discussed here have become central to scholarly discussions only in recent years so it would be inappropriate to claim that he adhered to the views expressed here. What the paper aims to do is to show

[1] This issue is pointed out in Ramazzotti (2012).
[2] The 2012 symposium on Caffè in the *History of Economic Ideas* provides a survey of his views.

that, in the light of these discussion, Caffè's work still provides interesting insights. It is a pity that these insights should be neglected and somewhat overshadowed by a rhetorical and superficial praise of his life.

The paper begins by discussing the dimensions of complexity. The first one is synchronic complexity: it has to do with the multiplicity of variables that interact in a non-simple way as a result of the systemic openness of the economy. The second one is diachronic complexity, i.e. the existence of cumulative quantitative processes that eventually lead to qualitative change. These two dimensions interact, so that it may be rather difficult to understand what is going to be the outcome of this sequential interaction within a cumulative process. The third relates to knowledge, i.e. the attempt to make sense of such a reality. Knowledge involves a higher order of complexity because it often consists in a sequential interaction of ideas within a cumulative learning process related to the complex reality above. Under these circumstances there is no a priori reason for economic actors to (understand how to) behave and interact in any specific way, nor can we say much about the pattern of evolution of the economy. What we do know is that different coordination mechanisms are at work and affect economic evolution in one way or another.

The second section of the paper focuses on coordination. Relative prices are the typical coordinating instance in a capitalist market economy. How they carry out this function, however, depends on the behavior of proactive economic actors. Furthermore, institutions, whether spontaneous or purposively established, are also important. These coordinating instances regulate how society achieves its material reproduction. Given the systemic openness of the economy, however, the material reproduction of society is strictly related to its social reproduction. While conventional economists view institutions as regulators of a predefined set of economic relations – typically, the market – an alternative view, which is more consistent with the above themes, is that institutions provide the framework and the background for the co-existence and co-evolution of sectional and collective interests. In so doing, they determine the relation between the economy and society.

The final section of the paper deals with the implications that this framework has for a proper understanding the specificity of economic policy and how it relates to economic theory. It contends that insofar as coordination of the economy occurs in such a varied way and interacts with the coordination of society, its evolution may follow many different paths, which depend on policy choices. Any policy perspective must deal with two issues. First, how institutions are expected to frame the operation of the economy. This reflects a moral value judgment concerning what priorities should be pursued, thus what variables should be identified, given the existence of synchronic complexity. Second, which – economic and societal - institutions should be maintained and which should be made to change, and over what time range. Here, too, value judgments are involved that depict the features diachronic complexity is going to have. It is fairly easy to acknowledge, here, the centrality of Myrdal's link between value judgments and economic inquiry.

Only when we properly address these issues is it possible to provide an outline of the economy's and society's evolution, and only when such an outline is available are choices actually possible. Such an approach involves that we can adequately deal with second-order (knowledge-related) complexity only if we appreciate the interdependence between moral value judgments – what we believe should be – and cognitive value judgments - what we believe can be.

The implication this has for the topic of this paper is that economic theory cannot precede economic policy: they are interdependent. This interdependence is of no minor import. It is at the core of Caffè's approach to economic policy and it allows us to appreciate his approach to scientific dialogue among different strands of economic thought.

2. Complexity

Complexity is a multi-faceted phenomenon. A detailed discussion of its characteristics lies beyond the scope of this paper. What I wish to point out is only some key features of complexity, along with their implications for economic analysis and economic policy.

One kind of complexity is synchronic. Simon (1981) described it as "many variables interacting in a non-simple way". The non-simple way often depends on changes in the way a variable interacts with others, so that the interaction can never be taken for granted. These changes may result from endogenous processes that lead to the emergence of new variables or new patterns of interaction. I will get back to these when I discuss diachronic complexity.

The "non-simple way" may also depend on systemic openness (Boulding 1956; Georgescu-Roegen 1976; Kapp 1976; Chick 2004). An open system is one that interacts with its surrounding environment. The very notion of openness means that this type of interaction is not given once and for all. If the interaction was knowable, the variables involved would also be knowable, thus also the boundaries of the system. Openness would be a misnomer for inadequately defined boundaries, i.e. for a description that excludes at least one of the known variables.

Openness means that we do not know the actual boundaries of the system. We may resort to heuristics but whatever boundaries we choose to delimit the subject of our inquiry are based on a discretional decision. This means that there may always be something we do not take into account that may be relevant. It also means that we may take account of variables in an inadequate way, that is, by identifying incomplete forms of interaction. This problem is accentuated by changes that may occur over time: What is irrelevant now may become relevant at some time in the future.

Examples of how openness manifests itself abound. Consider the expansion of markets for petroleum as this commodity became a key energy input for transports, for electricity and for heating, thereby changing the extension of markets around the world. Similarly, the establishment of the welfare state changed the boundaries of private markets and of the economy as a whole insofar as it determined the provision of specific services according to non-market criteria. Similarly, the narrowing down of its role determined new boundaries for private markets while it changed the real income available to broad sections of society.

Changes such as these affect relative prices but also the balance of power within society. A new industry such as the oil industry leads to the insurgence of vested interests in the exporting as well as in the importing countries. It is likely to affect the political regimes of the countries involved, either by empowering those vested interests within those countries or subjecting those countries to the economic and political will of foreign vested interests. These changes feed back on the cultural and religious values of the populations, sometimes determining radical changes in the polity, in international relations, in the balance between both domestic and international power groups[3]. As we look at these historical processes, we are obliged to acknowledge that they affect the economic performance of the oil market, of a great many other markets, of trends in growth and in income distribution, etc.

The examples of synchronic complexity suggest that variables that were of minor relevance at some point in time subsequently became more relevant. If we focus on the historicity of the outlined processes, those same examples allow us to understand another kind of complexity: diachronic complexity. Consider a cumulative causation process, one that is reinforced by positive feedbacks. It may eventually converge towards some orderly situation. Alternatively, the cumulativeness of the process may be such that it eventually undermines itself, thereby leading to qualitative, as well as quantitative, changes. They emerge as phenomena that are different from the past to the point that they could not have been described beforehand. Consider the oil shocks of the 1970s, the fall of the Berlin Wall, the 9/11 attack on the Twin Towers, the financial and economic crisis that began in 2007-2008. These changes, which are accounted for in some way or another once they have occurred, often come as a surprise when they happen. The processes that determine them may possibly be understood, and someone may even realize that something is bound to happen as a result. The nature of the change, however, is often difficult to predict. Examples of this type of cumulative processes include hyperinflation, core-periphery relations within and among countries, different rates of innovation and growth among industries.

The distinction between synchronic and diachronic complexity is useful on conceptual grounds but, as the examples show, the two types of complexity are interdependent in the real world. This issue was pointed out years ago by authors such as Karl William Kapp and Karl Polanyi. Kapp (1976) described evolution by stressing that systemic openness involved sequential interaction within a cumulative process. Polanyi (1944) pointed

[3] The Iranian Revolution, the recent insurgence of Islamic radicalism and the wars associated to these circumstances are evidence of the issues here discussed.

out that the material reproduction of society, that is, the provisioning process, could not be delinked from the social reproduction of society: There had to be some degree of coherence between economic rules and social values[4].

Under the above circumstances how can we explain economic change? Doubtless, the issues discussed above provide an explanation. It is a very broad explanation, however, which may give the impression that it is difficult, when not impossible, to make any further qualifications. Indeed, if the term "explanation" refers to a fairly accurate description of the economy and of how it evolves a range of problems arise. First of all, what does the economy consist of? Is it the market as it is described by standard microeconomics textbooks? Is it the market plus government agencies and, perhaps, nonprofit organizations? Does it include the unions, lobbies, political parties, religious organizations? The systemic openness of the economy implies that we cannot trace a once and for all boundary. It also suggests that when we do trace a boundary – possibly because we choose to focus on a specific issue - we are not only leaving some variables out of our inquiry. We are assuming away possible interactions between what we include and what we leave out.

Similar considerations apply with regard to time. If we focus on the short run and neglect the long run, we implicitly assume that the short run and the long run are – at least to some extent -independent of each other, so that we can disregard the latter and infer the future from the present. The disillusion of the end of the century's Great Moderation is there to show how this can happen. Focus on the long run, in turn, may give the impression that, no matter what we do, we cannot change historical trends. The claim that we can focus exclusively either on the short run or on the long run depends on the implicit assumption that, since a range of variables appeared to be either irrelevant or constant over time, they are destined to remain like that in the future, so that they can be neglected for simplicity's sake. Just as with the economy, we are faced with a boundary issue: What does "short (or long) run" mean?

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[4] The absence of such a coherence not only determined what Polanyi termed "the double movement". It eventually caused a qualitative change in the setup of society: Fascism.

Economic actors need to make sense of what occurs in the economy. Given their different perspectives, they are likely to formulate different assumptions with regard to the boundaries of the economy and the appropriate time range. Their outlooks depend on what they are concerned with, thus on what they focus on. Since they are not substantively rational (Simon 1976), they must rely on their partial outlooks on reality. The ensuing variety of explanations and decisions reflects and accentuates radical uncertainty, with all the implications pointed out by Keynes (1936, 1937) and Post Keynesians.

Economic scholars try to make sense of reality in much the same way as other actors. Since everything is connected to everything else and they are unable to grasp everything, they must decide what they intend to focus on, i.e. what boundaries they wish to draw. They cannot rely on a "correct" method to deal with what they do not know. In order to select such a method out of those that are available they would require a meta-method, which in turn would have to be selected by means of a meta-meta-method, and so on. A scientific community may agree on what the appropriate criteria are but this does not mean that the criteria are objective. Scholars, in their attempt to provide a coherent picture of the economy, are bound by uncertainty much like other actors.

In order to deal with these problems scholars must resort to heuristics and/or conventions (Newell, Shaw, Simon 1958). These methods tend to evolve over time. They change because reality changes and because individual experience evolves. Scholars must deal with "real" complexity by resorting to concepts and criteria that may be more or less extensive: for instance, they must define the economy in some way or other. These concepts and learning criteria feed back on previous knowledge, thereby determining a cumulative learning process which may well question the concepts accepted until that moment and lead to the emergence of new perspectives, involving new concepts and criteria. Learning, much like the reality it draws upon, may consist in sequential interaction (of ideas and criteria) within a cumulative learning process[5] that relates to a complex

[5] This need in no way mean that the process is incremental. A new perspective may well draw on all that has been known until that moment but the redefinition of key concepts and criteria may involve discontinuity in knowledge, that is a Kuhnian change of paradigm.

reality. In other terms, knowledge involves what Delorme (1998; 2010) refers to as second order complexity.

If we acknowledge that human behavior is not merely adaptive but proactive, a further dimension of complexity ensues. Actors try to change the environment to their advantage. There surely are instances where they – or the outcomes of their actions – are selected by the external environment (Metcalfe 1998). There are other instances where they generate new knowledge (e.g. technological knowledge), establish new bargaining relations (e.g. between employers and workers), introduce new organizational setups (e.g. through international outsourcing), lobby for different legal-economic nexuses, etc. in order to change its selection procedures.

This brief outline of the key features of complexity raises the issue whether, and to what extent, there is a way to coordinate such a complex environment, possibly attaining order out of chaos. This is the topic of the next section.

3. Coordination

Relative prices associated to contracted exchange are generally considered the typical coordinating instance in a capitalist market economy. This claim needs to be qualified, however. It is fairly easy to acknowledge that the economies we live in are indeed coordinated by prices but also by a range of institutions, i.e. rules. The role that institutions play remains an open issue among economists. New Institutionalists – I refer, here to Coase (1937; 1960; 1988) and Williamson (1975; 1993; 1994; 2000), just to mention the most prominent scholars within this school of thought – point out that the market operates in a relatively costly fashion, whereby it is possible to devise institutions that reduce those costs. Institutions therefore may allow a relatively more efficient allocation of resources, where efficiency is cost-effectiveness.

"Efficiency" as cost-effectiveness should not be confused with overall (Paretian) allocative efficiency. Cost-effectiveness only means that a single actor can reduce her costs. For instance, firm A may do away with R&D-related transaction costs by taking over a company – firm B - that carries out

R&D. While this is convenient for firm A, it restricts the scope of the market. The R&D output may be a commodity that firm B does not sell to the highest bidder. The transactions that are carried out within the resulting firm (A + B) are likely to keep the technological knowledge that firm B generates within its boundaries. Indeed, firm (A + B) will avoid disclosing what presumably provides it with a competitive advantage. Although firm (A + B) will presumably take advantage of the new technology, there need be no reason for it to be the one who brings out all of its potential. Furthermore, following the takeover, firm (A + B) may have little incentive to innovate since it can outcompete other firms through lower transaction costs, without any need to focus on a nevertheless risky qualitative upgrading of its products and/or production processes. It may remain competitive, but in the context of a "low road" to development (Sengenberger, Pyke 1992; Milberg, Houston 2005).

The above considerations apply even if we accept the (mostly implicit and rather unrealistic) assumption that markets are impersonal. As we saw in the section on complexity, however, actors do not merely react to prices. They purposively interact through rivalry, cooperation, imitation, predation. These types of interaction result from strategies that have less to do with abiding by the constraints of relative prices than with acting upon market relations in order to direct them towards their specific goals. As a result they preclude the competitive environment where relative prices ought to carry out their coordinating role. Indeed, the firms who act this way affect the decisions of other actors, so that they exert a coordinating action which cannot be separated from other market relations. This effect is, obviously, greater as their size increases.

An important implication is that the market is not independent of the action of the firms. It may well operate as a selection mechanism but the nature of such a selection depends on the action of those very firms who should be selected (Ramazzotti, Rangone 2002). Furthermore, the market does not provide an independent terms of reference to assess whether what firms do is efficient or not for the economy as a whole. Both the distinction between the market and institutions and the distinction between efficiency-centered and strategizing behavior turn out to be impracticable, under these circumstances.

While the Coase-Williamson tradition focuses on institutions that make up for the inefficiency of the market, North (1990; 2005) focused on extra-economic institutions such as, for instance, religion. It is these institutions that may be a major cause of inefficiency in terms of low rates of growth. The reason is that they may provide behavioral rules that preclude maximizing behavior. Since these institutions are strongly related to beliefs, changing them is not an easy task.

Both of these accounts of the role of institutions assume that the market is the logical point of departure for any inquiry. Institutions may increase or reduce its efficiency and this is how their economic relevance is assessed. An alternative strand of thought, centered on Original Institutional Economics, denies this centrality of the market. It argues that, historically, not all types of economy have been coordinated through contracted exchange and the relative prices that it leads to. Quite to the contrary, since all economies are a sub-system of society, they are all regulated in one way or another. They all need some kind of institutional setup to coordinate activities, with or without the concurrent action of relative prices (Polanyi 1957).

Following this perspective, let us consider the economy we live in. No price system may exist unless it is backed up by a set of rules that allow it to function (Schmid 1987; Bromley 1989; Samuels, Schmid, Shaffer 1994; Samuels, Schmid. 1997). Property rights need to be assigned, appropriate behavior – hence, also misbehavior – among actors must be defined, possible sanctions must also be identified, and some organization has to inflict those sanctions. Furthermore, the very extension of coordination by relative prices has to be decided. For instance, human beings as well as parts of their bodies may or may not be subject to contracted exchange.

The above institutions require some ethical system to exist, i.e. criteria that determine how they are to regulate (economic) activity. For instance, the assignment of property rights may be based on efficiency criteria – however defined – but also on distributional equity. The organization of production may depend on what is most profitable but other criteria may hold. They may complement or constrain profit: Consider the protection of human rights as they appear in a range of important charters such as the Universal Declaration of Human Rights. The extension of the price mechanism may depend on the importance assigned to alternative criteria in the production and distribution of resources, as in the case of the welfare state.

There would seem to be a common ground for discussion between those New Institutionalist scholars who, like North, emphasize the importance of beliefs – and, more generally, mental models (Denzau, North 1994; North 2005) – and Original Institutionalist scholars who stress the relevance of ethics. Indeed, these appear to be different ways to look at the same phenomenon (Dequech 2002). What beliefs, ethics and institutions in general imply for the functioning of the market should be clearly stated, however. They determine rights for someone, thus duties for someone else. They determine the choice sets of economic actors, thus what they can do and what they cannot do. Ultimately, they determine "who may do what to whom" (Bromley 1989: 49).

Here, too, it is inappropriate to consider the market as a given terms of reference. Different institutions determine different relative prices. Granted that some type of efficiency is the goal, it can be assessed only in terms of the existing set of relative prices. It is not possible to compare the efficiency associated to one set of relative prices with the efficiency associated to another set.

Let us move a step further. Following the discussion in the section on complexity, the market has to be conceived of as a part of a broader economic system, which in turn is part of society as a whole. This means that the economy does not just reflect the institutional setup determined by society. It also feeds back, thereby affecting society and how it changes over time. The output produced, the techniques used, the labor relations established: These and other circumstances affect the organization of society, how it functions and how it pursues both its economic and not economic ends. Thus, how people work – the number of hours, the stress, the safety conditions – as well as the income they receive, affects how they live in general, how they take part in other dimensions of their societal life, how they understand the world that surrounds them and that they are a part of (Scott 1995; Dequech 2014). This understanding, in turn, feeds back on how people deal with that world, i.e. the extent to which they (intend to) accept it as it is or, alternatively, attempt to change part or all of it. Ultimately, it affects the way they contribute to the formation of the institutions that guide their lives (Hodgson 2002).

This leads us to the conclusion that the beliefs people have, their understanding of the world they live in and the ethics that derives from this understanding affect how people behave, what they choose and how they go about doing it. Knowledge in this broad sense is as much a coordinating instance as the ones mentioned above. It is not independent of them, however. In so far as advertisements – just to mention a fairly intuitive case – do not merely inform but exert their power of suggestion, they act upon the perception that people have of (sections of) reality and, consequently, the interpretations and explanations they subsequently elaborate.

Summing up, there are various coordinating instances that act upon the economy and the society it is a part of. Their nature is such that the distinction between the notion of price-centered coordination, as it is used in conventional theory, and non-price-centered regulation fades away: the two are intermingled. To some extent, this accounts for the complexity described in the first section of this paper. On the other hand, owing to some balance of power or convergence of interests, some dominant institutions may emerge and ensure an order out of what would otherwise be total chaos. This may account for the persistence of the institutional setup that is generally labeled "capitalism". It may also account for the persistence, within capitalism, of periods of relative stability.

The final coordinating instance we need to focus on is government action. Given the above discussion on complexity and coordination, two issues should be pointed out. First, it is not possible to discuss public policy with regard to "market failures". Aside from the inconsistency of such a concept – whereby it is reality that fails to meet the requirements of theory, not the other way round – the term is misleading in that coordination does not occur through the price system alone. It occurs in a varied way, which need not lead to any specific outcome. On the other hand, just as firms try to influence the way that economic actors interact, so may the government. The second issue is that, whatever the ends government action pursues, policy makers must somehow make sense of a complex environment. These issues are discussed in the section that follows.

4. Purposive action

The discussion of complexity and of coordination leads to the conclusion that there is no general law that we can rely on when we try to describe the economy and the society we live in. The attempt to somehow regulate or direct the evolution of the economy is just as problematic. This does not mean that the conclusions lead us nowhere, however. They simply tell us that no mechanistic description or policy is available (Sotolongo 2004).

One key point that arises from the discussion is that coordination is a contested process: Different economic actors try to direct the economy in one way or other. Traditionally, the main actors in this process are big business and big government but trade unions, consumers' associations, religious groups, etc, may all take part in the process. They may do so through their strictly economic choices. They may act in order to change the rules that regulate those economic choices. They may act in order to change the understanding of the economy and the society that those rules frame.

These actions need not lead to the outcome that the actor expects. Most often the consequences are unintended. The savings paradox is a typical example that relates to strictly economic choices. The rules underlying the Eurosystem are an example of an institutional framework which has led to undesired as well unintended consequences. As for the unintended consequences of a misleading representation of the economy, Alan Greenspan's acknowledgement that he simply did not understand how the evolution of American financial institutions would have eventually led to the 2007-8 crisis is probably an appropriate example.

This contested coordinating process does not occur within the disciplining context of an ideal market. Actors choose their strategies in relation to what other actors do but there is no equilibrating mechanism. Under these circumstances, even if information was complete, there would be no once and for all algorithm they could use to make their decisions.

The pursuit of individual payoffs need not be consistent with collective goals. Although institutions consist in enabling constraints for economic actors, it is in the interest of at least some of these actors to try to change them: The evolution of financial markets in the USA over the past decades is a case in point (Varoufakis 2011). Institutions and the structure of knowledge provide for some stability in the economy because they usually tend to change slowly. While this does not mean that we can rely on economic laws, it does suggest that the economist's toolbox may provide insights. Given the complexity of the economy, these insights may not lead to a full fledged theory but they may reduce the degree of uncertainty that any policy decision involves.

This leads us to a second key point: the pervasive nature of uncertainty. The denial of a mechanistic account of how the economy works suggests that, as a general rule, policy cannot consist in switching a structural model of the economy into its inverse reduced form. It is hardly possible to identify the value that instrumental variables must have in order to achieve a given policy goal.

This difficulty arises because any (structural) model is an approximation not only in the sense that it abstracts from trivial issues, i.e. issues that are not important for a correct understanding of a core issue. It is an approximation because – owing to complexity - it cannot definitely distinguish core issues from trivial ones[6]. The gap between a model and reality is not filled with more information. It requires greater understanding. Contrary to what is likely to occur in a closed system, uncertainty does not necessarily fall as you increase the available information. Uncertainty may increase because the new information suggests that aspects of the core issue were not taken account of. The decisions concerning the boundaries, the heuristics and the time devoted to the inquiry may prove to be inappropriate, thereby undermining the previous understanding.

The open-ended process described here raises two issues. First, what direction should public policy pursue? Second, how can policy makers choose the appropriate policy in such a context of uncertainty? As far as the first one is concerned, I already pointed out that, contrary to conventional views, policy is not constrained by "the market", viewed as a coordinating mechanism centered on relative prices. It is constrained by the uncertainty associated to the unpredictable conduct of other actors and to the patterns of

[6] Following Musgrave's (1981) taxonomy, it is not possible to properly distinguish between "domain" and "heuristic" assumptions.

change this conduct may determine. Policy has to cope with actors who contrast any measure that clashes with their, actual and potential, vested interests. Some type of appropriate regulation is called for. From this perspective, policy cannot be envisaged as a set of fixed institutions and incentives that allow the market to operate successfully, thereby making economic actors behave in a desired fashion. Rather, it is a continuous process where vested interests try to contrast public action, thereby forcing government to counter-react, only to be followed by a new reaction, etc..

Policy must reduce the uncertainty of the economy as a whole. Examples include: the 2012 statement by the president of the ECB that the Bank would do "whatever it takes" to avoid the collapse of the Eurosystem; a regulation of the financial system to avoid it from becoming "the by-product of the activities of a casino"; appropriate information to avoid the Richardson paradox whereby nobody invests in some potentially profitable business because everybody expects others to do so, thereby reducing its potential profitability.

Policy is also constrained by societal values. Owing to the systemic openness of the economy, the material reproduction of society that it is supposed to ensure cannot be separated from the social reproduction of society. The rules underlying the economy must be compatible with extra-economic values that transcend it. It is up to policy makers to decide which ones should be given a priority.

Despite these constraints, there is a broad range of policy perspectives that governments can choose from. Which one they do choose depends on the ultimate end that they pursue. Examples of such ends include Sen's ((2000) "development as freedom", Layard's (2005) and Kahneman's (Kahneman, Wakker, Sarin 1997; Kahneman 1999) notion of happiness, the forceful establishment of the institutions required for a liberal market (Foucault 2004; Brown 2005; Ramazzotti 2014) or the straightforward protection of some vested interest. Choosing among these and other options obviously involves what I refer to as a moral value judgment: deciding how the economy and society should be, i.e. what values should be assigned a priority.

Let us now consider the second issue. The systemic openness of the economy and of society makes it extremely difficult to describe how they function[7]. It is impossible to describe everything, but drawing boundaries involves cutting out potential explanatory variables. Investigating only up to some point in time before taking a decision over what to do is inevitable. It may nonetheless lead to an inadequate description/explanation of a given situation. It is generally necessary to investigate unknown phenomena by resorting to heuristics. These may fit the phenomena only to some extent.

Decisions concerning boundaries, the time devoted to the inquiry, and heuristics involve a discretionary assessment over what the best way to carry out the inquiry is. Such an assessment is usually based on the questions underlying the inquiry, which cannot be taken for granted in a systemically open economy. They include the ultimate end pursued and the related moral value judgment. They also include another type of value judgment, which has to do with the general idea one has of how the economy is and of how it should be investigated. This is what I refer to as a cognitive value judgment: a decision concerning how we believe the economy and society operate.

The above process occurs in the midst of uncertainty because of the difficulty all actors have in making sense of the economy's performance but also because actors pursue their different, and sometimes divergent, goals in the absence of a constraining mechanism such as the market, as it is conceived of by conventional theories. This implies, however, that the market does not constrain public policy either. Thus, as Caffè insistently argued, there is no a priori reason to reject policies that are usually considered inconsistent with the functioning of the market: price controls, protectionism, nationalizations and government-owned companies.

5. Concluding remarks

Scholars and policy makers who believe that you need a clear-cut, and possibly deterministic, theory of how the economy works may conclude from the above discussion that all policies are doomed to failure because of

[7] "An open system is one where not all of the constituent variables and structural relationships are known or knowable, and thus the boundaries of the system are not known or knowable. […] an open system can be segmented into subsystems which can be approximated to closed systems for partial analysis, but which are always open organically to influences from other parts of the overall system." (Dow 1996, p. 14)

no such theory exists. Quite to the contrary, the conclusion is that policy makers should free themselves of the bounds that a simplistic view of the economy suggests. By simplistic view I refer to the belief that there is an automatism that coordinates the conduct of economic actors. The complexity of the economy depends on the co-existence of diverse, and sometimes inconsistent, coordinating instances. This results in economic and social outcomes that most often reflect the predominant role of sectional - vested – interests. It also results in a difficulty – for all actors - to single out a pattern of behavior and performance of the economy, i.e. to formulate reliable expectations about the future.

The policy implications are that the pursuit of some sort of social welfare implies dealing with the strategies of the sectional interests as well as reducing the degree of uncertainty in the economy. The actual policies, however, cannot be devised in the conventional way, which consists in taking a model from political economy and identifying the appropriate objective and instrumental variables. The reason for this is that an important gap exists between any model and historical reality. The gap depends on the impossibility, in a complex environment, to identify all the relevant variables and interactions.

The gap between all attempts to theorize the economy and the historical specificity of that very economy is a major theme in all of Caffè's work. He is less concerned with the internal inconsistencies of specific approaches than with the mechanical conclusions that scholars and policy makers draw from theory, to the neglect of the actual state of affairs.

It is in this complex environment that policy makers must formulate a decision concerning what the problems are. This involves asking whether a change is possible that solves those problems. In turn, this leads to the use of the economist's toolbox in order to frame the problems in an account of how the economy is working. The resulting account of the economy allows the policy maker to assess the original problems in the light of what appears to be possible. The assessment is the starting point for a recursive process which eventually will allow the policy maker to formulate an educated guess over what to do.

Identifying the problems in terms of their importance and of the presumption that there must be some way to deal with them involves the value judgments that Myrdal pointed out. When Caffè recalled Keynes' notion of a possible civilization and his ethical points of reference he was stressing the relevance of value judgments in much the same way.

Emphasis on these ethical points of reference should allow us to understand another important aspect of his approach. Caffè is aware of the shortcomings of actual markets as well as of the shortcomings of economic policy. He does not consider these two issues as symmetric. In his view, economic policy is not just a means to deal with market failures. It is a means to pursue a humane society. Whatever the shortcomings of economic policy may be, they cannot lead to the conclusion that we should rely on markets. Market goals and societal ends are not, and cannot be, on the same standing.

The above reference to the economist's toolbox is another important issue that allows us to discuss Caffè's approach. Given the complexity of the economy, there is no way to grasp all of the latter's features. All theories provide partial views. This involves that the theories we choose to rely on may prevent us from identifying specific issues. It also involves that theoretical approaches that we deem less relevant than the ones we rely on may provide important insights. This leads Caffè to deny that we can draw a distinction between correct and incorrect theoretical approaches. It also makes him stress that eclecticism and intellectual tolerance are inevitable.

The impossibility to rely on a theory that proves to be valid once and for all leads Caffè to conceive of economic policy as a discipline in its own right rather than as a mere deduction from economics. Its autonomy derives from the explicit ends that it focuses on, which need not be restricted to specifically economic ones. This leads to another type of autonomy, which consists in relying on available economic knowledge as a toolbox rather than as a consistent framework that can be mechanically applied to reality.

This paper is an attempt to discuss Caffè in terms of the relevance that his approach to economic policy may have today. I do not intend to provide definite conclusions. I do hope that the issues the paper raises will contribute to further discussions about Caffè's views on economic policy and will avoid the oblivion that an affectionate reference to his human features prefigures.

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G. & L. E. R., Vol. 18 No. 2, 2014

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THE REFORMISM OF FEDERICO CAFFÈ

Abstract

This paper is the testimony of one of the many pupils of Federico Caffè on the centenary of his birth. It contains fragments of the "story" of the man, the professor, the economist and the intellectual and it is addressed to those who did not have the opportunity to know him personally, though he was well-known to many people through his newspaper articles. The author remembers him as a man, with "an extraordinarily expressive face showing his intelligence, irony and melancholy" and, as both a professor and a man, with a particular "ability to understand other people's points of view", which proved to be very important in the student protests that were very heated at times. The author also recalls that, as an economist, he "contributed significantly to the recognition of economic policy as an independent discipline rigorously anchored to economic theory" (see Acocella's paper in this volume). Lastly, the author outlines the cultural content that distinguishes the intellectual's reformism, which he repeatedly proposed in his writings and the author likes to define as "radical". It is an "excellent synthesis of ethics, economics and history", which as Caffè wrote, offers "a vision of the world that gives mankind responsibility for social improvement".

JEL CLASSIFICATION: B52; H11
KEYWORDS: FEDERICO CAFFÈ, NEOLIBERALISM, REFORMISM

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1. Introduction

I accepted the invitation to make a contribution to this special issue dedicated to Federico Caffè on the anniversary of his birth with great enthusiasm, but also with some trepidation. It is, in fact, one of those occasions, which so far have not been rare, but will become increasingly so in the future as age begins to take its toll, when we pupils are given the opportunity to "tell the story of our Mentor, especially to the younger generations who did not know him as a professor or writer of newspaper articles. Enthusiasm for the possibility to fulfil this task, but also some concern about not doing it adequately or, perhaps repeating things that have already been written about him by myself or with others[1]. I find comfort in the knowledge that in other authoritative seats Caffè's centenary has been celebrated by defining his academic work[2]. And here I would like to mention the "Federico Caffè Lectures" that are organized each year by the Department of Economics and Law at the Sapienza University of Rome in conjunction with the Bank of Italy and given by prestigious foreign and Italian scholars; some of these Lectures have been published by the Cambridge University Press.

I decided this occasion was the right time to propose once again, in the light of new readings and in particular an anthology of newspaper articles competently and generously completed by Giuseppe Amari[3], my thoughts on a text from Caffé's work as an economist and intellectual that I believe to be very important. This text is the preface to one of his traditional collections of academic papers which he published in books in order to reach a wider audience. I have already described elsewhere this preface as his cultural will (Tiberi 1997, p. 137), memorable for its brief and penetrating content, for its inclusion in a work with a clearly emblematic title in a period dominated by

[1] Cfr., for example, Tiberi (2001 e 2012); Acocella, Rey, Tiberi (1998) and Acocella, Tiberi (2014).
[2] Last year a conference was organized by Piero Roggi and Monika Poettinger in Florence and later another meeting was held at the University of Rome 2, which has named the Faculty of Economics and also the School of Economics and Business Studies after him. It is also a pleasure to mention the book edited by Ciocca and De Cecco which closes a series on economists from Abruzzo; cfr. Caffè (2014b).
[3] Cfr. Caffè (2013, 2014a) Previous collections can be found in Caffè (1990, 2007). Luigi Einaudi wrote, "Popularization is noble", as Caffé himself remembered and honoured that statement with extensive unpaid journalistic work. In a certain sense, Caffè's interest in translations, both of his and our work, can be included in this area.

the neoliberal approach and its timing, just before the onset of his depression deprived him of the will and ability to write[4].

2. Fragments of his life

Before developing this point further, I would like to recall some other aspects of his personality that come to mind from the many memories I have of my long association with him, even though it dates back many years. He has often been described as a great man, even though he was physically very small. But he had a distinctive and extraordinarily expressive face showing his intelligence, irony and melancholy.

Caffè was really a great man, very generous, especially with his family, as well as his students and pupils. At the same time he expected his pupils to show intellectual rigour, commitment, ability to analyse deeply, creativity and, above all, a taste for systematic doubt, because "compulsory pre-constituted pathways of investigation are dangerous for those who are taking their first steps in research" (Caffè 1986, p. 9).

Caffè was not a practising Catholic. "His prodigious humanistic knowledge was based, to use Gramsci's expression, on a kind of "absolute historicism", with which to look upon the things of the world without providentialism or metaphysical determinism" (Tiberi 1997, p. 133).

However, he led what has been described as a Franciscan life style and, indeed, he liked to recall the evangelical image of "the breaking of bread for the disciples" when talking about his role as teacher and writer. And he may even have made a sincere search for comfort in religion in the critical moments of his life.

Caffè was a great teacher; he prepared his lectures meticulously and delivered them in a warm baritone voice, transmitting both values and techniques with great objectivity. His oral exams were conducted with an inimitable ability for dialogue with the examinees and was scrupulous and stimulating as thesis supervisor.

His help and support was almost legendary, though there may be some former students somewhere in the world who have experienced his outbursts of anger, which he himself admitted was his uncontrollable capital sin, or still bear the metaphorical signs of his scathing misogyny.

[4]Cfr. Caffè (1986, pp. 7-11). A second edition of this work has been published recently, see Ramazzotti (2014).

The aspect that was most striking in this continuous open dialogue was his ability to understand other people's points of view. He was helped in this by his belief that "there is no violence without suffering", as well as his indignation "at the idea that a whole generation of young people should think they were been born at the wrong time and have to accept job insecurity as inevitable" (Caffè 1990, p. 209).

Caffè was a great economist, having contributed significantly to the recognition of economic policy as an independent discipline rigorously anchored to economic theory; only then, in fact, could one assert "a vision of the world that gives mankind responsibility for social improvement" (Caffè 1986, p. 10). He was also a great intellectual, not only because of the wealth of his humanistic and musical knowledge, but also because he advocated a global view of "a higher type of society". Nominalistic debates, such as "the overcoming of capitalism", that have always engaged precious intellectual and political energy in Italy and elsewhere, irritated him. But we should not be puzzled by the vagueness surrounding the idea of "a higher type of society". Caffè himself gives us a concrete example of the concept when he talks about small farmers in 'his' Abruzzo who could at long last travel by bus and no longer needed to walk barefoot to save their shoes or could use health services at the new hospital of Atri[5].

3. The contents of his reformism

He was well aware of the complexity of modern day capitalism dominated by transnational firms and financial intermediaries. He went so far as to demand, in defence of small, inexpert savers, "… an informative work to illustrate and document the deceptive or fraudulent nature of promises (to which they were exposed) of large earnings and the rapid multiplication of their possessions" (Amari, Rocchi 2007, p. 252). In view of this complexity, he preferred, however, an "unrepentant stopgap" policy than the, perhaps fanciful, wait of those in favour of "a radical transformation of the system" (Caffè 1990, p. 3).

Caffè was, therefore, a bearer of a reformist conception which was based on the following "fixed points":

[5]Cfr. Tarantini (1985, pp. 153-60). In this rare interview, Caffè did not fail to recall, in line with a 19th century Italian economist, "the only form of redistribution that we can create are social services".

"an economic policy that does not exclude from its possible instruments checks conditioning individuals' choices, that considers as irrevocable the objectives of egalitarianism and assistance, usually epitomised in the State as guarantor of social wellbeing, and that entrusts the state with a fundamental role in economic management" (Caffè 1986, p. 7).

Caffè, more than others, managed to remain loyal to the same ideas, even when the overwhelming success of neoliberalism was disorienting reformists both politically and culturally from the 1980s onwards. At that time he was one of the few, if not the only one, to show actively that neoliberalism, at least as far as the economists' contributions were concerned, re-proposed a dated and apologetic conception of the "market", which had finally been re-evaluated, if not discredited, in the work of great scholars, as well as by historical experience[6].

A consolidated awareness of 'the numerous flowers in the economist's garden' can explain the resoluteness, marked at times by bitterness and at times by impatience, with which Caffè systematically responded to supporters of neoliberal positions that were presented as "undisputed truths" or "conventional wisdom"[7].

And it is through his important institutional positions as advisor that he acquired a deep understanding of real capitalism, which, in his opinion, confirmed Keynes's illuminating statement, "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes" (Keynes 1973, p. 372).

As far as the question of employment was concerned, Caffè observed that historical capitalism is different from ideal capitalism. He shared the opinion of Joan Robinson and Frank Wilkinson, who, in line with Kalecki, stressed that "The modern economies have failed to develop the political and social institutions, at either domestic or international level, that are needed to make permanent full employment compatible with capitalism" (Robinson,

[6]Caffè's interventionist approach did not stop him from acknowledging the repeated failures of the non-market, indicated by both economic theory and his direct assessment of the workings of national and international institutions.

[7] The reference to flowers arises from a personal memory dating back to the end of the 1960s, when I showed Caffè a page that my supervisor, Joan Robinson, had circulated in Cambridge on her return from China, using the Maoist metaphor of the "hundred flowers" to represent the variety of approaches of economic theory that had evolved in the course of time. Caffè was very pleased with it because it reflected his argument in favour of the need for eclecticism in economic science, as suggested also by Samuelson.

Wilkinson 1977, p. 13). His commitment to the question of equity was more personal. As early as 1945 he wrote a brief article in clearly Pigouvian terms, "Keeping the technical problem of production separate from the social problem of equal distribution means practically leaving the latter unsolved. This is shown by the fact that the freedom from want, the reduction in individual economic inequalities and equal opportunities are objectives that still have to be accomplished today, even though they are age-old aspirations"[8].

Further studies persuaded Caffè that the search for equity could not be logically motivated by the comparability hypothesis of individual utility, as proposed by Pigou. The hypothesis, nevertheless, remains an inspiring and legitimate value judgement of the theoretical work of economists.

These economists included those who were convinced of Pareto's ordinalist approach, according to which the economist has to concentrate his analytical energies on efficiency, as he cannot do so on equity, because of the fragility of the comparability hypothesis.

There are, however, many other economists, in disagreement with Pareto's exhortation, who have not left the question of equity to scholars of other disciplines, but have tried to strengthen the connection between equity and efficiency.

Given the inevitable brevity of this paper, two metaphorical images will suffice to illustrate the widespread point of view of contemporary economists who are not particularly sensitive to the egalitarian theme.

The first is Okun's "leaky bucket", which was intended to warn us about the possible inefficiency of redistributive measures. Although he was not entirely indifferent to the need for greater equity in the economic system, he said that the redistributive measures may lead to the less well-off still having an empty bucket, after having filled it with the water of the better-off (Okun 1975).

The second is the "trickle down effect" that was proposed by the more convinced advocates of neoliberal globalization at the end of the last century. This term was meant to describe the mechanism, centred on the spontaneous working of the market forces, which could determine a large increase in the income produced with the biggest slice going to those with more economic power, and the rest trickling down to the poorer classes. And

[8] Cfr. Caffè (2009, p. 142). The article reproduced in this volume was written by Caffè in 1945.

this mechanism should not be blocked with redistributive measures aimed at greater equity, because they could endanger the objective of efficiency.

In truth, it has to be acknowledged that millions of people have been saved from absolute poverty by greater international integration, but globalization has also accentuated the overall inequality of distribution in most parts of the world[9].

The arguments repeatedly advanced by Caffè to re-establish a positive connection between equity and efficiency have won acceptance in this context. I will just mention two citations worthy of note because of their sources.

The first is from a World Bank document of 2005, one of the principal international organizations, which told us that "For many if not most people, equity is of intrinsic importance as a development goal in its own right. But this report goes further, by presenting persuasive evidence that a broad sharing of economic and political opportunities is also instrumental for economic growth and development. This is for economic reasons, because greater equity can lead to a fuller and more efficient use of a nation's resources" (World Bank 2005, p. xi).

The second can be found in a recent issue of the Economist, the prestigious British liberal magazine, where we can read that, on the basis of valid empirical evidence, the share of the national income acquired by the richest 1% has increased in recent years in most parts of the world, with the interesting exception of some Latin American countries. After having affirmed that "growing inequality is one of the biggest social, economic and political challenges of our time", it adds "research by economists at the IMF suggests that income inequality slows growth, causes financial crises and weakens demand" (Economist 2012, Special Report, p. 3, p. 6).

Therefore, Caffè's evaluations of many years earlier now find confirmation at the highest levels. Caffè considered the objective of egalitarianism a "fixed point" of his teaching and wrote explicitly way back in 1974 that "the objective that all hold up as efficiency today must necessarily be pursued by searching incessantly for solutions that attenuate now, and not in some undefined future, social inequalities, rather than perpetuate and consolidate them" (Caffè 1990, p. 115).

This did not mean ignoring the importance of the interests at play and the ideas that fuelled them. In fact, in one of his most highly valued articles, he

[9] On this topic cfr., among others, Acocella et al. (2004).

cited the ability of the ruling classes to condition the emancipating force of the weaker classes, by using an apocalyptic tone each time there loomed a serious attempt to solve the most clamorous problems to do with equity (Caffè 1972).

As we have seen above and as Caffè pointed out, taking up the interesting distinction made by Einaudi, historical capitalism differs from ideal capitalism. It is therefore legitimate, when evaluating the inefficiencies of its functioning, to ask how the inefficiencies produced both by the market and the State can be overcome, but always bearing in mind the needs of the "final beneficiaries" of the action of public and private actors.

4. The relevance of Caffè's reformism today

One wonders what Caffè's frame of mind would be today when some of his most significant suggestions do not seem to have been heeded very much[10]. He believed that the emphasis should be placed on the immense gaps to be filled, rather than on the limited excesses to be eliminated, within the Welfare State (Caffè 1990). and in the call for the function of the public sector as "employer of last resort" (Caffè 1990, p. 228). He also firmly opposed the application of selection processes for university education, (Caffè 1990, p. 107) warned about the risk of the "dissolution of trade unions" in the modern economy, which had already been indicated by John Kenneth Galbraith, and insisted that "the fundamental role played by the organized working classes in strongly supporting the democratic institutions in times of difficulty" should be acknowledged (Caffè 2014, p. 96). In addition, he thought that "the crucial challenge of our time is to overcome the 'monarchic' structure of firms"[11] and that "today we are messing around nominalistically in the search for a 'new development model'. And yet, we

[10] I cannot help but include, together with these "fragments" suggested by Caffè's works, his advice to those who quote Keynes; "Using incidental statements, that seem to foretell the events of our time, does not mean that they can deduce appropriate indications of how to solve the problems that are afflicting us now". Caffè (1981, p. 78). For other "fragments", see Faucci (2002) and Amari (2014).

[11]Caffè (2013, p. 81). This echoes Caffè's concern about the problem of industrial democracy and his regret for the failure of the Morandi-D'Aragona bill for the official recognition of numerous Joint Management Councils soon after the end of the Second World War; "This is a first lost opportunity". See Amari, Rocchi (2007, p. 306).

continue to ignore the fact that its idealistic aspirations are embedded in the Constitution"[12].

As happened during his lifetime, he could have drawn some consolation from the criticisms of the functioning of real capitalism that come from Christian solidarism, whereas the lay culture, which was more congenial to him, seems to have lost its vitriol and the "aspirations that are identified in that bit of socialism that may be possible in the context of conflictual capitalism" with which we still have to live (Caffè 1990, p. 139). This economic-social progressive conception, as defined by Caffè himself, is the end product of his intellectual work. It was an admirable synthesis of ethics, economics and history that I like to define as Caffè's "radical reformism".

This definition enables me to literally identify the roots of his thought. This can be seen in the two following passages from his writings. The first is inspired by a comment written by Ferruccio Parri for his collaborators when he had to abandon the office of Prime Minister, "There is no shade in the life of those who have the guiding light of an ideal". Caffè added, "Mine leaves no margin for opportunistic moderation" (Caffè 2007, p. 386). In the second, to reaffirm his cultural bearings based on neoliberal surges on the one hand and "revolutionary" ones on the other, Caffè wrote, "As he is usually a well-read man, a reformist understands very well the deep roots of hostility towards any intervention aimed at creating institutions that can improve things"[13]. And, in my opinion, Caffè's reformism, and that of many others, can still inspire us to look to the future with "the optimism of the will" to confirm his Keynesian, we can say, conviction "of the inevitable prevalence of ideas over established interests".

There would remain just one last point to be made and that is to say whether Federico Caffè can be considered a "left-wing economist". Some scholars before me have dealt with the point and reached different conclusions (Bovero 1995, Archibugi 1999, Faucci 2002); naturally I have my own idea, but in an academic context like this, I feel I would need to support it with a good set of cards, starting from Bobbio's concise and lucid work of a few years ago (Bobbio 1994). I think there will be other occasions

[12] Cfr. Amari, Rocchi (2009, p. 126). I personally consider what Calogero wrote to be very illuminating: "The most solid democracy is born of a multiplicity of democracies" (Calogero 1945, p. 102).

[13] Cfr. Caffè (2007, p. 383). It is for the very force of his good readings that the reformist does not have to fear taking on the challenge of sustaining the validity of his proposals. As far as Caffè's reformism is concerned, I like to recall how Ermanno Rea thought of using the happy oxymoron "revolutionary reformist"; cfr. Rea (2014).

on which I can return to this question so that I can give it a full and satisfactory answer.

5. Conclusion

In this paper I have responded to the need I felt, as one of Federico Caffè's pupils, to take part in one of the many events held to remember his work on the centenary of his birth. It has given me great pleasure, because I am in the company of many other pupils. Secondly, I wanted to tell others about some aspects of his person which I became familiar with after studying and working with him for more than twenty years. For this reason, I have written about some lesser-known aspects of his life as a man and a professor, perhaps unknown even to those who were his students or readers. Lastly, I have given my view of that part of Caffè's intellectual personality, the professional economist, which was capable of arousing great cultural interest among large sectors of the country, thanks also to his intense journalistic activity. For this reason, I have dwelled on the essential elements that make, in my opinion, his reformism distinctive, the fruit of his extraordinary knowledge of literature, both economic and otherwise. And I would like to close by mentioning another characteristic of his reformism which he ably expressed as follows, "… because the market is a human creature, public intervention is a necessary component and not an element in itself distorting and restrictive …, ...public spirit guided by knowledge can be the craftsman of social improvement…." (Amari, Rocchi 2009, pp. 592-680).

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G. & L. E. R, Vol. 18 No. 2, 2014

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REMEMBERING FEDERICO CAFFÈ**

Abstract

This contribution represents a privileged celebration of Federico Caffè's ideas and lessons. The transmission of knowledge of this great teacher is considered in the light of the issues that afflict the Italian contemporary economy and cause a prolonged crisis. On this regard, starting from the works of Caffè, the discussion is on three main aspects: the present crisis and the economic policy response, human capital and technological progress. The first aspect is observed through the imperfect functioning of the market, and macroeconomic policies adopted during a period of great change, at the same time characterized by banks and financial institutions to much attracted by the short term results and distant from real economy needs. The widespread financial practice was too far from the vision of Caffè, neglecting the commitment aimed at the welfare system, leaving the market at its supposed self-regulation and instability. Recommendations include the need to go beyond the 'market failure' supporting aggregate demand, considering simultaneously the supply side. The second aspect, the human capital, represents one of the issues related to the failed economic recovery, and also, as proposed by Caffè, education and training characterize a possibility of equal opportunity reflecting on the social equality and the personal work fulfillment. Finally, it is presented a vision of technological change as the third aspect that is not undesirable by the employment point of view, but positive if accompanied by appropriate policy intervention, to encourage the economic growth path and even useful for social development. All

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** Paper presented to the Conference "L*earning never ends… Federico Caffè, Economist and Teacher for the young Generations* ", held in Pescara (Italy), on the 30th January 2015.

this is discussed in the work of Federico Caffè, who was always on the side of the weak people in order to surpass the typical iniquities of the process of economic growth.

JEL CLASSIFICATION: B22; B31; E24; E44; O33.
KEYWORDS: FEDERICO CAFFE'; ECONOMIC CRISIS; MARKET FAILURE; HUMAN CAPITAL; TECHNOLOGICAL PROGRESS; SOCIO-ECONOMIC THOUGHT.

1. Introduction

I would like to thank President Luciano D'Alfonso for inviting me to take part in this celebration of the life, the ideas and the work of Federico Caffè, who was born one hundred years ago last year. Several events were held in his memory, some of which I managed to attend, and I am extremely pleased to be present today in the city where he was born.

I will focus on the points I made at the meeting organized by the University of Roma Tre on 12 November last year, adding some remarks on three issues I have also considered recently. These are: 1) the serious crisis afflicting our economy and some possible economic policy solutions; 2) the need, nowadays, to invest in human capital – in knowledge and skills; and 3) the challenge that technological progress poses for employment.

We live in a very different world from the one in which Federico Caffè worked, the world he 'served'. It would be wrong to try to guess what line his thoughts would have taken today, or to 'mechanically' apply ideas he developed several decades ago to interpret and tackle the present. So I will not attempt to do so with regard to my three issues, except to recall briefly some of Caffè's observations on such matters in very different occasions and circumstances. First, however, I would like to say a few words myself to recall the important contribution he made, above all as an economist and a scholar.

Federico Caffè was an eminent Italian, a member of the Accademia dei Lincei, voluntary university research assistant in 1939, lecturer in 1949 and then from 1954 professor of Economic and Financial Policy (and of Finance and Political Economy), head of staff of the Minister for Reconstruction Meuccio Riuni in the government of Ferruccio Parri, manager in the Bank of Italy's Research Department from 1937 to 1954 and then advisor to the Governor until 1969, and director of the Ente Einaudi from 1965 to 1975.

Many of us still owe a great deal to the teaching of Federico Caffè, to the way he encouraged us in our studies and our profession, and to the example that he set of moral rectitude, dedication to duty and the transmission of knowledge. We remember him as an exceptionally gifted teacher, one who had hundreds of students hanging on his words during his hour-long lectures on various aspects of national and international economics, cyclical questions and core structural problems, the great institutional issues and apparently ordinary everyday events.

Caffè was fully aware, in his reasoning, that judgments of fact are not independent of subjective values, but he was always careful to base his conclusions on a thorough analysis of historical and political experience and highly effective use of economic theory or theories. He did not hesitate to refer to the remark of Paul Samuelson, the great 'Keynesian' and 'neo-classical' economist (something of an oxymoron), that 'experience has taught us the hard way that eclecticism in economics is not so much a desirability as a necessity'. Nor did he fail to point out, nearly forty years ago, that 'economic science is now in crisis precisely because this necessity has been recognized and the consequences drawn, or because economic science has been equated with a single school of thought (be it neo-Ricardian, neo-Marxist, neo-classical or post-Keynesian) that has been attributed a hegemony that it does not actually warrant'. And yet, despite the doubts created by daily contact with reality he remained convinced that the 'constant, continuous and successive' value of economics – to quote his teacher, Gustavo Del Vecchio, with whom he had close ties – depended on 'recognizing the valid contribution of the various approaches'. A lesson in method, therefore, and a prophetic one I should say, given the difficulties facing economics today, particularly in explaining and resolving our severe, protracted economic and financial crisis.

We should therefore recall along with his dedication and his rejection of ideologies, his acknowledgement, with Schumpeter (as Pierluigi Ciocca remarked some years ago, Caffè often spoke 'through the mouth of the great economists'), that 'though we proceed slowly because of our ideologies, we might not proceed at all without them'. So, I believe it is important to remember that even after he left the Bank of Italy Federico Caffè continued to serve as a memorable consultant (and especially of the Governor, Guido Carli, whose centenary we also celebrated last year). They had great mutual respect and admiration. Certainly, there was also great respect and admiration between Caffè and Luigi Einaudi, and Paolo Baffi too, despite the different roles they assigned to public and private sector, State and market.

Federico Caffè was always deeply attached to the Bank of Italy, and many of his students and interlocutors have worked here. During the years of student protest in 1968-69 he was hurt by senseless accusations, based on his advisory capacity in the Bank, of connivance with those who were naively and improperly labeled defenders of capitalism, of economic and financial power, of the 'masters'; he was mortified by the narrow-mindedness of the young people who made them but appreciated their energy and enthusiasm. (Of course, every age has its senseless opinions and today is no exception). To avoid pointless discussions and unpleasant repercussions he resigned his position with the Bank but maintained regular contacts with the institutions and those who worked there, exchanging information and offering abundant advice.

2. On the present crisis and the economic policy response

A volume on the topicality of Caffè's ideas in the current crisis was published in 2010, on the morrow of the first – global – manifestation of this long and essentially financial crisis, consequent to the collapse of the Lehman Brothers investment bank, itself triggered by the US subprime mortgage crisis of 2007, which was initially addressed with insufficient determination.

The global financial crisis has certainly highlighted serious shortcomings in the conduct of macroeconomic policies in a context of high mobility of goods and capital (and people) and the great demographic and technological transformations of the last quarter-century. The crisis has also thrown serious deficiencies in financial regulation into relief, with large banks and financial institutions (especially but not solely in the United States) paying excessive attention to short-term results, with conduct frequently disjoined from the needs and constraints of the real economy.

With a few exceptions, policy makers and economists have displayed an excessive and decidedly misplaced trust in the self-regulating capacity of markets. Caffè's position on this point was always clear, albeit in the very different context of impetuous if uneven economic growth in the two large political blocs that established themselves following World War II (and with a third world at a considerable distance), at a time of severe limitations on international capital movements in many countries. Caffè was no dogmatic adversary of the market economy as such – he certainly grasped its enormous contribution to the general welfare – but he viewed the market not as an end in itself but as a means to achieve that welfare. So he was always openly critical of acritical free-market fundamentalism: a market that is not properly regulated in the interests of its own participants is fundamentally unstable on the one hand and, on the other, does not behave neutrally but is open to monopolistic abuse and predatory conduct.

To address the many 'market failures' Caffè (who also dealt with the 'government failures') proposed the determined use of economic policy measures, in particular short-term demand stimulus to reduce unemployment. In this respect, like Keynes, he was not particularly interested in interventions on the economic structure that could be more effective but only over a period too long to actually help the weakest parties in the economy.

In today's debate there is a great deal of talk about structural reforms. In the euro area, in particular, little has been done to get the economy ready to respond to the transformations I mentioned earlier. But the difficulties in exiting the crisis (first the global financial crisis and then the sovereign debt crisis in the euro area) also depend on the serious insufficiency of aggregate demand. For some time now I have been making the case for an intervention based on investment (public and private, national and European) to complement the equally necessary structural reforms, to be implemented according to a comprehensive plan.

In any case, Caffè did not ignore the need to examine supply-side problems and policies, which are ultimately the ones that have to address such structural problems as insufficient productivity growth, the constraints of demography, the need for energy security and efficiency, environmental protection and enhancement, and the excesses of regulation, sometimes in defence of vested interests to the detriment of the community at large. The emphasis on the need to act simultaneously on both supply and demand justifies the reference that I want to make to Caffè's introductory notes to the book The economics of supply and demand, published in 1983 by the Nobel prize-winning economist, Lawrence Klein – like Caffè, one of my own teachers – whose Italian edition, published by Giuffrè in 1986, was translated by Caffè himself.

In one passage of the introductory notes to that volume, Caffè recalls that one of Klein's important teachings was the idea that support for aggregate demand is in any case a necessary ingredient of any economic policy. But Caffè goes on to underline the fact that Klein placed equal emphasis on the need to tackle the problems of supply, productivity and production capacity. I also think it is interesting to note, without attributing any particular opinion on it to Caffè, that a few years later Klein remarked that 'There is nothing in the Keynesian prescriptions to support highly unbalanced policies or excessive reliance on monetary policy to provide economic stabilization.'

On another level, as distinguished economists now emphasize (possibly a few decades late) with reference to the difficulties of explanation and response to the ongoing economic crisis, you cannot mistake the formal elegance of mathematical models – so much in vogue in the profession – for analytical truths or policy prescriptions. This does not mean that we should not pursue and recommend the judicious use of abstraction and the careful application of theoretical models that can eliminate logical errors and pinpoint the essential elements of an analysis or an argument. However, as Caffè pointed out in an article published in the first issue of the review MicroMega in 1986, we must make sure that, in an excess of technical economic analysis, we do not lose sight of reality.

Comparing, in particular, the constructive approach taken by Pigou (who theorized the economics of welfare, one of the themes of 'pure theory' dearest to Caffè), with some more contemporary inquiries, Caffè found confirmation of the 'loss of relevance that notoriously so often accompanies an increase in formal rigour' and complained that this 'progressive impoverishment of the real and preponderance (or abuse) of the formal' was occurring even within welfare economics itself.

Also regarding the indispensability of tools of quantitative analysis, especially for economic policy, it is interesting to cite Caffè's observation that notwithstanding the impressive volume of highly specialized and technical work involved in the construction of econometric models, in the book just mentioned Klein 'shows another face: that of an author possessed with an extraordinary capacity for popularization. […] The lesson is of no small account, since it is important not only to build econometric models but also to make them understood'. In this instance too, more than the reference to one of the foremost economists of his day, what strikes me as important is the lesson of method that Caffè seeks to get across with his 'make them understood.'

3. On human capital

Again this morning, at the Catholic University of Rome, I recalled how the slow growth of our economy even before the crisis and our greater difficulties in weathering the protracted recession depend in no small measure on shortcomings in the stock of human capital. I do not believe that the term 'human capital' would have met with Caffè's unconditional approval. I myself find it unnecessarily cold and mechanical and would prefer to speak of investing in knowledge and attention to the development of the skills required for a given work or life context. But by now the term has moved from the language of economics to common parlance, and there is little point in trying to put up a resistance to it.

It is well known that Caffè regarded education and training as vital components of equal opportunity, interpreting work as not just employment but also personal fulfillment. For Caffè the 'starting conditions' belonged to those deeply held ethical principles, of justice and social equality, from which his theories sprang.

In an article from 1986 suggestively entitled 'Anything but equal starting conditions' (Rinascita, 10 May 1986), commenting on the proposal for restricted admissions for state universities, branded 'truly calamitous' by Caffè at the time, he observed that 'our present-day concern about an alleged "excess" of higher education is a clear indication that the real crisis is not about notions of social welfare and the attendant financial burdens, but about our capacity for intellectual daring.' He added that 'State universities … cannot, without discrediting themselves, renounce the establishment of "equal starting positions", a precept on which all respectable liberal conceptions are based.'

Here too, I think it is important to stress the contiguous use of two terms such as 'equality' and 'liberal'. Investment in knowledge, by each one of us and by all of us as a community, in ways suited to the situations in which we find ourselves and in view of the major economic, demographic and technological changes I mentioned, seems to me to constitute an essential bulwark in defence of our freedom and in favour of our economic, social and civil welfare.

Finally, I think it is right to observe that the necessity of socially useful expenditure to develop the stock of human capital was among the concepts of high theory such as 'externalities' in consumption or 'social costs' on which Caffè – though inspired by specific criteria of equity – carefully based his observations when studying the problems of the welfare state.

4. On technological progress

I often refer to the massive and varied changes brought about by technological progress, highlighting a particular characteristic of today's digital revolution: the increasing speed at which machines appear to be able to replace human labour. And this seems to be happening not just for routine work but increasingly (and this is the biggest change) for non-standard jobs as well.

The undoubted benefits of technical progress for society as a whole, including new and better job opportunities, must not make us lose sight of the effects associated with the transition towards a situation in which the impact of new technology on employment has been deployed fully. Equally, I feel it is right to stress the term 'transition', in an effort to understand the extent to which 'the second machine age', as some economists now define it, differs from the first or second 'industrial revolution'. Everybody knows how short-lived – though intense – were the movements of opposition and revolt against machines, which by replacing human beings threatened to deprive them of their ability to earn a living by manual labour. Now the challenge seems to go much deeper than that, in the direction of what even in 1930 Keynes could call 'technological unemployment'.

Federico Caffè was certainly no opponent of progress and technology. On the contrary, he counted on innovation to overcome the 'limits to growth'. Yet as far back as 1967, in an essay in Economia Internazionale, he had begun to ponder 'the social aspects of automation'. Caffè observed that 'the specific objectives of a social policy on automation must reflect at one and the same time recognition of its inevitability and the awareness that it ordinarily combines general benefits with sectoral costs'.

In this regard, citing the famous work of a contemporary of his, Ben Seligman, on the challenges to man in the age of automation, Caffè made it clear from the outset that 'explicitly acknowledging that "the worker's reaction to technological advances is one of fear" does not mean indulging in an anachronistic luddism, although it is hard to avoid such a charge'. He then referred to the 1966 report of the US National Commission on Technology, Automation, and Economic Progress, entitled 'Technology and the American economy', to observe that in discussing the relationship between job losses and technical progress the Commission stressed that 'high unemployment (which motivated the institution of the commission) was the result of passive public policy, not the inevitable consequence of rapid technological change'.

While we cannot know how Caffè would have commented on the consequences of the digital revolution, we can at least derive some notions from his lessons on method. In the face of change, Federico Caffè was not afraid to underscore the opportunities it brought; but he was also attentive in highlighting the difficulties and contradictions and emphasizing the need for public action to correct distortions and counter unfair outcomes.

So it seems appropriate to conclude – with no special commentary, and recalling the historical period he was referring to and the differences between the circumstances and constraints of that age and those of today – with a passage from his 'Lectures in political economy'. 'Technical progress, notoriously, is a vital necessity for any economy that seeks to develop and advance. Yet there is no denying that in an economic system based on multiple initiatives, technical advances will be introduced insofar as they prove to be advantageous in terms of the private costs and benefits of individual entrepreneurs, with no account taken of the difficulties that technological change causes, in particular for working people. In this regard the tendency is to argue that their losses – temporary unemployment, relocating from their home areas, readaptation, retraining – are the price paid in the short term for widespread benefits in the long run. But this appeal to the long term – which often expresses the limits of our knowledge rather than any real certainty – can hardly justify an indifference to immediate problems, namely those provoked by the social costs of technical change and the manner and pace of innovation'.

On second thought, some comment does appear to be in order. The great technological transformation under way, the extraordinary inventions of information and communications technology, and the digital revolution can – indeed must – be expected to bring great opportunities for economic growth and even for social development. But there are also great risks. If thanks to technological progress we are not doomed to the 'secular stagnation' still feared today by some eminent economists, we must nevertheless be prepared for the great challenges that these technological advances cannot fail to pose. We must respond to these challenges, and in particular to 'technological unemployment', as I noted earlier, with large-scale investment in knowledge, skills, capacities. Nor can we ignore the impact on the distribution of incomes (and, Federico Caffè would have said, opportunities) and above all the consequent constraints on the very possibility of most people's sharing fully and fairly in the benefits of this progress.

5. Conclusion

To conclude, Federico Caffè always took the side of the weaker party, the victims; he was an outspoken critic of any idealization of 'the market' and a firm advocate of an active role of government in correcting market inefficiencies and remedying 'diseconomies'. He considered labour not just as 'employment' but as self-fulfillment and saw education and training as a fundamental component of equal opportunity. And he was alarmed by a speculative financial system disjoined from the real economy, a world in which the voice of the people was drowned out by the domination of 'big business', 'big labour' and 'big government', in which the prevailing interests were determined purely by the power of the multinational corporations and perfectly indifferent to the implications not only for fairness and social justice but even for efficiency and economic stability.

But he was not against progress and technology, or in favour of violating budget constraints, or against recognition of merit, or in favour of some vague 'egalitarianism' (which he set against an equally vague 'professionalism'). Rather, he was confident of our capacity to overcome the 'limits to growth' through innovation, organization and – why not? – the operation of relative prices, in the market. In the final analysis, Federico Caffè found the primary justification for the study of economics in the conviction that one must never abandon the hope of defeating poverty and ignorance. As a reformist, he held a deep-seated belief in man's ability to shape and change his fate. And to his students, to all of us, he left the warning not to be conditioned by fads and fashions but to exercise, with wisdom and modesty, independent thought and action.

G. & L. E. R., Vol. 18 No. 2, 2014

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MACROECONOMICS OF FISCAL POLICY IN TIMES OF THE GREAT RECESSION

Abstract

The article examines academic debates about austerity and their influence on real policy decisions, namely, fiscal stimulus programs adopted by governments in the wake of the current crisis and the consequent switch to fiscal consolidation as well as latest discussions and decisions in favor of fiscal loosening. The author presumes that pains of austerity haven't yet brought desired results since public debt-to-GDP ratios in advanced economies still remain on their historic heights and are predicted to decline only in 2016. Meantime, austerity did hurt fragile recovery in the euro zone. A comparative case study of anti-crisis fiscal policies in Russia and Italy supports this hypothesis.

JEL CLASSIFICATION: E20; H30; H60.
KEYWORDS: austerity; fiscal consolidation; fiscal stimulus program; Great Recession; neo-Keynesianism; neoliberalism, public debt-to-GDP ratio; Russia's active fiscal policy; Italy's fiscal austerity

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1. Introduction

Each stage of the current world crisis was accompanied by an unprecedented scientific discussion which was shaping more or less concerted anti-crisis efforts of governments in the developed world. The Great Recession has reignited a never-ending battle between adepts of the Keynesian and neoclassical thought. Albeit, it wasn't a usual scientific dispute which the antagonists used to hold with varied success during decades. The Great Depression had led to a historic shift of the dominant paradigm from free market ideology to state regulation in major Western economies. World War II and building-up of militarized economies had further consolidated the Keynesian victory. In parallel, there existed the socialist world which favored Keynes' ideas by implication. In mid-1970s, tireless underground activity of neoliberal scientists had gradually manured the soil for their revanche not only in industrialized economies but, moreover, in developing countries. Finally, nearly forty decades of economic and, particularly, financial deregulation have resulted in one of the most severe financial crisis of 2008-2009.

2. From Financial Liberalism to Neo-Keynesianism and Vice Versa

On the wake of the crisis, debates resumed with renewed vigor. This time, not only prominent neo-Keynesians such as Nobel Laureates Paul Krugman and Joseph Stiglitz, as well as Greg Mankiw ruled the roast. Surprisingly enough, Dominique Strauss-Kahn, then the Managing Director of the IMF (Strauss-Kahn 2009), and the IMF's chief economist Olivier Blanchard (Blanchard, Dell'Ariccia, Mauro 2010) called for active fiscal policy. Ahead of the G20 Summit in November 2008, the IMF proposed a global fiscal stimulus program, suggesting that a stimulus of 2% of world GDP was necessary to help restore economic growth. The European Commission prepared a plan, under which each EU member state should commit to a stimulus package of 1% of GDP (IMF 2008).

However, as soon as immediate danger of depression had shrunk, new heavyweight disputers joined the discussion, namely, the European Central Bank and the German Council of Economic Experts. Over late 2009 and early 2010, the European Central Bank had become even more insistent on the need for European countries returning to normal patterns of spending, and in particular for members of the Economic and Monetary Union to make a speedy transition back to compliance with requirements of the Stability and Growth Pact.

In due time, there appeared two analytic articles under NBER's auspice which presented economic models on the basis of massive long-range data. Alberto Alesina and Silvia Ardagna argued strongly for an immediate retrenchment, suggesting that, according to historic data, fiscal tightening could in fact enhance countries' growth prospects by improving investor confidence (Alesina, Ardagna 2009, pp. 62-63). Harvard economists Carmen Reinhart and Kenneth Rogoff had discovered a dangerous debt threshold at 90% of debt-to-GDP ratio at which the average growth rate falls to -0.1% (Reinhart Rogoff 2010, pp. 22-23). These works were massively cited by the scientific community and high-rank decision makers. However, some scholars had questioned their theoretical assumptions but these voices weren't heard. In 2013, researchers at the University of Massachusetts had found the famous Excel error in Reinhart & Rogoff model (Herndon Ash Pollin 2013). They wrote, "When we performed accurate recalculations, we found that, when countries' debt-to-GDP ratio exceeds 90 per cent, average growth is 2.2 per cent, not -0.1 per cent. We also found that the relationship between growth and public debt varies widely over time and between countries" (Herndon, Ash, Pollin, 2013, pp. 14-15). Even after this disclosure Reinhart & Rogoff conclusions still serve as a textbook justification for austerity and both authors continue defending their stand in favor of fiscal consolidation.

Future science historians would be amazed by the fact how promptly academic debates were translated into real macroeconomic policies. It seems that the Keynesian resurgence had paved the way for an unprecedented financial and fiscal stimulation during 2008-2010. In their turn, Alesina & Ardagna and Reinhart & Rogoff works were the landmark contributions to the U-turn towards austerity. In fact, the very timing of these papers was perfect. On June 27, 2010, the G20 Summit in Toronto proclaimed the good news that the global economy was recovering faster than it was expected. The Summit prescribed consolidation for "advanced economies in 2011, and earlier for countries experiencing significant fiscal challenges at present" (G20 2010).

Following this historic decision, the IMF issued *Ten Commandments for Fiscal Adjustment in Advanced Economies* warning that "too much adjustment could also hamper growth, and this is not a trivial risk". As

Olivier Blanchard stated, “Our current macroeconomic projections imply that an average improvement in the cyclically-adjusted primary balance of some 1 percentage point per year during the next four–five years would be consistent with gradually closing the output gap, given current expectations on private sector demand, and would stabilize the average debt ratio by the middle of this decade. Countries with higher deficits/debt should do more, others should do less” (Blanchard, Cottarelli 2010). Unfortunately, this conclusion was over-optimistic and the premature transition to fiscal adjustment had plunged the world economy into the Great Recession.

Since 2010, Paul Krugman (Krugman 2011) and Joseph Stiglitz (Stiglitz 2012) have been warning about perils of fiscal tightening which could reverse fragile recovery but all in vain. The UNCTAD report *Development and Globalization* highlighted that “before the crisis most governments had fiscal surpluses or small deficits, and debt-to-GDP ratios were relatively low and in several cases declining. The fiscal problems have been the result, not the cause, of the financial crisis, which was fundamentally associated with the expansion and collapse of private debt, and consumption. Only in developed economies did public debt soar after the crisis” and concluded that “recovering growth is essential for curbing high public debt-to-GDP ratios; fiscal austerity may well be a self-defeating strategy” (UNCTAD 2012, pp. 16-21).

The crucial question is the following: whether this much-touted shift towards Keynesianism took place in reality? The general public was mesmerized by enormous volumes of budget injections into economies. This fact apparently can't be questioned. Even so, if we look more attentively at the composition of anti-crisis support measures as shown in Table 1, we can easily find out that financial rescue packages in developed economies had overwhelmingly prevailed over fiscal ones.

According to the UNCTAD, developed economies dedicated the lion's share of rescue efforts to the financial sector which made 48.5% of GDP and an orphan share of 3.7% to stimulate the public sphere. In the USA and the UK this proportion was still more striking, 81.1 and 81.7% correspondingly to save banks; 5.5 and 1.9% to help people. In emerging economies, the proportion of rather moderate rescue packages was quite reverse. For example, China and Russia directed 0.5 and 8% to the financial sector and 6.2 and 5.4% to the public sphere.

Table 1. Fiscal Stimulus and Support to Financial System in Selected Economies (Per cent of GDP)[1]

	*Fiscal stimulus**	*Support for the financial sector***	*Years to spend fiscal stimulus*
Developed economies***	3.7	48.5	-
United States	5.5	81.1	3
United Kingdom	1.9	81.7	3
Germany	3.6	22.2	2
France	1.5	19.1	2
Italy	0.3	3.3	2
Japan	4.7	22.3	3
Spain	3.9	22.9	3
Developing economies***	4.7	2.9	-
China	6.2	0.5	2
Transition economies***	5.8	7.4	-
Russia	5.4	8.0	2
Total***	4.0	36.1	-

Source: UNCTAD (2009), Trade and Development Report 2009, United Nations, New York, 32.

* Corresponds to discretionary measures on public spending or revenues in response to the financial crisis, excluding the "automatic stabilizers".
** Comprises capital injection, purchases of assets, lending by government treasuries, central bank support provided with treasury backing, liquidity provision by central banks and guarantees, excluding deposit insurance provided by deposit insurance agencies. Liquidity provision by central banks only includes the new special facilities established to address the present crisis and excludes the operations of the regular liquidity facilities.
*** Country grouping weights based on current dollars.

Engelbert Stockhammer reveals striking details about banks' rescue campaign. "Two factors are remarkable about the sovereign debt crisis. First, the 'rescue packages' have in no case led to a decline in public debt. Essentially, the 'rescue packages' have been gigantic machineries to transform private debt into public debt... But the interrelation between public and private debt does not end here. Most government bonds are held by private banks and public debt is essential for the working of the private financial sector... After the financial crisis interest spreads on southern European countries increased sharply; essentially the banks started speculating against the governments that had rescued them (Stockhammer 2012). Thus, bad private debts had performed a salto mortale and toxic assets were successfully transformed into secure and profitable government bonds held by private banks.

In my opinion, the shift from market deregulation to massive budget stimulation wasn't a true return to Keynesian economic policy, even temporally. As a matter of fact, Keynes never advocated massive budget injections into financial sphere. While being many years in the underground, Keynesians have undergone a curious mutation, just as their ideological opponents had done decades earlier. When in 1970s Liberals had reappeared at the light of day, they had filled old bottles with new wine developing the neoclassical synthesis combining Keynes' macroeconomics with classical microeconomics. In their turn, all stripes of neo-Keynesians while being in disgrace had drifted toward the mainstream economics adopting its financial stance. So we can witness the birth of a brand new neoclassical synthesis.

In fact, neoliberals and financial Keynesians make two sides of the same coin. Initially, neoconservatives had succeeded in financialization of economy which led to creation of financial bubbles, and after their collapse financial Keynesians had picked up the baton and contributed to providing massive support to financial institutions. Once banks had been safely rescued neoliberals started insisting on austerity measures. Meantime, Keynesians are still advocating further financial injections. In fairness, I would like to note that neoliberals have partly changed their steadfast commitment to a small state. In fact, tough austerity measures have been demanding very strong state governance. Not all democratically elected governments had stood the austerity test and were forced to step down. They were replaced by representatives of opposition parties or unelected technocrats. Permanent government reshuffles in Italy can serve as a visual confirmation of this tendency.

In his essay *The relevance of Keynes*, Robert Skidelsky revives an authentic theory of Keynes. He replicates his doctrine in one brief phrase. "The purpose of the General Theory" (Keynes 1973) was to explain how an economy could get stuck in a low employment trap. This explanation was provided by the theory of effective demand. Demand is effective at the point where the aggregate supply and demand schedules intersect; the theory of effective demand states that any inequality between the two is removed—equilibrated—by a change in output (or income) and not price". Skidelsky makes a powerful conclusion: "Keynes's recipe for a less uncertain economy consisted of three main elements: measures to stimulate investment, measures to stimulate consumption, and a reform of the international monetary system to prevent the transmission of unemployment from one country to another". He brings back a very important insight about socialisation of investment and reproduces Keynes' words: "I expect to see the State…taking an ever greater responsibility for directly organising investment" and "I conceive, therefore, that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment (Keynes 1973, p. 164, p. 378)" (Skidelsky 2011, p. 2, p.10).

One of the most controversial issues in current debates is the interdependence between austerity and growth. The above-mentioned Reinhart & Rogoff model and Alesina & Ardagna computation had convinced policymakers that austerity would not hurt fragile recovery. One of the main arguments used by austerity advocates was that multiplier effects of budget cuts and tax increases would be less than 1. That meant they would not cut away the growth. In reality, they did affected adversely the growth. Recently, the IMF updated its calculations and acknowledged that multipliers proved to be much higher than they had calculated. In 2013, Olivier Blanchard and Daniel Leigh acknowledged in their paper Growth Forecast Errors and Fiscal Multipliers that "fiscal multipliers were, on average, underestimated for both sides of the fiscal balance, with a slightly larger degree of underestimation associated with changes in government spending" and "actual multipliers were substantially above 1 early in the crisis" (Blanchard Leigh 2013b, p.3, p. 17).

In 2012, Nicoletta Batini et al. published under IMF's auspice a paper with a rather controversial if not ironic title *Successful Austerity in the United States, Europe and Japan*. They presumed that "the exact size of the 1-year cumulative fiscal multiplier is country-, time-, and circumstance-specific, with ranges in our sample countries (in downturns) between 1.6 and 2.6 for expenditure shocks, and 0.16 and 0.35 for tax shocks... Expenditure multipliers are significantly larger than tax multipliers in downturns (up to 10 times larger) but less so during expansions (up to 6 times larger)". They made a conclusion that "withdrawing fiscal stimuli too quickly in economies where output is already contracting can prolong their recessions without generating the expected fiscal saving. This is particularly true if the consolidation is centred around cuts to public expenditure - likely reflecting the fact that reductions in public spending have powerful effects on the consumption of financially-constrained agents in the economy - and if the size of the consolidation is large" (Batini Callegari Melina 2012, pp. 23-25, p. 32).

Meanwhile, growth prospects are still gloomy throughout the world economy. Ahead of the G20 Summit in Brisbane, Australia, (November 15, 2014), the OECD warns in the *Economic Outlook* that the global economy remained stuck in low gear, with the risk of further stagnation without substantial action. The OECD predicts that global growth would reach 3.3% in 2014, rising to 3.7% in 2015 and 3.9% the following year, down from its September 2014 forecast and still a modest pace compared with the years prior to the global financial crisis. Similar to other projections, the United States is seen driving the recovery with growth of 2.2% in 2014 and around 3% in 2015 and 2016. The eurozone is expected to gradually emerge from recession with a sluggish 0.8% rise in 2014, expanding to 1.1% in 2015 and 1.7% in 2016 (OECD 2014a, p. 2).

As a positive result of fiscal consolidation during the last five years the average debt-to-GDP ratio have been stabilized. Nevertheless, it is still expected to exceed 100% of GDP at the end of the decade. Though the main declared scope of austerity - reduction of government debt - wasn't achieved, it has led to massive redistribution of wealth from the poor to the rich. The European Anti Poverty Network (EAPN) stated, *"While the wealthy were hit by the financial crisis, by 2010 their wealth was above 2007 pre-crisis levels and they are again increasing their investment in commodities and equities. The wealthiest tenth of the world's adults now control 83% of wealth; 1% control 43%. The bottom 50% of adults own just 2% of the world's wealth"*. The EAPN sums up the social impact of the crisis and concludes that *"measures to reduce public expenditure have hit social protection and social inclusion systems first. Though only a minority of countries have implemented each of these measures, they all hit the vulnerable. Measures included restrictions on eligibility, shortening of benefit payment period, reduced benefit, narrower family benefits, reductions of benefits to disabled people and children, abolition of maternity and school grants, changes in indexation rules for benefits, cuts in sickness benefits and in social care* *services, increased targeting of housing and child benefits, staff cuts in social services"* (Duffy 2012, p. 13, p. 28).

3. Russia and Italy: a Tale of Two Anti-Crisis Policies

At the end of the seventh year of the Great Recession, we can clearly distinguish at least three pronounced types of anti-crisis policies: 1) American and Japanese aggressive financial Keynesianism + moderate fiscal policy, 2) EU's moderate financial Keynesianism + austerity and 3) (some) emerging markets' limited support of financial institutions + active fiscal policy.

Italy and Russia belong to the second and third types. The two countries are members of the G20 and are roughly comparable in terms of nominal GDP. According to all ratings (UN, IMF, World Bank and CIA), Russia and Italy were ranked 8th and 9th with $2.01 trillion of GDP in 2013.

Russia belongs to the BRICS and Italy is one of the European Union co-founders. The membership in these two prestigious world clubs makes the crucial difference for anti-crisis policies. While BRICS is a rather loose formation which provides ad hoc coordination of its policy measures, the EU has proved to impose on its members very binding and rigid rules.

Emerging markets have learnt very hard lessons from the 1998-99 crisis. Recently, they have demonstrated an exemplary pre- and post-crisis conduct. Olivier Blanchard acknowledged that «having your macro house in order pays off when there is an (external) crisis. In contrast to previous episodes, wise fiscal policy before this crisis gave emerging market countries the room to pursue countercyclical fiscal policies during the crisis, and this made a substantial difference» (Blanchard 2013a).

3.1. Russia's active fiscal policy

Russia, in particular, had worked hard to improve its macroeconomic position after disastrous neoliberal economic reforms which were overlapped by the 1998-99 financial crisis. Till the mid-2008, Russia's economic growth rates stayed high, following the trend of the preceding nine years (the average annual GDP growth rate in 1999-2007 was 7%; in 2007 the rate was 8.1%). During the decade between two crises, Russia had not only repaid loans from the international monetary organizations but, moreover, had accumulated massive reserve funds. In December 1999, the international reserves of the Russian Federation amounted to $12.5 billion, but in August 2008 they had hit the record $596.56 billion. On January 1, 2004, the Government of Russia had established the Stabilization Fund where oil and gas revenues had to be «sterilized». The main purpose of the Fund was to balance the federal budget when oil prices would fall below a cut-off price. At the beginning of 2008, the Stabilization Fund was abolished and divided into two earmarked funds. The Reserve Fund was given $125 billion and the National Welfare Fund - $32 billion. The Reserve Fund had reached its peak of nearly $143 billion in September 2008 and the National Welfare Fund - $93 billion in November 2009 (See Table 2). Moreover, in the first half of 2008 the Bank of Russia was the third largest international reserves holder in the world. So the Russian economy was well prepared to the current crisis.

Table 2. Fiscal Stimulus and Support to Financial System in Selected Economies (Per cent of GDP)[1]

	December 1998	*December 2008*	*December 2010*	*December 2013*	*October 2014*
International Reserves	12.5	455.7	483.1	515.6	454.2
Reserve Fund	-	132.6	40.1	86.9	90.0
National Welfare Fund	-	76.4	88.2	88.1	83.2

[1] The table is compiled according to official data of the Bank of Russia (http://www.cbr.ru) and the Ministry of Finance of the Russian Federation (http://www.minfin.ru).

Beside large financial reserves, Russia had a significant space for anti-crisis maneuvers due to previous fiscal and monetary performance. In pre-crisis years, the state budget was run with considerable surpluses, the government budget surplus reached 8.3% of GDP in 2006, decreasing to 4.3% in 2008. Meanwhile, in the major advanced economies the average budget deficit made 4.7% of GDP in 2008, in the USA – 7.0%, UK – 5.0, in the euro area – 2.1, in Italy – 2.7%. Between two crises Russia had diminished debt-to-GDP ratio to 7.8% (2008). It was one of the lowest levels in the world, since in 2008 the average debt-to-GDP ratio in the euro area was 70.3%, in the USA – 72.8, UK – 51.9 and in Italy – already 106.1% (IMF, 2014d, 196).

In addition, the Bank of Russia was historically committed to inflation targeting and held a very high refinancing rate which reached 13% in December 2008. This fact led to four important consequences. Firstly, though property prices had skyrocketed in the pre-crisis period, there weren't housing bubbles since mortgage rates stayed at more than 15% and were unaffordable for the majority of property buyers. Moreover, banks adopted very strict eligibility criteria for borrowers. Secondly, due to high domestic interest rates, private firms resorted to foreign borrowing and that led to massive capital inflows on the eve of the crisis. When the crisis erupted, private debts were much higher than the state one. Thirdly, high refinancing rates gave the Bank of Russia considerable room for using this instrument, thus, since April 2009, the refinancing rate started to decrease and was varying in a fairly wide range; it peaked to 12,5% (from April 24, 2009 to May 13, 2009) while falling in the middle of 2010 to 7.75%. From September 14, 2012, it stays at a level of 8.25%. Fourthly, households preferred to keep their money in banks which offered high interest rates, especially, for deposits in national currency.

One more powerful monetary instrument in the arsenal of the Bank of Russia is an exchange rate. For an oil-exporting country devaluation of national currency is an efficient means to support exporters and, thus, to improve Russia's trade balance. During the 1998-1999 crisis, the Bank of Russia was powerless to stop devaluation which, eventually, proved to be useful for the economy. During the last crisis, the Bank practiced a gradual controlled devaluation backed by its massive international reserves. However, the devaluation was accompanied by adverse effects. Prior to the crisis, many bank depositors preferred to keep their money in national currency because of their confidence in the future of the national economy and high interest rates for saving deposits in national currency. At the beginning of the crisis, holders of deposits in national currency rushed to convert them into dollars and euros. Another devaluation problem was connected with high foreign indebtedness of business whose debts became more heavy. In 2007, the external private debt was more than 20% of GDP. The government authorized companies to use resources from the National Wealth Fund to refinance their foreign debts. In fact, there were spent only \$11 billion from \$50 billion earmarked for this program. After that major

Russian borrowers started debt restructuring negotiations with creditors, sometimes with mediation of the government.

One more important lesson from the first post-Soviet economic crisis which Russia has learnt perfectly well was a kind of immunity against austerity. Tough fiscal stabilization in the early 1990th or simply "a shock-therapy" had resulted in severe economic and social hardships. It was clear that the Russian people wouldn't accept austerity for the second time during a lifetime of one generation. In spite of a slightly liberal mood of the government, it didn't concern austerity as a feasible option.

The program of anti-crisis measures adopted by the Russian Government in 2009 was very extensive, however, it is possible to feature four main directions: 1) social support to population (increase in pensions, public works) and enterprises, 2) financial aid to the banking sector, 3) budget transfers to regions and 4) support of the aggregate demand by expanding public procurement. According to the IMF, Russia's discretionary measures made 4.5% of GDP in 2009, about 5.3% in 2010 and 4.7% in 2011. Meantime, the average discretionary package in G20 was 2.1, 2.1 and 1.1% correspondingly; in USA – 1.8, 2.9 and 1.7%; in UK – 1.6, 0.0 and 0.0%; and in Italy – less than 0.1% in all three years (IMF 2010, pp. 6-7). Besides massive fiscal packages, discretionary fiscal policy in Russia was supplemented by functioning of automatic tax stabilizers which were built in the severance tax and oil export duties that led to an automatic decrease in tax rates in case of a decline in oil prices.

The fiscal support to the real economy granted by the Russia's Government was one of the biggest in the world, as a share of GDP, and seconds only to China. The government used three main fiscal tools: 1) tax policy (decrease in certain tax rates; changes in the procedure of tax charging); 2) customs policies (multiple changes in customs duty rates in different directions) and 3) procurements for public needs. According to the World Bank, the total tax rate in Russia decreased from 51.4% in 2008 to 48.9% in 2014 and the country has incredibly upgraded its rank for paying taxes climbing from 130 up to 56 (World Bank 2007, p. 146; World Bank 2014, p. 213).

The massive government support had given a positive impetus to the economy. Already in 2010, GDP increased by 4.5%. After a drastic decline in 2009, all components of GDP had visibly increased. In 2011, the Russian economy expanded by 4.3% and 3.4% in 2012. However, later on the economy had lost momentum. In 2013, growth rate was only 1.3%.

According to the IMF's forecast, GDP will increase by 0.2% in 2014, 0.5% in 2015 and only in 2019 the economy will grow up to 2.0% (IMF 2014d, pp. 184-185). The previous slowdown was caused by internal structural problems. Meanwhile, the future poor performance will be the result of the interplay of considerable external downside risks.

The Russian authorities are slightly more optimistic than the IMF. However, the medium-term projection by the Ministry of Economic Development (MED RF), which served as a basis for the draft federal budget for 2015 and the planning period of 2016-2017 has been downgraded before introducing into the State Duma (the lower house of parliament). Given the changing geopolitical and financial conditions, GDP growth in the baseline scenario for 2015 was reduced from 2.0 to 1.2%, in 2016 - from 2.5 to 2.3% and in 2017 - from 3.3% to 3%. Assessment of capital outflows in 2014 was increased from \$90 billion to \$100 billion. It is expected that by 2017 the capital outflow will fall to \$20 billion. According to the Ministry, there will be a temporary and controlled increase in the federal budget deficit up to 1.4-2.0% of GDP in 2015-2017. At that, debt-to-GDP ratio won't exceed 16% (MED RF 201:13-18). The main reasons behind reducing expectations for economic growth in 2015 were more tough than expected geopolitical situation, increased restrictions on capital markets in relation to the largest Russian banks and companies. In addition, there was taken in account a new negative factor, namely, a significant increase in estimates of inflation. In 2015, inflation is expected to be around 5.5%, which is 0.5% higher than in the previous version of the forecast. At the same time, the forecast didn't take into account a sharp drop in oil prices and corresponding devalution of national currency. The average price for crude oil "Urals" was assumed as \$100 per barrel and an exchange rate of 34 rubles per one US dollar. Meanwhile, the price for crude oil “Brent” has dramatically deteriorated during August-November 2014 from \$106 to \$80. In parallel, an exchange rate of the Russian national currency ruble has plummeted from 34.63 to 47,4 per US dollar. Such a sharp and sudden devaluation had never happened even in the worst times of the 2008-2009 crisis. The forecast for capital flight was recently again upgraded to \$128 billion. In order to cope with these rapidly developing negative trends, the Bank of Russia has decided on October 31, 2014 to rise its key rate from 8.0 to 9.5% per annum. At that, the refinancing rate remained unchanged at 8.25% (Bank of Russia, 2014b). On November 5, 2014, the Central Bank has drastically decreased its support for the national currency in order to start transition to free floating currency exchange rates. The Bank of Russia expects that these measures will help to balance the government budget through increasing oil and gas revenues in ruble terms.

It is noteworthy that despite unfavorable geopolitical and macroeconomic environment Russia's Government is firmly committed to active fiscal policy. Minister of Economic Development Alexei Ulyukayev believes that in the short- and medium-term, “there is a good chance not to raise taxes and even slightly reduce tax burden” (Ulyukayev 2014). On the expenditure side, the government provides for considerable public investments.

Along with the basic medium-term forecast, the Ministry of Economic Development has presented a so-called moderately optimistic version which relies on improved objective conditions and a more active fiscal policy. An active government policy is supposed to provide in 2015-2017 the average annual increase in public capital investment up to 7.4% against 1.9% in the baseline scenario. In this case, GDP growth will start accelerating from 2015 at a rate of 3.3%, and by 2017 will reach 4.3% (MED RF 2014, pp. 77-80). In both scenarios, the increase in investment will be provided by the expansion of public expenditures on infrastructure projects, mostly through the National Welfare Fund. In addition, there is expected a resumption of growth of private investment in infrastructure, mainly, by companies with state participation, such as "Gazprom", "Transneft", "Rosneft" and some others. Recently, it has been launched the biggest in history infrastructure project – the construction of the 4000-km and $55 billion worth pipeline "Power of Siberia" which will transport gas from Irkutsk and Yakutia via Khabarovsk and Vladivostok to China according to the Russian-Chinese gas contract signed in 2014. Other ambitious projects will be also financed from the National Welfare Fund, namely, construction of the high-speed railway Moscow-Kazan, building of the Central Ring Road (CRR) around Moscow and modernization of the Trans-Siberian Railway. According to Sberbank's assessment, short-range multiplier can reach 1.9 and long-range multiplier - 3.2 (Sberbank 2013, p. 3).

In this turbulent situation, it is needed a concerted action of the Government and the Central Bank of Russia. As the Bank of Russia stated its policy will be aimed at ensuring price and financial stability. The main target of the monetary policy is decreasing inflation in the medium term up to 4%. The Bank of Russia expects that before the end of 2014 inflation will remain above 8%, which significantly exceeds the targetted level of 5%. Notably, the Bank of Russia has revised its macroeconomic forecast twice during autumn 2014. The latest version of the *Guidelines for Single State Monetary Policy in 2015 and for 2016 and 2017* of November 8, 2014, presents five scenarios with different assumptions regarding external factors, such as possible changes in the mutual sanctions regime introduced in 2014, external financial conditions, and prices in world energy markets, which determine the dynamics of terms of trade. In the situation of high environmental uncertainty, assessments of main macroeconomic indicators are characterized by a large spread. According to five scenarios, GDP growth can vary considerably in 2015-2017. The next year is expected to be the most unfavorable when GDP can decrease by 0.7% or increase by 0.6%. However, in 2016-2017 under all conditions there is predicted GDP growth by 0.1-1.8% and 0.8-2.6%, correspondingly (Bank of Russia 2014a, pp. 25, 47).

3.2. Italy's fiscal austerity story

Unlike Russia, at the beginning of the financial crisis the Italian economy was already depressed. In 2008, in spite of serious efforts to diminish public debt, public debt ratio of 118.8% of GDP was the second highest in the OECD, with no sign of significant decline. A fiscal program for 2009-2011, adopted in September 2008, was aimed to bring the budget into balance by 2012 and debt below 100% of GDP by 2011 (OECD 2009). The budget deficit of 2.7% of GDP was rather moderate but already in 2009 it reached 5.4%. In fact, Italy had a very limited space for implementing anti-crisis measures.

One more peculiar feature of the Italian economy is one of the highest share of revenues in GDP which was already 49.5% in 2007 and reached 51.9% in 2014. Only Nordic countries and France had more high indicators (IMF 2014b, p. 69). Italy ranks the 141th for paying taxes in "Doing Business 2015" with the total tax rate of 65.4% of the profit, though the country has made considerable progress since 2008 decreasing the rate from 76.2% (World Bank 2007, p. 128; World Bank 2014, p. 194).

According to the IMF, the public sector budget in Italy suffers from a number of distortions which hold back growth. Marginal tax rates on capital and labor are high. The government reduced the personal income tax (PIT) for low earners by around ½ percent of GDP in 2014 (roughly □1.000 per household), but at around 48% of total labor cost, the labor tax wedge is well above the OECD average of 36%. Public spending has one of the highest elderly bias and lowest levels of education spending in the EU, leaving little room for active labour market and education policies to strengthen productivity and employment (IMF 2014a, p. 25)

In addition, the membership in the European Union puts further limits on country's anti-crisis policy. When joining the EU, the Bank of Italy had to downsize policy rates which are now at a historical minimum. Freedom of goods, capital and labor mobility created highly competitive environment, including tax competition, which has weakened the country's economic performance. Finally, Italy should conform to strict Maastricht criteria and provisions of the Stability and Growth Pact which requires to keep budget deficits below 3% of GDP, and debt levels below 60%. In 2009, the country was put under the Excessive Deficit Procedure in order to undertake fiscal adjustment. At the end of 2013, Italy had achieved the objective of reducing deficit-to-GDP ratio below the 3% threshold and due to that had left the Excessive Deficit Procedure.

Fortunately, there were some positive factors in the pre-crisis macroeconomic situation, mainly, the absence of bubbles. Firstly, the banking sector had escaped risk of insolvency that had hurt banks in other countries, but this did not protect the economy from credit difficulties. Italy's financial system managed to cope with the “first round” of the crisis better than most of its European peers, and banks suffered mostly on the funding side, due to strong tensions affecting interbank markets. Secondly, households and businesses had relatively healthy balance sheets (OECD 2009). Due to both factors, it was not necessary for the government to grant considerable financial rescue packages to banks and businesses. Thirdly, a relatively smaller budget deficit and higher level of savings in the private sector had contributed to greater stability of the external balance of payments. Due to absence of visible property bubbles, the housing market hadn't collapsed and prices had not dropped dramatically. However, the construction industry suffered a severe downturn.

In 2008-2010, Italy had produced one of the smallest fiscal and financial rescue packages in the world - 0.3% and 3.3% of GDP correspondingly (see Table 1). But even these modest efforts helped the economy to restore economic growth from minus 5.5% in 2009 to 1.7% in 2010. It is possible that not rescue packages as such but non-interference of the government into functioning of automatic stabilizers was the main reason. Nonetheless, since 2011 the country has been put under an austerity program. The economy reacted immediately, downsizing by -2.4% in 2012 (IMF 2014d, p. 184-185).

Under the Euro Plus Pact guidelines, the government adopted in July 2011 a fiscal adjustment package which included measures for € 48 billion (in 2012-2014). In mid-August 2011, it was extended to €59,8 billion in order to achieve the balanced budget already in 2013. The stabilization package included measures aimed at both sides of the balance sheet. On the revenue side, the package provided for an increase in the ordinary VAT rate by one percentage point; a reform of taxation on financial income; harsher penalties for tax evasion; higher taxes on energy companies; and new revenues from excise duties. In December 2011, the newly appointed government was forced to adopt an additional austerity toolkit in order to hit the balanced budget target in 2013. This new package provided for reducing pension expenditure and cutting local government transfers. On the revenue side, it was aimed at strengthening of real estate tax at municipal level; higher excise taxes on fuels; tax surcharges on luxury items; and higher taxes on financial assets. Overall, the 2012-2014 fiscal package provided for a cumulative adjustment of €81,3 billion (5% of GDP), of which €54 billion related to measures in the field of taxation (3.3% of GDP). The fiscal package involves mainly six taxes: personal income tax (PIT), real estate property tax (IMU), excise duties (ED), value added tax (IVA), corporate income tax (IRES), and regional business tax (IRAP). Introduction of this tax package has led to an increase in overall tax-to-GDP ratio from 42 to 44% (Arachi et al. 2012, pp. 6-8).

Generally, the Italian anti-crisis program can be defined as a double austerity because it has involved both sides of the budget sheet by spending cuts and tax hikes. This time, even automatic stabilizers were affected and that made austerity particularly unsupportable for vulnerable groups of population.

Austerity measures were immediately translated into a worsened macroeconomic performance. According to the Bank of Italy, contraction of domestic activity has been dramatic: industrial production has shrunk by 25% overall. In the last quarter of 2013, while exports were almost back to the level of late 2007, household consumption was still down by about 8% and investment by 26%, with a capacity loss in manufacturing of approximately 15%. In the last four years public investment expenditure has diminished by nearly 30% (Banca d'Italia 2014a, pp. 171).

The main burden of fiscal adjustment was imposed on citizens. As the result of fiscal novations, tax burden on households reached 44.7% of gross income. In the case study *The True Cost of Austerity and Inequality,* the OXFAM gives a striking account of devastating effects of fiscal consolidation on ordinary people. In particular, financing of the main national funds for social support was cut by 75% during five years. At the local level, Italian municipalities decreased their social spending by 3.6% in 2012. Together with rising unemployment, these cuts of social expenditures and essential services have reduced the safety net for the most vulnerable groups, thus contributing to increased poverty and inequality (OXFAM 2013, p. 4).

After all, what are the main results of the Italian style austerity? Have been the main goals reached and at what price? As the Bank of Italy states, "Important progress has been made in adjusting the public finances. The deficit is equal to 3 per cent of GDP, below the European average. With Germany, Italy has the highest primary surplus in Europe, and Italy is close to achieving structural budget balance" (Banca d'Italia 2014, p. 173). At the same time, debt-to-GDP ratio has not decreased but reached new heights. The ratio rose from 107.3% in 1998-2007 to 132.5% in 2013. As IMF predicts, "public debt is set to rise further, peaking at more than 136,7% of GDP in 2014, due to slower growth and one-off operations from arrears clearance (IMF 2014b, p. 71).

The Italian Government plans to diminish debt-to-GDP ratio in 2015-2017 the ratio by about 10 points, to 125.1%. Only in 2018, debt-to-GDP ratio is projected to return to the level of 2011 (120.5%) (Banca d'Italia, 2014a, p. 117). However, the IMF is more pessimistic and predicts that even in 2019 the debt will still remain as high as 125.6% of GDP (IMF 2014b:71).

The Italian economy has contracted by 1.9% in 2013 and in 2014 GDP is expected to fall by 0.2% on average, giving way to a very modest growth of 0.8% in 2015 and 1% in 2019 (IMF 2014d, pp. 184-185). This year, Italy's economy has entered into the third recession since 2008 (OECD 2014c). The long-lasting decrease in GDP has being translated into job losses. According to the OECD Employment Outlook 2014 (OECD 2014b, p. 44), unemployment rate in 2014 will reach 12.9% and slightly decrease to 12.2% in 2015. That is a little bit worse than in the EU (11.7 and 11.2%) and considerably worse than in the OECD (7.4 and 7.1%). Youth unemployment (15-24 years) in Italy was 40% in 2013. Meanwhile, inflation is set to reach historical lows. HICP inflation, which has been slowing down since the second half of 2012 owing to falling domestic demand and decelerating energy prices, is expected to reach a historical low of 0.7% in 2014, before resuming to 1.2% in 2015 (OECD 2014b, p. 273).

Turbulent international environment casts light and shadows on Italy's macroeconomic future. The IMF presumes that Italy's public debt is sustainable but subject to significant risks. Market funding conditions have been relatively benign, supported by ample global liquidity, but real borrowing rates still exceed economic growth rates. With annual gross financing needs reaching 24% of GDP (almost € 400 billion), Italy is also vulnerable to swings in market sentiment. Fortunately, there are certain positive moments. Firstly, most part of the public debt is held domestically (IMF 2014a, p. 26). Secondly, declining sovereign-bond yields lead to a reduction in interest expenditure, offsetting the decline in the primary surplus. As European Commission (EC) presumes, "following the ongoing bank balance-sheet adjustments and the eventual pass-through of lower sovereign interest rates to the private sector, more favourable credit conditions are forecast to support the recovery and strengthen investment from the end of 2014" (EC 2014, p. 68).

Along with certain loosening of the public debt situation, there have been shifts in the field of private indebtedness. Italian households' debt fell slightly in the first quarter of 2014 to 64% of disposable income, well below the euro area average (about 98% in December 2013). Households' debt servicing costs remained broadly stable at 9.1% of disposable income. Decline in financial debt of firms that began in mid-2011 continued in 2013, decreasing by 2.7% per annum. Debt-to-GDP ratio shed two percentage points, bringing it to 81% (Banca d'Italia 2014b, p. 20-22).

Some positive factors have recently emerged in the country's external performance. In 2013, Italy's current account balance recorded a surplus for the first time since 2001 (1.0% of GDP). The correction was substantial, equal to 1.3 percentage points of GDP vis-à-vis 2012 and 4.4 points with respect to 2010. Moreover, Italy continued to attract capital inflows. Between January and May 2014 foreign investors made substantial net purchases totalling € 75 billion of mostly medium- and long-term Italian government securities, sharply up on the € 13 billion recorded in 2013 as a whole (Banca d'Italia 2014a, p. 97).

Unfortunately, Italy's fragile recovery is subject to considerable downside risks. The aggravation of geopolitical situation (Russia/Ukraine and the Middle East) and the slowdown of the world economy can hurt country's external market performance. The IMF states that the economy has sizeable trade and financial exposures to the rest of Europe with high dependency on energy imports. Italy imports nearly 80% of its energy needs, and is a net importer of both oil and natural gas. Financially, the direct exposure of Italian banks to the euro area is also considerable (23% of GDP), mainly, to Germany and Austria. Italy is also sensible to geopolitical tensions via financial and investment linkages. Italian banks' consolidated claims in Russia and Ukraine roughly equals to 2% of GDP. Italian direct investment into Russia and Ukraine has increased significantly in recent years, reaching \$3 billion in 2012 after averaging less than \$50 million annually during 2002-2007. However, Italian direct investment stock in both countries combined is less than 1% of GDP (IMF 2014a, p. 11).

4. The Next Fiscal Round: A Light at the End of the Tunnel?

Statistics and forecasts of autumn 2014 have been disappointing. According to the IMF, the growth forecast for the world economy has been revised downward to 3.3% for this year, 0.4 percentage point lower than in April 2014. The global growth projection for 2015 was lowered to 3.8%. Weak economic growth has predictably led to aggravation of the employment situation and persistent deflation. Inflation in advanced economies remains generally below central bank policy targets, indicating substantial output gaps. In the euro area, inflation remained below expectations and declined further to 0.4% in August 2014 (IMF 2014d, p. 3).

Already in January 2014, the ILO had warned about possibility of jobless recovery. Almost 202 million people around the world were unemployed in 2013, an increase of almost 5 million compared with the previous year. In 2013, the crisis-related global jobs gap (since 2008) reached 62 million jobs, including 32 million additional jobseekers, 23 million people that became discouraged and no longer looked for jobs and 7 million economically inactive people that preferred not to participate in the labour market (ILO 2014, p. 3).

In the light, or better saying, in the gloom of retarding and fragile recession, the international monetary authorities acknowledge that monetary policy alone won't be able to reverse the grave unemployment situation. IMF's Fiscal Monitor (October 2014) with an eloquent title *Back to Work. How Fiscal Policy Can Help* argues that while "fiscal policy cannot substitute for comprehensive reforms, it can support job creation in a number of ways». Admitting limited fiscal space for many governments, the IMF outlines main modes how fiscal policy can contribute to job creation: 1) «the design of fiscal consolidation matters for labor market outcomes», 2) «the fiscal stance can buy time for labor market reforms» and 3) «reducing labor taxes can have a significant positive impact on employment in advanced economies, but often comes at a high fiscal cost» (IMF 2014, p. 1).

Here we return to an "eternal" problem of fiscal multipliers. The IMF admits: "The challenge is how to absorb the ensuing costs in a budget-neutral manner, through tax shifts or compensatory spending cuts". The IMF suggests that targeted fiscal measures can be part of a toolkit to address localized labor market malfunctions, such as high youth unemployment, low female and falling elderly labor force participation. Measures targeted to specific segments of the labor force are expected to be more cost effective than blanket ones. These measures include targeted cuts in employer's social contributions and targeted pension reforms. Among other measures can be a shift toward indirect taxes ("fiscal devaluation") and to less distortionary taxes, such as property and environmental taxes (IMF 2014b:22). Finally, the IMF presumes that an increase in public infrastructure investment, "particularly for advanced economies with clearly identified infrastructure needs and efficient public investment processes, could provide a boost to demand in the short term and help raise potential output in the medium term" (IMF 2014b, p. 94). Generally, the IMF is more or less optimistic about fiscal consequences of public investment, admitting that "evidence from advanced economies suggests that an increase in public investment that is debt financed would have larger output effects than an increase that is budget neutral, with both options delivering similar declines in the debt-to-GDP ratio" (IMF 2014d, p. 21).

The OECD in the autumn *Economic Outlook* admits that consumer spending in the euro area per head is below its level ten years ago. Private-sector investment is weak. Governments have reduced spending and raised taxes. Subdued demand has contributed to inflation remaining well below the ECB's target for some time and continuing to fall. Until recently, unemployment continued to drift up, and it remains at a high level. The OECD states that "flexible and well-designed fiscal policy could better support growth". Thus, "in the euro area, easing the pace of consolidation would help to support demand and help already-agreed structural reforms. All available room under the EU fiscal rules should be used to avoid pro-cyclical fiscal contraction and allow the automatic stabilisers to operate fully" (OECD 2014a, p. 5, p. 10)

In August 2014, ECB President Mario Draghi has begun promoting a more growth-friendly fiscal policy. Speaking at the Federal Reserve Bank of Kansas City, Draghi implicitly acknowledged that fiscal austerity has largely contributed to high levels of unemployment in the Eurozone. He suggested that "it would be helpful for the overall stance of policy if fiscal policy could play a greater role alongside monetary policy". He suggested "to achieve a more growth-friendly composition of fiscal policies. As a start, it should be possible to lower the tax burden in a budget-neutral way. This strategy could have positive effects even in the short-term if taxes are lowered in those areas where the short-term fiscal multiplier is higher, and expenditures cut in unproductive areas where the multiplier is lower" (Draghi 2014b).

In his recent speech dedicated to the centenary of Federico Caffè, Mario Draghi highlighted that "the current unacceptable level of unemployment... has its origins first in the great recession which has touched all the advanced economies; then in the sovereign debt crisis which has concentrated the job losses in those countries where the debt and the public deficit were higher, where the fiscal instruments of macroeconomic stabilisation have been paralysed by the need to show to investors that the debt, despite the crisis, was sustainable; in those countries where the transmission mechanism of monetary policy has stopped working, causing a credit crunch that has further aggravated the crisis". He admitted that monetary efforts made by the ECB should be complemented by "a fiscal policy which, in compliance with the existing rules, may see more investment and lower taxes". However, an accommodative monetary policy and a more active fiscal policy should be supported by structural reforms in product and labour markets (Draghi 2014a).

The European Commission's new President Jean-Claude Juncker has put public investment back on the agenda with his idea of a three-year □ 300 billion capital spending plan. The EU leaders are expected to discuss his proposal in December 2014. ECB President Draghi has already backed Juncker's proposal to invest in infrastructure such as roads, bridges and ports, drawing on existing EU funds and private investment.

It seems that this time the international monetary authorities are ready to make a U-turn to genuine Keynesian policy in order to create jobs. This supposition is partly corroborated by their mentioning of hysteresis risk and frequent citing of Alvin Hansen's hypothesis of secular stagnation. The IMF states that “Secular stagnation and low potential growth in advanced economies remain important medium-term risks”. There is a real danger that “the major advanced economies, especially the euro area and Japan, could face an extended period of low growth reflecting persistently weak private demand that could turn into stagnation. In such a situation, some affected economies would not be able to generate the demand needed to restore full employment through regular self-correcting forces” (IMF 2014d, xvi, 17).

Ignazio Visco, Governor of the Bank of Italy, admits that “public and private real investment fell in Italy by over 30 and 25 percent, respectively, between 2007 and 2013, well above the already high average of 20 percent recorded for the euro area as a whole”. At that “fiscal consolidation has often implied massive cuts in public investment, which may cast a shadow on potential future output”. He reminds that “Investment is the linkage between today’s demand and tomorrow’s supply. Reviving investment – public and private, national and European – would thus go a long way towards addressing both cyclical weaknesses and structural challenges to future potential growth. Indeed, ...lack of investment in infrastructure, education and training is another possible source of secular stagnation” (Visco 2014, p. 1, p. 4).

It is not at all surprising that the intended fiscal U-turn has been preceded and accompanied by neo-Keynesian theoretical reasoning. In early 2014, Lawrence Summers has reintroduced such concepts as “secular stagnation, the idea that the economy re-equilibrates; hysteresis, the shadow cast forward on economic activity by adverse cyclical developments; and the significance of the zero lower bound for the relative efficacy of monetary and fiscal policies” (Summers 2014a, p. 66, p. 73). In his recent article Summers suggests two possible strategies to cope with secular stagnation. The first is to find ways to further reduce real interest rates. The alternative is to raise demand by increasing investment and reducing saving. Appropriate strategies “should include increased public investment, reduction in structural barriers to private investment and measures to promote business confidence, a commitment to maintain basic social protections so as to maintain spending power and measures to reduce inequality and so redistribute income towards those with a higher propensity to spend” (Summers 2014b).

Another prominent neo-Keynesian Jeffrey Sachs proposes “a new macroeconomic strategy” in order to cure “an investment paralysis” which have been seizing the US and EU economies during two decades. “We need long-term public-investment strategies, environmental planning, technology roadmaps, public-private partnerships for new, sustainable technologies, and greater global cooperation" (Sachs 2014).

A rather notable fact about current turnabout in the attitudes of the international monetary authorities is their enriched fiscal lexicon. Though they warn countries about the necessity to continue with fiscal consolidation\adjustment and to respect fiscal rules and discipline depending on their individual fiscal environment (positions), at the same time, they recommend a certain fiscal expansion or loosening and even relaxation. Notwithstanding fiscal vulnerabilities and fiscal risks, they presume that "well-designed fiscal strategies can support job creation". A quintessence of the new fiscal discourse has been a concept of a smart fiscal policy introduced by Vitor Gaspar, Director of the IMF's Fiscal Affairs Department, who wrote: "Smart fiscal policy is imperative for countries facing the difficult juncture of an anemic recovery, weak potential growth, and very low inflation». It "supports jobs and growth while bringing public debt to safer levels, …values efficient public investment and facilitates structural reform» (Gaspar 2014).

5. Conclusion

Recent publications by the international organizations and scientific discussions in favor of smart fiscal policy and public investment blaze a trail to upcoming turnaround to Keynesian macroeconomic policy. Therefore, Russia's consistent commitment to active fiscal policy and considerable public investment has proven to be a reliable anti-crisis strategy. There is also a light at the end of the tunnel for Italy, since the next fiscal round has been gaining momentum not only in the international monetary headquarters but in the national governments, as well. Recently, Italian Prime Minister Matteo Renzi and his French counterpart, Manuel Valls, have declared that they will not comply with the EU Fiscal Compact 2012 that means that the second and the sixth most indebted EU countries will proceed with building-up debts for the sake of saving their economies.

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