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Linking economics with economic policy-making

Interview with Jerzy Osiatyński



Jerzy Osiatyński (born 1941) is Professor of Economics at the Institute of Economics of the Polish Academy of Sciences, Warsaw, Poland. He was Poland's Minister of Finance (1992–1993), Minister and Head of the Central Planning Office (1989–1991), Economic Advisor to the President (2010–2013), Member of the Monetary Policy Council (2013–2019), and was and is Fellow of the Committee for Economic Sciences of the Polish Academy of Sciences (2007–2010 and since 2020). His research interests focus on post-Keynesian economics, economic policy, public finance and economic transformation. He is the editor of the six-volume *Collected Works of Michał Kalecki* in Polish (PWE, Warsaw, 1979–1988) and its seven-volume publication in English (Oxford University Press, 1990–1997).

What in your life made you take up economics and how did you become an economist, as well as an economic politician?

I studied at the Faculty of Foreign Trade of the Main School of Planning and Statistics [SGPiS] in Warsaw. In the fourth year, Professor Kazimierz Łaski, who was the supervisor of my Master's thesis, offered me a job at the Department of Political Economy he headed, which I accepted. These were busy and good years. I graduated in 1964 and by the end of 1967 I had my PhD thesis written and positively reviewed, and a handful of publications.

In 1965, on Łaski's recommendation, I became the research secretary of a workshop run by Michał Kalecki and Łaski studying issues of growth in a centrally planned economy. The workshop was part of one of three of Kalecki's study-groups (seminars). The other two covered issues of planning and development of economically underdeveloped countries, and economic problems of developed capitalist countries. Each seminar was attended by prominent Polish academic economists, next to young assistant professors and post-graduate students. The three study-groups were real 'crash courses' in economics. In our seminar, apart from Kalecki and Łaski, the most active participants were professors Włodzimierz Brus, Tadeusz Kowalik and Cezary Józefiak. All this lasted until 1968 when we were chased away as a result of political and anti-Semitic purges.

Perhaps because of my involvement in this seminar, Kalecki introduced me to Joan Robinson when she visited Warsaw in 1966, and he mentioned a few kind words about me, which after 1968 helped me to continue my studies at Cambridge University. In September 1970 I came to Clare Hall – a college for advanced studies – where I spent the next two years, learned a lot, and also did a bit of teaching. Fortune – not the first, nor the last time – was kind to me.

At the end of 1972 I returned to Warsaw and a few months later I received a job at the Institute of the History of Science of the Polish Academy of Sciences, where I was assigned the task of preparing the edition of Michał Kalecki's *Collected Works*. That is how I got on the team led by Kowalik. The team's mission was to prepare the editions of collected works of Oskar Lange and of Kalecki, respectively. By the way, after the establishment of the Workers' Defence Committee in September 1976 (a Polish civil society group that was founded to give aid to prisoners and their families after the June 1976 protests and ensuing government crackdown), Kowalik's team provided its organizational structure and was strongly involved in political opposition of the time. I worked on the Polish edition of Kalecki's *Works* for many years and finished it only in the late 1980s. At the same time, once Oxford University Press decided to publish Kalecki's *Works* in English, I started working on that project. The last volume of the English edition was published in 1997.

Here I must adjourn the account of my research work and turn to my involvement in Poland's 'big politics'. After the Round Table negotiations between the Solidarity Trade Unions and the Government, in mid April 1989, I was invited to run on the lists of the Solidarity political caucus in the June elections to the Sejm (the lower house of the Polish Parliament). The caucus won all seats that the communists agreed to give up for free elections in the Sejm and all except one seat in the Senate. Thus, following the 4 June 1989 parliamentary elections, I became a member of the 'Lech Wałęsa team'. I sat in the Sejm for the next three terms on the lists of the Democratic Union party which later became the Freedom Union. In that time I served twice as minister: first as the Head of the Central Planning Office in the first post-World War II non-communist government headed by Tadeusz Mazowiecki (1989–1991); and a little later as the Minister of Finance in Hanna Suchocka's government (1992–1993). By 2001, I decided it was time to return to academia and did not run in the parliamentary elections held that year.

The 1989–2001 years offered me a unique opportunity to work closely and make friends with many outstanding Polish politicians (many of whom I already met in the years of political opposition in Poland): Tadeusz Mazowiecki, Bronisław Geremek, Jacek Kuron and Adam Michnik among them. Notwithstanding some differences regarding the course of the Polish 'shock-therapy' (see for example Kowalik 2012), we largely shared the views on what kind of crucial reforms Poland needed. Moreover, serving in the government and the Sejm gave me, as a macroeconomist, a unique opportunity to closely participate in determining the foundations of a new economic system in Poland. This experience – as a practitioner of economic policy-making – has in turn influenced my thinking as a macroeconomist. It made me pay attention to the micro- and the macro-economic assumptions underlying our theoretical views, as well as to economic policy recommendations founded on those theories. It also taught me prudence in determining the time in which the expected – and the unexpected or underestimated – consequences of any given policy measure would occur. With many actors of the political scene of those years I shared the happiness of a generation which got the chance to face the unusual economic and political challenges and to handle them as best as it could.

Returning to teaching and research after a 12-year break was not easy. During these years I have not followed the development of economic theory, let alone actively participated in it. For the purposes of editing Kalecki's *Works* I read what was directly related to his legacy but not much more. So it took me some time before I started to publish again, on matters either related to Kalecki, or on assessments of our economic transition (seen through the prism of present-day post-Keynesian and post-Kaleckian economics).

Did you have a mentor? Someone who guided you? Who exerted an impact on your economics?

Clearly, my intellectual mentor was Kalecki whom I was lucky to meet and work with. Prior to Kalecki there had been Łaski, who taught me first political economy, and next how to read and understand Kalecki. I had been friends with Łaski since the late 1960s and we worked closely together until the last days of his life. For both of us Kalecki was the most important reference point in our work and we both thought he was one of the world's most original economists of the twentieth century and beyond it, and at the same time a very principled man in his value judgment. In personal contacts he was very kind and charming with a rather sardonic sense of humour.

Łaski used to divide his intellectual development into three phases: before Kalecki, with Kalecki, and after Kalecki. In my case it is similar, except that there was hardly any 'before Kalecki' phase. From the beginning it was Kalecki, and then 'after Kalecki'. Intellectual and personal closeness to Łaski and Kalecki did not protect me, however, from various bumps in the years of my economic policy-making. Shortly after I left politics, Łaski rightly pointed out to me: 'If you are a follower of the theory of effective demand, how on earth could you argue in the Sejm that what Poland was short of was "first – money, second – money, and third – also money"?' Indeed, this was what I said in the Parliament when, as the Minister of Finance, I was presenting the 1992 budget. And, of course, Łaski was right: for a follower of Kalecki's theory that was a rather ridiculous thing to say.

Who was the supervisor of your doctoral dissertation: Kalecki or Łaski?

Truly speaking, my supervisor was Łaski. But after the March 1968 purges he was forced to emigrate, I was not allowed to defend my doctorate thesis and two years later I went to Cambridge. I came back with a newly written book. I thought, however, it was good enough to present it as my postdoctoral dissertation (habilitation). Therefore I thoroughly rewrote and expanded my old PhD thesis, and Professor Henryk Fiszal from the University of Warsaw agreed to become its supervisor. I obtained both my PhD and my habilitation degree at the Department of Economics of the University of Warsaw. The basis of habilitation was my aforementioned *Kapitał, podział, wartość: kryzys ekonomii neomarginalistycznej* (*Capital, income distribution, and value – the crisis of neomarginalist economics*) which reviewed post-Sraffian capital controversies in a broader context of contending theories of national income distribution. While writing this book, just like when preparing the Polish edition of Kalecki's *Works*, I was much helped by Kowalik, to whom I owe a lot when it comes to the research toolkit as well as the sharpness of editorial comments.

Who – in your opinion – has exerted the greatest influence on both Polish and global economics in the last few decades?

Of course, mainstream economics has had the greatest impact. Since the mid 1970s it has displaced the theory of effective demand of Keynes and Kalecki. Kalecki was ignored, and Keynes's *General Theory* was 'bastardized' (see Robinson 1973) and reinterpreted to represent no general, but a mere special case of a truly general theory, i.e., of the new version of neoclassical economics. In fact, in modern mainstream economics insufficient aggregate demand is treated as a marginal case related to 'rigidity' of markets and asymmetry of information. These, it is argued, must be dealt with by using completely different economic policy measures than those recommended by Keynes or Kalecki.

However, the paradigm of mainstream economics is based on assumptions that are simply surreal. Let's take two of them that – following Łaski – I particularly like to 'torment'. Mainstream economics and its DSGE [dynamic stochastic general equilibrium] models

assume in general that individuals smooth their consumption over their entire lifetime. Without going into technical details, let's imagine that each member of a company board or of a government agency receives a one-off bonus of €10 000 on top of their respective monthly wages. Let's also assume that those who are awarded are young people, their further life expectancy being 50 years, that is, 600 months, and that they all trust in the accuracy of mainstream macroeconomic models. Now divide this bonus by 600 months, receiving about €16.70 per month. Should we believe that – in line with the mainstream economics assumption about smoothing consumption over the entire lifetime – each awarded individual would divide his or her cash bonus into 600 equal parts and will be adding €16.70 from this bonus to their current consumption every month until the end of their lives? If so, why would they not accept these bonuses to be paid to them in installments: €16.70 per month added to their monthly remuneration? Show me among the adherents of mainstream theory those who would behave this way? I think not many.

Let's take another assumption, i.e. that whenever the government starts financing expenditures – say on some new social benefits – with a budget deficit, none of those who receive them will increase their spending because, in line with the Ricardian equivalence theorem, they know that shortly the government will have to tax them in order to finance that deficit. Moreover, because all taxpayers will have to pay off the debt, not only the beneficiaries of the new social welfare, everybody will immediately cut their expenditures in an appropriate amount as soon as the benefits are introduced. Do you know many people who abide to this principle and behave like that? Are these not surreal assumptions? Indeed, Ricardo has accomplished far too much in economics to be associated nowadays first and foremost with that theorem.

So if you ask me what dominates Polish and world economics today, I answer: rational expectations, representative agents, quantifiable risk substituted for unquantifiable uncertainty, ergodicity, the abovementioned nature of consumption functions and the Ricardian equivalence theorem. By saying that, I do not mean that simplifying assumptions are not needed, nor that they are not present in the post-Keynesian theory. But we must always try to make them as close to reality as possible.

What should be the role of government in the economy?

I will say the same thing that Łaski used to say: the market is not perfect and the government is not perfect. The government must not assume the role of the market, but no doubt there are areas where it should intervene. And I do not mean limiting its role to regulatory functions or to taking care of the infrastructure. It should also intervene in such areas as inequalities in the distribution of household incomes as well as counter-cyclical interventions in aggregate demand that drive business fluctuations. Government intervention in income inequalities is important if one wants to maintain decent growth rates combined with low unemployment. In addition, when income inequalities are not controlled and the percentage of people who have a sense of being devoid of equal opportunities for self-realization rises, maintaining social cohesion becomes ever harder. And without that it is difficult to talk about a market economy functioning in an environment of liberal democracy. Rather, it gives ground for majoritarian democracy and/or the political oligarchy system.

When it comes to counteracting the business cycle, probably the most important issue nowadays is to control the global financial markets. The challenge is that counter-cyclical policy instruments are national, while capital which finances budget deficits of individual countries is, in principle, international. Moreover, its short-term changes, most often of speculative nature, can destabilize any economy. To counteract this one can resort to taxing such operations. This is not about taxing the assets or liabilities of commercial banks, but about taxing speculative transactions. This was the essence of the Tobin tax. Implementing

it is politically difficult but would help individual governments to regain some sovereignty over the debt denominated in their own money.

Professor Jan Toporowski, in this very context, proposes a balance-sheet tax.

The balance-sheet tax proposed by Toporowski (2013) refers to the concept of capital tax developed by Kalecki in 1938 (see Kalecki 1938 [1990]). It was intended to finance government expenditures and, unlike the tax on fixed productive assets, its construction did not affect the expected profitability of investments (thus not discouraging them). Income from this source could be used to finance all types of expenditures, including, for instance, those related to servicing public debt or its repayment. Toporowski's balance-sheet tax would mainly apply to financial intermediaries and non-financial companies holding financial assets, and thus would only slightly reduce (at a tax rate of 1–2 per cent of the company's balance sheet) the possibility of financing short-term speculative operations. This is obviously important, but it seems to me that Tobin's proposal – if only it could be implemented – would be a more effective instrument.

Is there a country that functions (or used to function) in a way at least close to your vision of an optimal economic system?

I will not be original here: a social market economy has been functioning since after World War II in Scandinavia (Nordic Model) and since Ludwig Erhard in Germany, and it still works there today. Importantly, it also functioned when those countries were poor. It is not true that such a model can be introduced only when the economy is sufficiently rich. At the time it was introduced in those countries they were rather poor.

The argument used against the social market economy in its Scandinavian version is mainly based on a country's necessity to remain competitive in relation to the rest of the world. But let's think what it really means to maintain competitiveness in terms of unit direct and indirect labour costs in relation to foreign countries? As a matter of fact, for a group of countries at a similar level of labour productivity per hour that might imply reducing their hourly wage rates to those that are the lowest among the group of trading partners – although there is also non-unit labour cost competitiveness, but cost competitiveness may dominate, at least in the short term. However any such policy of competitive wage-rate reductions, cutting welfare and other social benefits, etc., first reduces total aggregate demand, and second is unlikely to attract public support.

How would you assess the condition of Polish economic science?

My regular reading is limited to *Ekonomista* and one or two more Polish economic journals. Therefore, I would not like to hurt my Polish colleagues with a biased judgment. But reflecting on the theoretical content of those publications and of the debates in the field of macroeconomics and economic policy-making in Poland, I must say that mainstream economics is dominant and professed with the greater passion. It is amazing that in the country of Kalecki there is not a single academic course of his theory, especially the theory of economic dynamics and business fluctuations of the capitalist economy. The same – as far as I know – applies to contemporary post-Keynesian economics in general, one exception being the circle of economists from Poznań gathered around its Summer School in Heterodox Economics.

Why do you think it is so?

Since the victory of Milton Friedman and the liberal school of economics, combined with pseudo-Keynesianism, which has little in common with Keynes, all those who build other

macroeconomic models, based on different assumptions and leading to other conclusions, are considered to be uneducated and underqualified. Of course, heterodox economists who teach macroeconomics must ensure that their students know also mainstream economics. But students should know the limits of the orthodox assumptions and of the conclusions derived therefrom. In any case, however, students should be able to learn about the corpus of alternative theories, their assumptions and conclusions. Then it will be harder to mock, undermine or ignore the quality of non-mainstream economists. However, this requires much more openness to other theories in macroeconomics than we observe in Poland today.

Would you agree that the proper measure to assess the use of any theory is the consistence between the projections based on it and the actual empirical data?

This is an important question. Sometimes you can build a model that produces the right forecast by accident, or forecasts that work until a collapse comes, for instance a speculative bubble bursts. Then, on the basis of such a model, it is impossible to explain where the crisis came from and economists such as Kalecki or Hyman Minsky are turned to for rescue. The model assumptions of these forecasts must always be examined to see if they work not only in a 'good weather' economic environment, but especially when there is a transition from a good to a bad one, to predict those shifts in advance. This is the purpose of any forecast after all.

When, years ago, after some public debate I pointed out the lack of realism of assumptions in one of the presentations, a friend of mine – a mathematician and an astronomer by education – sarcastically noted: 'to this day there are doctoral dissertations in astronomy based on the assumption that the earth is flat, because it doesn't matter if they're in line with reality. What matters only is whether their conclusions are consistent with the assumptions made'. This may be acceptable in astronomy, but not in a social science like economics.

Do you think the development of economic thought is affected by historical events: crises, wars, revolutions?

Yes. I suppose Kalecki's way of thinking, and perhaps the fact that he dealt with economics, and not with engineering which he had studied, resulted largely from his experience of the Great Depression. Large unemployment and widespread poverty were at the roots of his very leftist views throughout all his life, although he was never a member of the Communist Party. Wars and revolutions do affect our thinking about the economy, but so does our personal experience.

Do you think the 2008 crisis changed something in economics?

It hardly changed anything. Probably soon some eurozone countries will again develop structural foreign trade deficits so that Germany, the Netherlands, Austria and some other countries will continue enjoying permanent surpluses and along this new way of 'beggar-thy-neighbour' policy improve their unemployment rates. Those imbalances will collapse again after some time, because the growing debt of countries with permanent import surpluses will prove financially unsustainable. Of course, the EU's highly indebted countries on the eve of outbreak of the 2008 global financial crisis have recently been running current-account surpluses, mainly at the expense of the non-EU countries, thus moving unsustainability from a regional to a worldwide theatre. For a moment, there seemed to be an atmosphere conducive to a change in economic thinking, and interest in the economics of effective demand increased slightly. But it was all short-lived and shallow.

Of course, efforts towards expanding the theoretical menu of options for students should continue and Keynes's and Kalecki's theories should be in that menu. By the way, since 2015 a shift in economic policy towards increasing wage rates and, consequently, the share of the wage bill in GDP is seen in Germany, the United States and some other countries, which improves their respective GDP dynamics.

One of the virtues that mainstream economics prides itself on is the alleged pursuit of a scientific discipline devoid of value judgments. Do you think that such an economics is at all possible?

This is impossible. When constructing any model each economist adopts assumptions which are based on her or his value judgments. Is society merely a sum of individuals, or is it composed of differing classes and strata whose reaction functions to various economic changes will be different? Is unemployment a matter of individual choice between employment and leisure, or a result of other factors? Is the structure of income distribution important for economic dynamics, business cycles etc., or is it not? Then, when it comes to interpretation, the economist looks through the prism of his or her implicitly accepted value judgments. Value judgments are also important when deciding on what to focus our attention on, what factors to consider of fundamental nature. Is it unemployment? Or is it unrestrained *laissez-faire* and maintaining status quo when it comes to changes in the distribution of income, wealth, opportunities and power? The point is not that these matters are interconnected, but what we believe are the prime determinants of those interconnections.

This can be seen even in the classic macroeconomic trade-off – 'unemployment vs inflation'?

Yes. In this case there may indeed be a trade-off. But here one also needs to be careful in choosing the assumptions. In neoclassical economics and the present-day mainstream, it is assumed that unit variable costs – and, consequently, prices – are an increasing function of the volume of output while the 'invisible hand of the market' determines equilibrium prices which (at a given supply) are an increasing function of demand and (at a given demand) a declining function of supply. Here comes Kalecki, who in his *Theory of Economic Dynamics* (Kalecki 1954 [1991]) says: as a rule the market economy operates below capacity, even at the top of the boom. Therefore, supply of manufactured goods (as opposed to raw materials and agricultural products) is flexible and unit variable costs are basically constant up to full capacity use of factors of production. Moreover, prices of manufactured goods are set by the entrepreneurs themselves (and not by the 'invisible hand'). So – in contrast to prices of raw materials or agricultural products, the supply of which cannot be easily increased in the short run, and prices of which are demand-determined – there is room for increasing supply without raising unit variable costs. Unit variable costs, and therefore prices, can be constant as long as the economy operates below full employment.

Let us now return to the abovementioned trade-off between the unemployment rate and the inflation rate. As long as we maintain Kalecki's assumptions, in the relevant range of output changes, unit prime costs and prices are constant. Therefore, in the diagram in which unit prime costs and prices are denoted along the vertical axis and the volume of output and employment along the horizontal one, the aggregate supply curve runs parallel to the horizontal axis and it shoots up as the economy approaches full employment. Under those assumptions, talking about this trade-off – which is the essence of the Philips curve concept – doesn't make much sense. Adjustment to the new equilibrium goes through the channel of changes in output and employment, not through price changes. John Hicks (1968: 64–65), following Alfred Marshall, wrote

that when our supply or demand curves are not skewed there is no single equilibrium, but many. Then there must be another mechanism to achieve it. For Kalecki (1954 [1991]), the mechanism determining the sequence of short-term equilibria is provided by his theory of cyclical and long-term changes in output and employment, which are in turn determined by changes in private investment.

Let us now allow for a certain rise in unit variable costs, say, because the introduction of a second and certainly of a third shift requires a rise in wage rates. The aggregate supply curve will then be a rising function of the volume of output and employment, although output adjustment will dominate price responses. Then, in line with Kalecki's and Keynes's theories, volumes of output and employment will continue to be determined by changes in aggregate demand, but there will be some trade-off between inflation and unemployment. How much of a trade-off? The answer must be sought in empirical research. However, economic dynamics will continue to be determined by aggregate demand, primarily by factors determining private investment, because they, and not that trade-off, are the essence of entrepreneurs' decisions.

Would you agree that better knowledge of the history of economic thought and methodology of economics would help in the development of economics?

Undoubtedly, yes. Unfortunately, economic history is only taught in a rudimentary way and history of economic thought even more so. Virtually all universities strive to educate craftsmen rather than masters. It also seems to me that history of economic thought should be firmly rooted in the economic history of the period to which it relates.

What do you think about the statement by Herbert Stein (chairman of the Council of Economic Advisers under Richard Nixon and Gerald Ford) that 'It may seem a shocking thing to say, but most of the economics that is usable for advising on public policy is at about the level of the introductory undergraduate course'?

It depends on who uses these basic theoretical models and how. In a lifetime, the knowledge of only four elementary arithmetic operations may prove enough. It does not mean, however, that for an economist the knowledge of how to calculate the first and second derivatives is irrelevant, especially when examining changes in the phases of business cycles and economic dynamics. Stein's judgment seems to me rather of dubious value.

Of course, when one wants to persuade an economic policy-maker for a given policy option, one may well limit the argument to rudimentary reasoning. But then the matter is not that the argument is of the introductory undergraduate course nature, but that of the syllabus of that course and its canon. I think the problem is not that of rudimentary economics, but that it is rudimentary economics of only one school which is founded on rather unrealistic assumptions. This is the problem!

Since we came to economic policy advising, my last question concerns your own experience: How does an economist feel among politicians? How would you, after years, evaluate this relationship?

First of all, I consider myself extremely lucky – 'born with a silver spoon in my mouth' – to be given the opportunity to confront my macroeconomic knowledge with economic policy-making: I had the chance to actively participate in the process of Poland's economic and political transformation. Recently, I found in my papers a congratulatory letter from Prime Minister Hanna Suchocka of April 1993. She wrote: 'It gives me great pleasure to emphasize that your consistence in action and the ability to effectively defend your views – even in the most difficult situations – is the strength of our government'.

Perhaps this effectiveness of defending my arguments comes from the fact that I spared no effort to disclose on what premises my opinions and assessments were based, what assumptions were made, and on proving that in this sense they were not arbitrary – that I clearly said what were the implications of my argument in both the short and the long run. The past experience, as I said, is important because it affects our thinking about the challenges ahead of us. But our thinking about those challenges is also determined by the clichés we use to understand the present-day realities. However, we must be aware of the limitations of those clichés. And we must also have courage to disclose them in our debates. Finally, when forecasting the future, it is important to operate with a sufficiently long time horizon.

This interview was conducted by Grzegorz Konat in Warsaw on 3 September 2015 and was then shortened and amended by Jerzy Osiatyński in January 2020. It was first published, in full, in Konat/Smuga (2016). It was translated from the Polish by Grzegorz Konat (Research Institute for Economic Development, SGH Warsaw School of Economics, Warsaw, Poland; email: grzegorz.konat@sgh.waw.pl). Thanks go to Ryan Woodgate for editing the English.

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