
Stimulus Deniers



By [Antonio Fatas](#) , INSEAD Professor of Economics

There is too much distrust towards central banks and their ability to help smooth business cycles.

[Paul Krugman](#) summarises very well the position of some academic economists who deny the potential role that aggregate demand might have in explaining business cycles and, as a result, they reject any policies that might have an effect via the demand channel. Their models are only driven by changes in the productive capacity of an economy which means that the Great Recession (or the Great Depression) must have been the result of some destruction in our capital stock or our inability to remember how to work or produce or somehow our technology got worse than in previous years.

It might be that these economists are just describing an ideal world using assumptions that are very far from the real world but how is it possible that these ideas seem to have such a strong influence in economic policy and even support among the general public? Why is it that countercyclical policy (fiscal or monetary) has been challenged so much during the current crisis? Most policy makers and certainly the public at large do not share the assumptions used by those economic models.

In fact, when most people are asked to describe the dynamics of economic crisis, they immediately refer to some notion that shortages of demand cause recessions. When I teach about recessions and I ask my students about the cause of business cycles they immediately tell a story that sounds like the very basic keynesian multiplier (spending reduces income which further reduces spending...). But when the same students are asked to give their views about appropriate economic policies during a crisis, they immediately show their distrust in governments and in the ability of central banks to help smooth business cycles. Somehow, expansionary fiscal policy or monetary policy cannot work because it is driven by the government.

So we end up with an odd coalition of views against countercyclical economic policy: those who rely on models where by definition countercyclical policy is ruled out and those who do not believe in these models (they laugh at them if you explain all the assumptions) but because they have no trust in governments they end up reaching the same conclusion.

[Antonio's blog](#)

[Twitter](#)

Follow INSEAD Knowledge on [Twitter](#) and [Facebook](#)

Find article at

<https://knowledge.insead.edu/economics-finance/stimulus-deniers>

About the author(s)

Antonio Fatas is a Professor of Economics at INSEAD. He is also a Research Fellow at the Centre for Economic and Policy Research in London and has worked as an external consultant for the International Monetary Fund, the OECD and the World Bank.