
For whom does stagnation matter? The political economy of austerity¹

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Extended Abstract

Fifty years after the consolidation of post-Keynesian economics as a heterodox theoretical tradition, its analytical toolkit remains indispensable for understanding the economy through the lens of a demand-led monetary theory of production, in which effective demand, uncertainty and inherent instability play a central role in macroeconomic determinants. Yet, as secular stagnation entrenches itself as a defining feature of contemporary capitalism, a critical question is systematically displaced from the theoretical agenda: for whom does stagnation matter? This paper argues that a theoretically robust post-Keynesian macroeconomics must recover the debates of political economy as a constitutive dimension of macroeconomic analysis.

The stagnation criticism identifies demand shortfalls, financialization, and investment weakness as central mechanisms of sluggish growth. This apparatus, however, risks analytical incompleteness if it does not interrogate the class and political determinants that reproduce stagnation as a stable equilibrium. Drawing on Kalecki's (1943) foundational argument that full employment is politically threatening to capitalist discipline, we contend that stagnation is not merely a macroeconomic malfunction but an outcome that actively serves the distributional interests of financial wealth-holders.

This logic is nowhere more visible than in the political economy of austerity. Contractionary fiscal stances are routinely legitimized through ostensibly technical instruments: Taylor-rule prescriptions, debt sustainability thresholds, inflation-targeting regimes. Those mechanisms systematically obscure their redistributive content and jeopardize those who depend on labour income and government social spending for their material reproduction.

Following Clara Mattei's (2022) historical excavation of austerity as a class project and Mark Blyth's (2016) account of its ideological construction, we argue that fiscal contraction

¹ This study was financed in part by the Coordenação de Aperfeiçoamento de Pessoal de Nível Superior – Brasil (CAPES) – Finance Code 001. This study has also received financial support from the think tank Transforma.

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functions as a mechanism for transferring income from labor toward holders of public securities and financial assets. The apparent technicality of these policy rules is ideologically productive: it naturalizes a politically contested distributional outcome as economic necessity.

Against the portrayal of austerity as a technical and apolitical principle, we return to Abba Lerner's (1944, 1951) functional finance, often associated with Modern Money Theory. By subordinating fiscal policy to macroeconomic outcomes rather than financial conventions, Lerner's framework reveals austerity not as economic necessity, but as a political choice.

We conclude that the renewal of post-Keynesian macroeconomics in an age of global transformation and chronic stagnation requires a deliberate re-engagement with power, class, and distributional conflict. Restoring political economy to the center of macroeconomic theory is not a retreat from analytical rigor, it is its necessary condition.

Abstract

This article investigates why fiscal austerity is recurrently presented as a solution for stagnation, even though it deepens the insufficiency of aggregate demand that characterizes the capitalist economies slowdown. Starting from the post-Keynesian diagnosis of stagnation, the article reconstructs the orthodox defense of austerity, centered on the expansionary fiscal contraction thesis and articulated within the New Macroeconomic Consensus, and examines the heterodox critique formulated through the principle of effective demand. It argues that, although theoretically and empirically robust, this critique remains confined to the terrain on which austerity itself is presented – that of effectiveness – and therefore fails to explain its persistence. Drawing on Lerner's functional finance, the article shows that austerity is not an accounting necessity but a political choice. Building on Kalecki and Mattei, it proposes shifting the analysis toward political economy: austerity is not a failed remedy but a political means of managing stagnation that redistributes its costs, disciplines labor, and preserves positions of wealth, while its technical appearance converts class interests into economic necessity. The article concludes that the renewal of post-Keynesian macroeconomics requires reincorporating the dimensions of power, class, and distributional conflict, and outlines a research agenda concerning the neutrality of economic theory and de-democratization.

Keywords: Austerity; Stagnation; Political economy; Effective demand; Functional finance; Kalecki.

JEL Classification: E6 — Macroeconomic Policy, Macroeconomic Aspects of Public Finance, and General Outlook.

Resumo

Este artigo investiga por que a austeridade fiscal é recorrentemente apresentada como remédio para a estagnação, embora aprofunde a insuficiência de demanda agregada que caracteriza o baixo dinamismo das economias capitalistas contemporâneas. A partir do diagnóstico pós-keynesiano da estagnação, reconstrói-se a defesa ortodoxa da austeridade, centrada na tese da contração fiscal expansionista e articulada ao Novo Consenso Macroeconômico, e examina-se a crítica heterodoxa formulada à luz do princípio da demanda efetiva. Argumenta-se que essa crítica, embora teórica e empiricamente sólida, permanece no terreno em que a própria austeridade se enuncia – o da eficácia – e, por isso, não explica sua persistência. Recuperando as finanças funcionais de Lerner, mostra-se que a austeridade não constitui uma necessidade contábil, mas uma escolha política. Com base em Kalecki e Mattei, propõe-se deslocar a análise para a economia política: a austeridade não é um remédio fracassado, mas uma forma política de administrar a estagnação, que reorganiza seus custos, disciplina o trabalho e preserva posições de riqueza, enquanto sua aparência técnica converte interesses de classe em necessidade econômica. Conclui-se que a renovação da macroeconomia pós-keynesiana exige reincorporar as dimensões de poder, classe e conflito distributivo, e aponta-se uma agenda de pesquisa sobre a neutralidade da teoria econômica e a desdemocratização.

Palavras-chave: Austeridade; Estagnação; Economia política; Demanda efetiva; Finanças funcionais; Kalecki.

Classificação JEL: E6 – Macroeconomic Policy, Macroeconomic Aspects of Public Finance, and General Outlook.

Resumen

Este artículo investiga por qué la austeridad fiscal se presenta recurrentemente como remedio para el estancamiento, aunque profundice la insuficiencia de demanda agregada que caracteriza el bajo dinamismo de las economías capitalistas contemporáneas. A partir del diagnóstico poskeynesiano del estancamiento, se reconstruye la defensa ortodoxa de la austeridad, centrada en la tesis de la contracción fiscal expansiva y articulada al Nuevo Consenso Macroeconómico, y se examina la crítica heterodoxa formulada a la luz del principio de la demanda efectiva. Se argumenta que esta crítica, aunque teórica y empíricamente sólida, permanece en el terreno en el que la propia austeridad se enuncia – el de la eficacia – y, por ello, no explica su persistencia. Recuperando las finanzas funcionales de Lerner, se muestra que la austeridad no constituye una necesidad contable, sino una elección política. Con base en Kalecki y Mattei, se propone desplazar el análisis hacia la economía política: la austeridad no es un remedio fracasado, sino una forma política de administrar el estancamiento, que reorganiza sus costos, disciplina el trabajo y preserva posiciones de riqueza, mientras su apariencia técnica convierte intereses de clase en necesidad económica. Se concluye que la renovación de la macroeconomía poskeynesiana exige reincorporar las dimensiones de poder, clase y conflicto distributivo, y se señala una agenda de investigación sobre la neutralidad de la teoría económica y la desdemocratización.

Palabras clave: Austeridad; Estancamiento; Economía política; Demanda efectiva; Finanzas funcionales; Kalecki.

Clasificación JEL: E6 — Macroeconomic Policy, Macroeconomic Aspects of Public Finance, and General Outlook.

Introduction

Capitalism is a mode of production traversed by internal contradictions: crises do not constitute an anomaly of its functioning, but a structural feature of capitalist dynamics, which operates under instability. Over the last three decades, these contradictions have manifested themselves in the most diverse crises - the 2008 financial crisis, the Covid-19 pandemic, the climate emergency, energy and food shocks, and the intensification of geopolitical tensions. Far from constituting isolated episodes, these crises are linked together in a context marked by high indebtedness, fragile investment, slowing growth and widening inequality. With each new crisis, society faces new challenges and bottlenecks to growth and to the distribution of income.

The growth indicators of the G7 economies illustrate this picture. The recovery after the 2008 crisis did not restore the dynamism of previous decades. Average real GDP growth fell from 2.45% per year, between 1990 and 2007, to 1.98%, between 2010 and 2019. The post-crisis slowdown in economic growth was not an isolated phenomenon: in the periods indicated, the proportion of years with growth below 2% p.a. rose from 28% to 50%, respectively. The fall in the investment rate does not go unnoticed either - gross fixed capital formation fell from 23.4% to 20.9% of GDP between these periods (authors' elaboration based on IMF, 2026; WORLD BANK, 2026).

The debate on secular stagnation returned to economists' spotlight after the 2008 crisis. In particular, after Larry Summers' speech at the IMF in 2013, a predominantly monetary interpretation of secular stagnation gained strength, centered on the insufficiency of aggregate demand in the face of a negative equilibrium real interest rate that would prevent monetary policy from stimulating investment. This formulation places the insufficiency of demand back at the center of the debate, but explains stagnation as a monetary phenomenon, that is, one that could be solved through a more effective economic policy.

This reading does not arise out of nowhere; it is inscribed in the framework that guided economic policy in the decades prior to the crisis. From the 1990s onwards, the New Macroeconomic Consensus (NMC) consolidated itself as the dominant macroeconomic framework. This model combines New Keynesian microfoundations with a strong emphasis on rules, credibility and expectations. In this framework, macroeconomic stability depends primarily on controlling inflation, and not on managing aggregate demand, while private agents form forward-looking expectations and respond strongly to the credibility of economic policy. Monetary policy constitutes the main stabilization instrument, through supposedly independent central banks oriented towards price stability. Interest rate policy is preferred to fiscal policy because it is considered more flexible

and less distortionary. The Taylor rule synthesizes this logic in a simple operational formulation, according to which the Central Bank adjusts the policy interest rate in response to deviations of inflation from the target and to the output gap, reinforcing the idea of a countercyclical monetary stabilization.

Fiscal policy plays a secondary and limited role, since its discretionary use is considered potentially destabilizing and, for this reason, it remains in the background, subject to the imperative of "neutrality" and to rule-based economic policymaking. On this level, the subordination of fiscal policy translates into numerical primary balance rules, spending ceilings and debt sustainability limits that end up converting fiscal policy action into a rigid variable. The Taylor rule, the inflation targeting regime and the limits on indebtedness are presented as neutral technical instruments that guarantee the solvency of the State and the confidence of agents. However, by setting the interest rate at levels that guarantee accumulation for the rentiers who hold the public debt and, in doing so, compressing the public spending on which those who live from labor income depend, it becomes evident that economic policy decisions, far from being technically neutral, carry a distributive content that their technical form insists on concealing.

The persistence of low economic dynamism after the international financial crisis occurred in parallel with the return of fiscal austerity policies. Although the acute phases of the crises were marked by a significant increase in government spending, the recovery period, characterized by slower growth, lower consumption expansion and a share of investment lower than in the pre-crisis period, was accompanied by the return of contractionary fiscal policies. Austerity and stagnation, therefore, coexisted throughout the 2010s and overlapped again after the pandemic. This overlap is a central element of the post-crisis debate on austerity, especially for the interpretations that attribute to the restriction of aggregate demand a role in maintaining stagnation.

Part of the post-Keynesian tradition approaches the same problem from different foundations. From the perspective of a monetary economy, in which money is not neutral and radical uncertainty and effective demand condition the level of activity, weak economic dynamism coexists with deepening inequality and with the continuous transfer of income and wealth from workers to capitalists. Through this lens, distribution is not a residual of growth, but a determinant. The trajectory of low dynamism must, therefore, be read in light of who appropriates the income and wealth generated by labor. In 2024, the richest 1% received, in the median⁴ of the G7 countries, 12.7% of pre-tax national income, while the bottom 50% received 18.8%. Wealth concentration is even more pronounced. In that year, the richest 10% held 59.1% of household net wealth, while the

⁴ We use the median to represent the "typical country" of the G7 without allowing a country with a very high or very low value to excessively alter the result.

poorest half held only 4.6% (authors' elaboration based on WID, 2026). The coexistence of increasingly slow growth and increasing concentration of wealth suggests that stagnation is not equally burdensome for all. Now, if there is an increase in the concentration of income and wealth in economies with sluggish dynamism, a question that macroeconomic criticism rarely asks must be posed: for whom does stagnation matter?

The heterodox critique of the use of austerity as a remedy for stagnation consistently demonstrates the theoretical and empirical problems of this prescription. In economies with unemployment and idle capacity, public spending plays an important role in economic dynamism by mobilizing underutilized resources and, therefore, generating income and employment and creating conditions for investment to take place. Contractionary fiscal policy runs counter to the Keynesian view of effective demand since, by reducing spending, it reduces the capacity to generate income; thus, demand, which is already insufficient in sluggish economies, is discouraged even further. In this sense, a significant part of the heterodox interventions that combat austerity rescue the principle of effective demand by arguing that increased spending, in the face of recessionary shocks, is more effective in restoring growth - and even in reducing the primary deficit in the public accounts. This defense, although relevant, privileges the technical terrain and the criteria of efficacy, established within the orthodox economic debate itself, to the detriment of a political analysis of the correlations of power present in society.

The effective demand tradition is not, in itself, blind to the political aspect of economic management. Kalecki (1943), in “Political Aspects of Full Employment”, argues that resistance to full employment is not a problem of technical capacity, but of a political nature. If sustained, full employment erodes factory discipline, since dismissals would cease to function as a coercive and disciplinary measure: class struggle is inscribed here (KALECKI, 1943, p. 326). By extension of this argument, stagnation should not be read merely as a macroeconomic failure or as a challenge of efficient resource allocation, but as a politically stable equilibrium that favors class interests. Maintaining idle capacity in the economy preserves wage discipline and protects the value of financial wealth, which ultimately serves the rentiers who oppose full employment, as Kalecki himself formulated. This research does not argue, therefore, that heterodoxy ignores the question “for whom does it matter?”, but something more delimited: that the dominant rhetorical strategy in a significant part of the heterodox critique⁵ of austerity in the public debate, especially after 2008,

⁵ It is evident that “heterodoxy” encompasses an extensive and not very homogeneous range of theses and authors. In this sense, the article devotes its analysis to a delimited set of post-Keynesian interventions in the public debate on austerity after the 2008 crisis. The analysis was guided by the investigation of distances and proximities between the argumentative frameworks: on one side, the arguments that operate on the terrain of efficacy; on the other, those that address the class interests, the distributive conflicts and the power relations that permeate the austere discourse.

has privileged the terrain of efficacy, that is, the demonstration that austerity fails on its own terms, to the detriment of the terrain of power, relegating the Kaleckian legacy.

In view of this, the central thesis of the article can be stated more precisely: the critique of the efficacy of austerity is technically sound and necessary in demonstrating that fiscal contraction and monetary tightening do not produce the economic stabilization promised by their advocates. On the other hand, this critique proves insufficient to explain the persistence and political functionality of austerity. By rebutting it predominantly through the argument that it fails on its own terms, there is the risk of grounding its resilience as a technical error, subject to correction, and not as a dispute in the political field that is traversed by class interests and conflicts.

The demonstration of the inefficacy of austerity does not seem sufficient to explain its permanence. The strength of austerity as an idea is essentially composed of a moral charge, and the insistence on this playbook seems to bear little relation to its efficacy, but finds its foundation in its capacity to define "moral" causes for financial crises and to determine the distribution of their burdens.

The insufficiency of the heterodox critique does not stem from a mistake in the technical arguments mobilized, but from the limitation of the analysis given the questions it sets out to answer. Thus, demonstrating that austerity does not work explains why it should be abandoned, according to its own declared objectives. However, it does not explain why it perpetuates itself as economic policy. That is, the passage from the critique of error to the critique of power requires placing back at the center of the debate other questions beyond technical functionality. In this sense, a critique of power starts from other guiding questions: whom does austerity serve? Which relations of power and inequality does it preserve?

A second relevant piece of evidence in questioning the perpetuity of austerity is whether its real economic function is the declared one. In the book *"The Capital Order"*, Clara Mattei (2022) proposes a new interpretive lens in which the real function of austerity is the preservation of the capital order. Unlike Blyth (2013), who points to an ineffective repetition of austerity, almost as a form of madness, Mattei (2022, p.3) points out that there is no insanity whatsoever, but rather a deliberate method whose objective is to strengthen the capital order through the maintenance of its main pillars - private property and wage relations.

The theory of functional finance, founded by Abba Lerner (1943), offers an important counterpoint to the allegedly technical necessities of austerity. The author rejects the principle of

sound finance, that is, the idea that the government must balance its accounts as if it were a household budget, and puts forward the idea of functionality, that is, that public spending, taxes and money issuance must be used according to their function in economic activity (LERNER, 1943, p.39). The author states that taxation does not exist simply to finance spending, but to fulfill a function of social interest: to control demand when it threatens to generate inflation. For the same reason, the absolute size of the domestic debt does not constitute a burden for society as a whole (LERNER, 1943, p.46-47). While directing fiscal policy towards social gain is a necessary manifesto, Lerner's work also helps to make clear that interest on the debt does not represent a loss for the nation, but a transfer from taxpayers to bondholders, and that the government could contain the growth of this concentration of wealth by taxing the richest instead of borrowing from them (LERNER, 1943, p. 49-50).

By removing from the debt the status of a technical constraint, Lerner reveals what it is: a distributive relation. There are, however, two relevant considerations regarding Lerner's theory that open a gap for the study of fiscal policy through the lens of political economy. The author attributes the resistance to functional finance to the public's lack of understanding and to the rhetorical concessions of its own advocates (LERNER, 1943, p.43), and states that it would work regardless of who was in control (LERNER, 1943, p.51). In the same year, Kalecki (1943) offered a contribution that made it possible to go beyond Lerner's explanation of the resistance to using fiscal policy with a social function. From the Kaleckian perspective, opposition to full employment does not stem from an error of understanding, but from class interests. Lerner demonstrates not only that austerity is not a necessity but that spending should be oriented according to the demands of society; Kalecki explains why it persists. Thus, there are class interests that prefer government accounts oriented towards favoring the few to the detriment of social gain. It is in the articulation between both authors that this article is situated.

The present text investigates why austerity is recurrently presented as a remedy for stagnation, even though it deepens the bottlenecks in aggregate demand that are responsible for the low dynamism of the economy, and which class interests this economic policy serves. The hypothesis is that its permanence does not stem from its efficacy in restoring growth, but from its political function: by reproducing stagnation, austerity also reproduces the conditions that make it functional for class interests. Austerity compresses the income and bargaining power of workers, preserves the interests of the rentiers who are creditors of the public debt, and transforms the costs

of capitalism's crises into demands for fiscal discipline. Its technical and accounting appearance, expressed in rigid rules for the conduct of fiscal policy, inflation targets and debt sustainability thresholds, is, in fact, the way in which this political function is naturalized and concealed.

The article is divided into three sections that aim to reconstruct the critique of austerity as an anti-stagnation tool. The first section discusses austerity as a response to stagnation, from the defense of orthodoxy to the limits of the critique of heterodox macroeconomics. The second section recovers Lerner's (1943) functional finance to discuss the social function of fiscal policy and distinguish it from accounting objectives built on neoclassical assumptions. The third and last section shifts the debate from macroeconomics to political economy by discussing the function of austerity as a mechanism for strengthening the pillars of capital. Finally, this article is justified by the need we identify to contribute to the renewal of post-Keynesian macroeconomics, in an era of global transformations and chronic stagnation, through the recovery of discussions on power, class and distributional conflict. Placing political economy back at the center of macroeconomic theory does not represent a retreat from analytical rigor, but a necessary condition for achieving it.

1. Austerity as a response to stagnation: from the orthodox defense to the limits of the critique of efficacy

This section aims to investigate whether austerity has sufficient theoretical and empirical foundations to be presented as a remedy for stagnation. The argument unfolds in three movements. Initially, we recover the post-Keynesian diagnosis of stagnation which, through the lens of effective demand, understands that the level of economic activity trails behind spending, that the level of investment is decided under strong uncertainty and that the economy does not tend towards full employment. We also argue that Keynesian macroeconomic theory itself has political limits, since its opposition to orthodoxy is formulated from the standpoint of preserving the capital order⁶. Next, we reconstruct the orthodox defense of austerity in light of the expansionary austerity thesis and its revival after the 2008 financial crisis. Finally, we argue that the heterodox critique of austerity as a remedy for stagnation, especially after 2008, prioritizes the discussion on efficacy to the detriment of the discussion on class power. The intended result is twofold. On the one hand, the critique of

⁶ In the text, we use the definition of the capital order presented by Clara Mattei (2026): "We live in a *specific* type of economy, with a particular historical form, different from those that preceded it and those that could succeed it. It is thus essential to provide a definition of our economy that is free from technicalities that hide its concrete meaning. Capitalism is a socioeconomic system in which employers use their private means of production to hire wage labor in order to produce commodities whose sale generates profits. The system's two pillars are wage labor and the private means of production. The roof of the system is profit. These two pillars are the attributes of the two main classes that confront each other in society: workers, who live primarily off their labor income, and capitalists, who live primarily off capital income in the form of dividend and interest payments. We're talking about human institutions, generated by precise collective decisions and historical processes that, being human, can be subverted." (MATTEI, 2026. p.15)

efficacy is necessary and proves correct in demonstrating that austerity deepens the insufficiency of aggregate demand. On the other hand, this critique has fundamental limits in relegating the question that guides the following sections: if austerity fails on its own terms, why does it continue to be adopted?

1.1. The post-Keynesian diagnosis of stagnation

The post-Keynesian tradition understands stagnation through the lens of the principle of effective demand. In it, the volume of employment and income is determined by entrepreneurs' expectations regarding the proceeds they will obtain from selling their output. That is, it is the point at which the expected proceeds from a given volume of employment equal the minimum proceeds necessary to induce the employer to offer this level of employment. In other words, it is the point determined by entrepreneurs' expectation of monetary gains. (FERREIRA, 2003, p. 94). In this diagnosis, investment under uncertainty represents a decisive element. Because it depends on expectations of future profits, investment spending cannot be reliably predicted, since it is the component of aggregate output most subject to fluctuations. (KEYNES, 1937, p.221)

In a monetary economy, wealth holders may, in the face of an uncertain future, prefer the liquidity of money to the acquisition of capital goods, whose production would employ labor (KEYNES, 1937, p.217). Hence, the decision to produce and employ is subordinated to capitalists' assessment of how to allocate their wealth. For this reason, lower nominal interest rates would not be capable of overcoming unemployment due to insufficient demand:

That is to say, unemployment increases because people want the moon; men cannot get employment when the object of their desire (that is, money) is something that is not produced and whose demand cannot be easily choked off. The only remedy consists in persuading the public that the moon and green cheese are practically the same thing, and in running a green cheese factory (that is, a central bank) under public control.

(...)

Our conclusion can be stated in the most general form (taking the propensity to consume as given) as follows. The volume of investment cannot be increased when the highest of the own-rates of interest of all available assets, measured in a certain standard, is equal to the highest of the marginal efficiencies of all assets, measured in the same standard. (KEYNES, 1996 [1936], p. 229, our translation)

Now, if the level of employment (and unemployment) of the economy is not determined within the labor market, but in other markets, in which capitalists make their investment decisions. Thus, even if workers accept a reduction in their nominal wages, this would not guarantee them access to jobs. There is, in other words, a basic asymmetry of power between the buyers and sellers of labor power: only the former determine the quantity that will be transacted. (FERREIRA, 2014,

p.5) In other words, involuntary unemployment does not stem from market failures, but is the result of the functioning of a monetary economy. (FERREIRA, 2003, p. 5)

The New Keynesian explanations, which by the way depart from that of Keynes himself, blame unemployment on the labor market itself and support precarizations harmful to workers as solutions to unemployment:

The “New Keynesians” are so called because they seek to rescue some issues raised by Keynes and forgotten, within the *mainstream* of macroeconomic theory, for several decades. One of them, perhaps the most crucial, is the existence of involuntarily unemployed people. People who want to work at the prevailing real wage and cannot find work.

(...)

How do these authors explain the existence of real wage rigidity? By the very maximizing rationality of firms – or, believe it or not! that of workers. That is: the explanation for the existence of unemployment is confined to the sphere of the labor market. It is not, as Keynes would have it, the result of a deficiency of demand, the result of the calculations of valorization of capitalist wealth, but the consequence of the rationality of the agents who buy and sell labor power. (FERREIRA, 2014, p.2, our translation)

In the post-Keynesian tradition, in turn, the level of output is determined by the expected level of demand (or of expected profit), since the decision to produce accords with producers' belief in their capacity to sell. This mechanism does not move towards the full utilization of productive capacity. Radical uncertainty and income distribution directly influence consumption and investment decisions, since workers and capitalists display different spending and saving behaviors. Hence, income distribution affects aggregate demand and represents important fluctuations both in the short run and in the growth trajectory of the economy (VAZ; CARVALHO, 2021, p. 7). Thus, there is no automatic mechanism leading the economy to full employment; it may reach equilibrium positions that still may not correspond to the full use of productive capacity, since uncertainty conditions allocation decisions.

Transposed to the contemporary debate, this diagnosis allows the post-Keynesian literature to place the rupture of the link between profits and investment at the center of secular stagnation. The advance of financialization would broaden the possibility of valorizing wealth outside production and directs accumulation towards non-productive allocations (ONARAN, 2016, p.4). That is, the increase in income concentration, in favor of profits, ceases to be converted into an expansion of productive capacity through an increase in the investment rate. The circuit becomes marked by rising inequalities and by the persistence of insufficient aggregate demand and low investment.

This diagnosis runs counter to the *mainstream* formulation after 2008, in which secular stagnation can be defined as a macroeconomic problem that can be solved through monetary policy, with negative interest rates, which could balance investment and saving. Even supposedly more Keynesian interpretations, such as those of Summers and Krugman, preserve in their analyses the use of the natural rate of interest to balance saving and investment at the level of full employment. (HEIN, 2015, p. 3).

Palley (2019) points out that this interpretation is, in fact, an extension of pre-Keynesian orthodoxy itself, which attributes economic bottlenecks to market imperfections:

The unexpected emergence of stagnation has prompted mainstream economists to search for a theoretical explanation. That search has now converged on the zero lower bound (ZLB) to nominal interest rates, which is claimed to obstruct clearing of the loanable funds market for full employment saving and investment. As a result, ZLB economics has become the new orthodoxy that saves 'New Keynesian' economics. It does so by introducing yet another nominal rigidity, this time regarding nominal interest rates. (PALLEY, 2019, p.151-152)

In this sense, the post-Keynesian diagnosis moves towards interpreting stagnation as a state of the economy in which effective demand is insufficient to mobilize the idle productive capacity of the economy. In other words, it has nothing to do with transitory anomalies correctable through macroeconomic adjustments of prices and confidence.

As early as the end of the 1970s, Steindl (1979, p. 8-9) observed that business opposition to full employment policies, described by Kalecki, had acquired a persistent character, to the point that one could speak of a "political trend". This trend of opposition to full employment, motivated by the increase in workers' demands, contributes to the maintenance of stagnation, since governments were more concerned with inflation and public debt than with the recovery of investment. On the other hand, the intended reduction of budget deficits would only occur with the recovery of investment, unlikely in the face of idle capacity without a fiscal expansion that stimulates spending.

Beyond recognizing that a monetary economy does not spontaneously tend towards full employment, from the Keynesian perspective, it is necessary to take a step further to investigate the real causes of stagnation. Keynesian macroeconomic theory is a theory of wealth allocation. Decisions are made by the capitalist, whose objective is to maximize their gains, and investment is only one of the possibilities (FERREIRA, 2003, p. 109). Now, if the level of employment depends on the decisions of capitalists, economic policy trails behind these very decisions. Keynes himself recognizes that prosperity "depends, excessively, on a political and social climate that satisfies the average type of businessman" (KEYNES, 1996 [1936], p. 170, our translation). Moreover, it is a mistake to assume that Keynes advocated a permanent policy of deficit public spending. Such

conduct should only be explored by the State in times of recession, with the aim of restoring the decisions of private agents. (FERREIRA, 2014, p.8).

The political meaning of this position had already been formulated a decade before the publication of the General Theory. In “Am I a Liberal?”, Keynes states that “the class war will find me on the side of the educated bourgeoisie” and laments that capitalist leaders are “incapable of distinguishing novel measures for safeguarding capitalism” from what they call Bolshevism (KEYNES, 1925, p.297-299). It is in this sense that Mattei (2022, p. 308) argues that “Keynes never strayed far from the deepest kernels of the austerity project”: by placing the entrepreneur at the center of economic dynamism and making macroeconomic management the creation of an environment favorable to investment, his theory would expel class conflict and entrust experts with the preservation of the pillars of capitalism (MATTEI, 2022, p. 308-309). The effective demand tradition thus provides the instruments to demonstrate the inefficacy of austerity, but its political horizon is not so distant from that invoked by the advocates of contractionary adjustments – the restoration of the confidence of those who hold wealth.

1.2. The bitter remedy: the orthodox defense of austerity

Although the post-Keynesian diagnosis of the causes of stagnation points to the insufficiency of demand and to the difficulty of restoring economic dynamism in the face of weakening investment, the response adopted goes in the opposite direction. From the perspective of a demand-led economy, as the principle of effective demand teaches us, the most evident solution would be the adoption of countercyclical measures capable of expanding public spending and inducing the recovery of aggregate demand. However, austerity is the prescription that returns with each new crisis. Spending cuts, public debt control and monetary discipline are presented as technically necessary conditions to restore business confidence and revive private investment.

In this subsection, we reconstruct this defense based on one of its formulations⁷, the expansionary austerity thesis, elaborated by economists linked to Bocconi University – the so-called “Bocconi boys” –, who, after the financial crisis, advised European and international institutions, such as Ecofin, the European Central Bank and the IMF, to commit to austerity (MATTEI, 2022, p. 211). This lens was chosen because it was the Italian school that gave austerity its currently

⁷ Silva (2023, p.141) points to other formulations that became part of mainstream economic theory, such as the Chicago school, the Virginia school (*Public Choice*) and ordoliberalism. The author mentions the contribution of the Italian school but understands that the first two acquired greater relevance in the *mainstream* economic debate. Even so, we maintained the choice of analyzing the *Bocconi Boys* because it is the formulation that founds the idea of spending cuts with expansionary functions and disseminates the meanings of this thesis as the essence of austerity policies to this day.

best-known meaning as a contractionary fiscal policy with expansionary output results. (SILVA, 2023, p.172)

Austerity can be defined as a policy of deflationary adjustment that reduces wages, prices and public spending with the aim of restoring competitiveness and business confidence. According to its advocates, voluntary deflation would be responsible for reducing the size of the State in the competition for resources available for investment and would guarantee greater confidence in state solvency through debt control. (BLYTH, 2013, p. 15)

The defense of this prescription has its main genesis in the Expansionary Austerity Thesis, according to which, under certain conditions, a fiscal contraction can produce expansionary rather than recessionary effects - formulated by Giavazzi and Pagano (1990) and consolidated by Alesina and Perotti (1995). Giavazzi and Pagano (1990, p.76) start from the confrontation between the Keynesian conclusion and the so-called “German view” on spending cuts, according to which the direct contractionary effect of reduced spending could be overcome by an indirect effect on expectations. The authors adopt a stance of alleged neutrality by arguing that only an empirical analysis could settle the conflict between these two views. However, as we will see later, the authors' empirical and supposedly neutral analysis is, in fact, loaded with a moral charge that defends austerity.

It runs counter to the Keynesian view of Effective Demand, for which, in a context of unemployment and idle capacity, public spending mobilizes underutilized resources and generates income and employment (ROSSI; DWECK; ARANTES, 2018, p. 16-17) Alesina and Ardagna (1998) seek to counter this result through demand and supply mechanisms in which cuts perceived as permanent would signal lower future taxation and raise consumption and investment; the compression of wages and transfers would increase investor confidence (ALESINA; ARDAGNA, 1998, p.491-493) That is, they argue that the composition of the adjustment matters more than its size: adjustments via spending cuts would be expansionary, while tax increases would be recessionary. The authors themselves make explicit the perverse ingredients of a supposedly “successful, long-lasting and expansionary” adjustment:

Three ingredients seem to be important for a successful, long-lasting and expansionary fiscal adjustment. It must combine spending cuts in transfers, welfare programmes and the government wage bill, some form of wage agreement with the unions that ensures wage moderation, and a devaluation immediately before the fiscal tightening. (ALESINA; ARDAGNA, 1998, p.490)

After the 2008 crisis, there was an intense revival of this thesis in order to justify a pro-austerity playbook for the affected nations. In particular, economists who advocated austerity

such as Francesco Giavazzi and Alberto Alesina, also called “Bocconi boys”, advised international financial institutions to follow this path. (MATTEI, 2022, p.211) The article “Large Changes in Fiscal Policy: Taxes versus Spending” by Alberto Alesina and Silvia Ardagna (2010), for example, revisits the Expansionary Austerity Thesis by analyzing fiscal stimuli and adjustments between 1970 and 2007 and indicating that spending cuts would have a greater capacity to reduce deficits and generate growth than tax increases. The article “Growth in a Time of Debt” by Carmen Reinhart and Kenneth Rogoff (2010) is another text that became popular among advocates of austerity by claiming that there is a technical threshold of 90% of debt to GDP for developed countries and 60% for emerging countries for indebtedness not to stifle growth.

The most systematic formulation of this agenda reaches the most recent debate. Alesina, Favero and Giavazzi (2019, p.4) reiterate the argument that austerity based on tax increases would be deeply recessionary, while contractionary fiscal adjustments would have costs that are “very low, on average close to zero”. This difference is due to the association the authors make with expectations and confidence – which leads them to claim that austerity can, indeed, be expansionary. It is also a fact that, although there is an excessive concern with which form of contractionary adjustment is least burdensome on output, the same concern is not found with the social cost of cutting assistance programs for vulnerable populations. As Mattei (2022, p. 296) observes, the common thread of these theories is the assumption that savers and investors hold the key to economic prosperity. This same principle is directly responsible for the constant transfer of income from vulnerable populations to rentiers:

It follows logically that the purpose of economic policy is to shift resources from the majority to an economic minority. Cuts in social spending, Alberto Alesina wrote, “signal that tax rates won’t have to rise in the future, thus spur investors to be ‘more active’” (Alesina 2012).

Specifically, to boost profit expectations, governments have incentives “to cut the most politically sensitive components of the budget: [social] transfers and government wages and employment” (Alesina and Perotti 1995, 12, my italics). The overall message here is explicit: cuts in social spending and labor costs not only boost the profits of the select few; they also serve as a control over the majority, who otherwise would slack off (the same kind of slacking that keeps them from being savers and investors). (MATTEI, 2022, p.296-297)

Articulated with the New Macroeconomic Consensus described in the introduction, the expansionary fiscal contraction thesis offers fiscal policy a role compatible with the primacy of monetary policy. The transmission mechanism of the adjustment operates through agents' confidence and the reduction of *crowding-out* effects. Thus, in addition to the contraction of public spending benefiting wealth holders, it causes the main economic policy instrument of the New Macroeconomic Consensus, the interest rate, to be used less, even due to its inefficiency (SILVA, 2023, p. 67). The result is the consolidation of a prescription presented as technical and politically

neutral, which articulates limits on indebtedness, fiscal rules and inflation targets with the promise that macroeconomic discipline would restore agents' confidence and, by this route, revive output growth. It is this premise, that the recovery of private confidence would convert fiscal contraction into an expansion of economic activity, that the heterodox critique, discussed below, confronts on the basis of the principle of effective demand.

1.3. The heterodox critique and the limits of efficacy

The heterodox critique of the orthodox defense of austerity is made in light of the principle of effective demand. On the theoretical level, it argues that contractionary adjustments deepen the insufficiency of demand that causes stagnation. On the empirical level, it points out that the evidence supporting the expansionary austerity thesis is built on questionable methodological bases. In this subsection, we argue that this critique is correct and necessary, but encounters a limit since it operates on the same terrain on which the defense of austerity is built: that of macroeconomic efficacy, measured in terms of growth, stabilization and debt control. In this format, the critique runs the risk of relegating the Kaleckian legacy which, within the same effective demand tradition, demonstrates the political reasons why full employment is not sought by the owners of wealth or their institutional representatives.

From the point of view of the principle of effective demand, austerity deepens precisely the problem it claims to address. This principle is the combination of two basic ideas: i) the autonomy of spending in relation to income and ii) the determination of income by spending. The first lies in the fact that agents decide how much to spend, but do not determine in advance how much they will receive; the second follows directly from this, since the spending carried out generates income for other agents and conditions the level of production according to the expectation of future gains. Production does not, by itself, create a corresponding demand, which contradicts Say's Law. In a demand-driven economy, it is spending that transforms potential demand into effective demand and induces decisions on the allocation of productive capacity and the creation of new wealth.

The defense of austerity starts from different assumptions. In the orthodox view, there is a dispute between the public and the private sectors over the allocation of saving and investment, so that the reduction of public spending opens space for private investment. The Keynesian view, on the other hand, points out that the effects of spending depend on the conditions of the business cycle. In an economy with involuntary unemployment and idle capacity, the expansion of public spending does not capture private investment, but mobilizes underutilized resources and generates effective demand, therefore generating income and employment. As Rossi, Dweck and Arantes (2018) summarize:

On the level of economic theory, this effect stems from the assumption that the public sector and the private sector compete for resources, or savings, and that a reduction in public spending opens space for private investment.

(...)

These assumptions are contrary to what John M. Keynes proposes, for whom this competition for resources between the private and the public sectors depends on the economic cycle. For Keynes, it is in the boom and not in the slump that the government can cut spending (Keynes, 1937). And the author's reasoning is quite intuitive: in the slump, since society's resources are underemployed, an increase in public spending generates growth and employment, while in boom periods public spending has a smaller effect on economic activity. That is, when the economy is heated, cutting investment in a public work, for example, may not have a negative effect on the economy, since the company that would be hired by the government will probably be hired by another person or private company. Likewise, the reduction of social transfers may have distributive impacts, but not necessarily contractionary ones. The same does not occur when there is a scarcity of demand, unemployment and excess idle capacity in the economy: in this case, public demand increases income and employment. (ROSSI; DWECK; ARANTES, 2018, p.17, our translation).

On the empirical level, micro-macro models help to understand the inefficacy of fiscal adjustments. Dweck, Vianna and Barbosa (2020) discuss the impacts of austerity through a multisectoral agent-based and demand-led model. The results directly contradict the expansionary austerity thesis. In the scenarios subject to the greatest restrictions on public spending, such as a fixed primary surplus target and a zero real growth rule, there is greater volatility and worse performance in the face of an external shock. The adjustment takes on a self-defeating character in which contractionary policy deepens the slowdown, reduces revenue and worsens the fiscal result itself. On the other hand, the scenarios of countercyclical fiscal policies sustain the best economic performance and the highest growth rates.

The empirical lens makes it possible to counter the view of the expansionary austerity thesis that the composition of the adjustment matters more than its size. Cardoso et al. (2023) analyzed the effects of public spending on social protection programs on GDP in 42 countries, between 1985 and 2020, by means of a structural VAR model. The authors concluded that the cumulative multipliers of this spending are, in general, higher than the multipliers of total public spending. In other words, public spending on social protection generates more income than total public spending. Among the 28 European countries examined, this relation was observed in all of them, with the exception of Ireland and Latvia. This occurs because social protection expenditures direct income mainly to the poorest groups, whose propensity to consume is higher; hence, there are more indirect effects on output (CARDOSO et al., 2023, p. 9). Therefore, the composition of the adjustment does indeed matter, but in a sense diametrically opposed to that defended by the advocates of austerity. Cuts in assistance programs do not favor economic recovery; they only further deepen the insufficiency of demand, since they compress the marginal propensity to consume.

The very theses of the advocates of expansionary austerity, who also relied on applied modeling to defend spending cuts, have already been directly challenged from both an empirical and a methodological point of view. Herndon, Ash and Pollin (2013) point out fundamental errors in Reinhart and Rogoff's (2010) article, such as the exclusion of countries from the database used in the analysis, selective exclusion of data and dubious weightings. They demonstrate, in the same technical garb, that austerity was grounded on a false image of a technical threshold. Even Roberto Perotti (2011), who was one of the authors responsible for systematizing mechanisms and evidence in defense of the possibility of expansionary fiscal contractions together with Alberto Alesina (1995), acknowledged in 2011, in his article "The 'austerity myth': gain without pain?", that the "success" cases behind austerity were more related to international trade flows than to domestic consumption expectations.

Guajardo, Leigh and Pescatori (2014) pointed out some important biases in favor of identifying expansionary effects in the literature defending austerity. The literature that supports the thesis identifies episodes of fiscal consolidation through the change in the cyclically adjusted primary balance. In doing so, changes in fiscal variables may reflect changes that do not stem from economic policy decisions, but from other factors that may affect output, such as the expansion of the stock market (GUAJARDO; LEIGH; PESCATORI, 2014, p. 950). With the same data used by Alesina and Ardagna (2010), the authors, by removing the bias of the adjustment, identify a completely different result in which fiscal adjustment produces contractionary effects on consumption and GDP. (GUAJARDO; LEIGH; PESCATORI, 2014, p. 961). The authors also investigate the relevance of the composition of the adjustment. The post-2008 experience went in the same direction. Blanchard and Leigh (2013, p. 8) compared the IMF's growth forecasts for European economies with the actual results and found results indicating that each percentage point of GDP of fiscal consolidation forecast for 2010 was associated with a GDP about 1% lower than forecast.

In this sense, there is no robust evidence to support austerity as an effective mechanism for restoring economic growth, nor for stabilization. On the other hand, historically, countercyclical economic policies have demonstrated a great capacity to recover economies affected by financial crises. The Brazilian response to the 2008 crisis is an example of this movement. According to Carvalho (2018, p. 36-37), maintaining public spending through increased social transfers, the minimum wage and investments by the Growth Acceleration Program (PAC) and Petrobras prevented an even greater contraction of domestic demand. After two consecutive quarters of falling GDP, the Brazilian economy returned to growth in the second quarter of 2009. The 2015 adjustment illustrates the opposite movement: fiscal contraction did not reverse the deterioration of the public

accounts; the recessionary effects contributed to a 6.3% reduction in revenues, greater than the spending cut, worsening the primary result itself (MELLO; ROSSI, 2017, p. 26-27).

The soundness of the heterodox critique is lent credibility even by the fact that the very institutions that prescribed austerity revisited it and drew conclusions critical of the previous consensus, especially after the 2008 crisis. Blanchard, Dell’Ariccia and Mauro (2010, p.5-6) acknowledge that, before the financial crisis, fiscal policy had been relegated because there was a consensus in academia that monetary policy was capable of maintaining stabilization; moreover, academia (*mainstream*, it should be noted) strongly rejected the use of discretionary fiscal policy, since it assumed that it was more subject to political pressures.

Years later, Summers and Blanchard (2017) record that, out of necessity, fiscal policy was rediscovered as a stabilization tool during the crisis, although, in the face of deficits and rising debt, fiscal expansion quickly turned into austerity:

Out of necessity, fiscal policy was rediscovered as a stabilization tool during the crisis, although, in the face of deficits and large increases in debt, fiscal expansion quickly turned to fiscal austerity and debt stabilization. Today, fiscal policy faces a highly unusual environment: On the one hand, and largely because of the financial crisis, debt levels are high by historical standards. On the other hand, interest rates on government debt are low, and, in many countries, expected to remain lower than growth rates for some time to come. As a consequence, levels of government debt service relative to GDP are low by historical standards.

One extreme hypothesis is that these low safe rates reflect an excess accumulation of capital in the world, what is referred to as “dynamic inefficiency.” If this were indeed the case, then higher debt, to the extent that it crowded out private capital, would actually be not only feasible but also desirable. (SUMMERS; BLANCHARD, 2017, p. 16)

Krugman (2015) went so far as to point out the discredit of austerity and the *mea culpa* of the institutions that had defended austerity on the basis of questionable procedures. In fact, no relevant gains in confidence as a generator of investment and inducer of aggregate demand were observed. Beyond that, the nations that entrusted the conduct of macroeconomic policy to the austerity playbook suffered from the deepening of demand insufficiency and from social losses:

On the other side of the ledger, the benefits of improved confidence failed to make their promised appearance. Since the global turn to austerity in 2010, every country that introduced significant austerity has seen its economy suffer, with the depth of the suffering closely related to the harshness of the austerity. In late 2012, the IMF’s chief economist, Olivier Blanchard, went so far as to issue what amounted to a *mea culpa*: although his organisation never bought into the notion that austerity would actually boost economic growth, the IMF now believes that it massively understated the damage that spending cuts inflict on a weak economy.

Meanwhile, all of the economic research that allegedly supported the austerity push has been discredited. Widely touted statistical results were, it turned out, based on highly dubious assumptions and procedures – plus a few outright mistakes – and evaporated under closer scrutiny.

It is rare, in the history of economic thought, for debates to get resolved this decisively. The austere ideology that dominated elite discourse five years ago has collapsed, to the point where hardly anyone still believes it. (KRUGMAN, 2015)

Even so, as Summers and Blanchard's (2017) own record indicates, austerity remained the policy adopted. The controversy over efficacy was won, even within the *mainstream* that once defended it; even so, the policy was not abandoned. It seems that efficacy criteria are not sufficient to explain the permanence of austerity as a rule for the conduct of economic policy.

The construction of macroeconomic theory under the apparatus of the New Consensus offers a key that can help in this investigation. By assigning to monetary policy the function of inflation control and restricting the discretionary action of fiscal policy, it makes use of involuntary unemployment as an anti-inflationary anchor. The Taylor rule makes this mechanism explicit by prescribing an increase in the interest rate in the face of inflation above the target. This increase induces saving, raises the cost of debt and triggers a contraction in aggregate demand and, consequently, in output and employment. Austerity reinforces this movement by limiting public spending and preventing it from offsetting the recessionary effects of monetary tightening. In this sense, maintaining idle capacity and involuntary unemployment ceases to be an undesirable result in the conduct of economic policy and comes to fulfill a function in the machinery of the model.

In the direction of this investigation, it is worth recovering the Kaleckian legacy, which already pointed to political limits to full employment. Kalecki (1943), in “Political Aspects of Full Employment”, argues that resistance to full employment is not a problem of technical capacity, but of a political nature. If sustained, full employment erodes factory discipline, since dismissals would cease to function as a coercive and disciplinary measure. Furthermore, the doctrine of “sound finance” grants capitalists indirect control over the government by making the level of employment and economic activity dependent on the capitalists' “state of confidence”. (KALECKI, 1943, p. 325-326).

What happens, however, is that part of the post-Keynesian interventions resort to the Kaleckian apparatus to reinforce efficacy criteria and relegate his contribution on the power relations that create obstacles to full employment. Cardoso et al. (2023, p. 16), when estimating the multipliers of social protection spending, turn precisely to “Political Aspects of Full Employment” to ground their results, specifically to the passage in which the author states that the government can stimulate effective demand through spending. It is evident that the argument is pertinent to the object of that work, which is the magnitude of the multipliers. It is equally evident how the Kaleckian legacy circulates in the critique of austerity as a theorist of the multiplier and not as a revelation of class opposition to full employment.

The heterodox critique correctly demonstrates that austerity lacks the capacity to stabilize economies in crisis or to generate growth. However, the demonstration of its inefficacy produces a new question: if austerity deepens stagnation and if the evidence supporting it is fragile, why does it continue to be adopted? The critique of efficacy identifies its failure from the point of view of macroeconomic theory, but does not explain its permanence from the political point of view. In this sense, the critique under technical apparatuses, although indispensable, ends on the terrain on which austerity itself is enunciated. Therefore, to answer the question of why austerity remains, even though it does not work, it is necessary to carry out a shift from the field of macroeconomic theory to that of political economy and investigate the class relations that permeate austerity.

2. From sound finance to functional finance: the social function of fiscal policy

The previous section addressed the insufficiency of austerity as an instrument of stabilization and growth and the insufficiency of the heterodox critique focused on efficacy parameters, which, although correct, ends on the same terrain on which austerity is defended. Before shifting the analysis to the field of political economy by asking for whom stagnation matters, a brief reflection on the function of fiscal policy is in order. The controversy over austerity is not reduced to an allocative choice, but involves two distinct conceptions of what fiscal policy serves. On one side, the advocates of austerity maintain that it serves to guarantee budgetary balance, as an autonomous objective, and to guarantee the reliability of the state through the subordination of economic policy to primary balance targets and the reduction of the debt/GDP ratio. In this view, it is strengthened as an independent objective, since the balance of the public accounts is pursued regardless of the economic conjuncture, the level of employment and the existence of idle capacity. On the other side, the budget is understood as an instrument that must be assessed by the social effects it produces on income, employment, inflation and development.

This second conception is formulated by Abba Lerner (1943) in the definition of functional finance. The idea behind the concept is quite simple: fiscal policy – spending, taxation, debt servicing and monetary control – must be conducted according to the way it operates, or its function in the economy. Although traditional economic theory calls for evaluating fiscal policy solely by a financially sound macroeconomic performance, as a scientific methodology, functional finance proposes that fiscal policy must be functionally directed and not assessed according to what orthodoxy considers economically healthy. (LERNER, 1943, p. 39).

The first law of functional finance assigns to the government the responsibility for maintaining the level of spending through fiscal policy. The government must not pass a value judgment on the deficit or surplus of the public accounts; it must keep it at a level that balances

unemployment and inflation. Hence, taxation decisions must not be made out of the need to make a payment, but rather with a predefined function. The main effect of taxation is thus to transfer money from the population to the government – not because the government needs means of payment, since it could acquire them more easily through money issuance (LERNER, 1943, p. 40).

In the same vein, the second law of functional finance establishes that the government should only borrow money, that is, issue public debt securities, when it is desirable for the public to have less money in circulation. This may be desirable when, as a result of very low interest rates, the volume of investment causes inflation (LERNER, 1943, p. 40-41). In other words, when the economy is running hotter than its capacity. Still deriving from the idea that the government should not use taxation or borrowing as a way of financing itself, but with a specific objective related to the function it performs in the economy, the author establishes that when taxation, spending and borrowing are governed under the aegis of functional finance, the excesses of spending over revenue and vice versa must be covered or destroyed through money issuance. (LERNER, 1943, p. 40-41).

Thus, functional finance rejects the traditional doctrines of “sound finance” and the principle of a balanced budget. The public accounts must be subordinated to the function of eliminating unemployment and inflation through taxation and spending, and not subordinated to an arbitrary budgetary control (LERNER, 1943, p. 41). The balance of the government accounts ceases to be an objective and becomes a result.

In a later text, Lerner (1947) explains the monetary foundation behind what the laws of functional finance establish. The argument revolves around something that seems obvious but must always be said: money is a creature of the state.

The modern state can make anything it chooses generally acceptable as money and thus establish its value quite apart from any connection, even of the most formal kind, with gold or with backing of any kind. It is true that a simple declaration that such and such is money will not do, even if backed by the most convincing constitutional evidence of the state's absolute sovereignty. But if the state is willing to accept the proposed money in payment of taxes and other obligations to itself the trick is done. Everyone who has obligations to the state will be willing to accept the pieces of paper with which he can settle the obligations, and all other people will be willing to accept these pieces of paper because they know that the taxpayers, etc., will accept them in turn. On the other hand if the state should decline to accept some kind of money in payment of obligations to itself, it is difficult to believe that it would retain much of its general acceptability. Cigarette money and foreign money can come into wide use only when the normal money and the economy in general is in a state of chaos. What this means is that whatever may have been the history of gold, at the present time, in a normally well working economy, **money is a creature of the state**. Its general acceptability, which is its all-important attribute, stands or falls by its acceptability by the state.

(...)

Depression occurs only if the amount of money spent is insufficient. Inflation occurs only if the amount of money spent is excessive. The government - which is what the state means in practice - by virtue of its power to create or destroy money by fiat and its power to take money away from people by taxation, is in a position to keep the rate of spending in the economy at the level required to fill its two great responsibilities, the prevention of depression, and the maintenance of the value of money. (LERNER, 1947, p. 314-315, emphasis added)

It is from this brilliant insight that Modern Money Theory (MMT) departs. The approach founded by Wray (1998) connects Knapp's chartalism, Keynes's theory of effective demand and Lerner's functional finance. The theory maintains that public deficits are not a problem, but a structural condition of a system in which the private sector wishes to hold state money and assets denominated in that money (SILVA; DEOS, 2020, p. 3). In MMT, sovereign money is fundamental to ensuring employment and inflation targets. Government spending, stemming from its own currency, does not bear default risk. The theory also takes up the idea that money is driven by taxes, that is, taxes are not responsible for financing the State, but serve to control the supply of and demand for state money (SILVA; DEOS, 2020, p. 4). Once again, the concept of functional finance is very present in prescribing that fiscal policy must have a function in the economy.

It is in this light that this article proposes to understand the social function that fiscal policy carries. The theory of functional finance and, later, MMT lead us to understand that the budgetary instruments in the hands of the State serve to bring results to society, and not to bring the State its balanced financing. The result is not, nor should it be, fiscal balance: economic policy must be oriented towards promoting employment, income, distribution and conditions for material reproduction. The contrast with the doctrine of austerity is direct. If its advocates insist on the question of how the budget should be adjusted to maintain an appearance of balance that pleases the rentiers, functional finance asks in what way the budget should produce economic and social results. While the former converts accounting discipline into a limit on state action, the latter subordinates public finances to the objectives of economic policy.

Although functional finance opens up a new analytical range regarding the subordination of fiscal policy, there is still a prevalence of the idea of equilibrium that leads to a horizon of efficacy. By establishing that the State is responsible for reducing unemployment and inflation through fiscal policy, even if on assumptions completely different from those of the advocates of austerity, the idea that the conduct of economic policy must be effective is preserved – which, once again, just as in the post-Keynesian framework, is necessary, but relegates the political and distributive character of fiscal policy. Functional finance thus makes it possible to distinguish the economic capacity of the State from the political disposition to use it. It demonstrates that austerity is not an accounting necessity, but leaves open which interests austerity serves and what the role of the State is in this

determination. In this sense, if there are instruments capable of confronting stagnation, the permanence of austerity needs to be explained on the terrain of political economy, which makes it possible to shift the question “does austerity work?” to the question “whom does austerity serve?”.

3. The political economy of austerity: efficacy, class and the capital order

In the previous sections, we discussed that the evidence supporting the defense of austerity is theoretically questionable and empirically weak. Furthermore, we showed that, far from being an accounting necessity, fiscal policy must have a function for the economy. Even so, austerity persists! Its permanence ceases to look like the effect of a cognitive dissonance when we shift the analysis from macroeconomics to political economy and explore its effects beyond the declared objectives. Economic policy can fail in stabilization and in the recovery of growth and, simultaneously, fulfill a nefarious and obscured function in the distribution of income and power.

This is the shift we propose based on a reading of Clara Mattei (2022). The author defines austerity through a lens different from that of traditional economic theory by observing the political function of austerity:

Austerity was most certainly a political project, but its assumptions weren't necessarily wrong. Indeed, it laid bare an undeniable truth: for capitalism to function, workers had to be disciplined into accepting the two pillars of capital accumulation—the primacy of private property and wage relations.

These core principles of austerity double as the assumptions underlying today's mainstream economic theory, especially its tendency to serve political ends. (MATTEI, 2022, p.163)

The author agrees with the Keynesian interpretation that austerity fails in the face of its declared objectives. Even so, she demonstrates that the true measure of efficacy that should be analyzed is the capacity of austerity to reinforce the class structure. In other words, austerity was never an irrational calculation; it serves and secures the capital order. (MATTEI, 2022, p. 288-289). The author makes another essential distinction that allows us to understand the political and class aspects of the permanence of austerity: she argues that the main critical views of austerity were conceived through economic crises, while her analysis uses the lens of the crisis of capitalism and allows us to conclude that austerity is a form of defense of the mode of production itself. Economic growth presupposes a certain social and political order, the capital order. Austerity is what secures this order (MATTEI, 2022, p. 3-4). For the author, austerity operates in three joint dimensions - fiscal, monetary and industrial - which are capable of reducing workers' bargaining power, exerting pressure on wages and transferring resources from the majority to the minority that owns capital. (MATTEI, 2022, p. 8-9) The New Consensus arrangement discussed in section 1, in which the

Taylor rule and spending limits make involuntary unemployment an anti-inflationary anchor, here acquires its class meaning. What constitutes failure from the point of view of full employment may represent success in recomposing the authority of capital.

This reading allows us to return to the 2008 crisis to investigate the narrative that became consensus in *mainstream* economic theory during the years of reconstruction. The financial crisis, originating at the core of the banking system, was transmuted and disguised as a sovereign debt crisis. The high cost required to recapitalize the banking system fell on the balance sheets of governments, which absorbed a large part of the burden of the collapse (BLYTH, 2013, p. 18-19). It is evident, however, that responsibility for the crisis was not placed on the banks, but rather on an alleged excess of government spending. In the public discussion on social spending, this narrative takes the form of a contrast between “good austerity” and “bad spending”. The cuts appear as the necessary penance after a period of “immoral party”, although their costs fall mainly on those who did not produce the crisis (BLYTH, 2013, p. 26-27).

The discourse that sustains austerity is mainly composed of two fallacies: the confidence fairy and the household budget metaphor. The “confidence fairy” argument is grounded on the idea that agents, having greater confidence in the stability and solvency of the government, would increase investment autonomously. This belief, however, completely ignores the components of aggregate demand, that is, the fact that a spending cut weakens demand and, therefore, does not stimulate investment. Even if there is an increase in confidence that justifies a sense of security to invest, investment is not fostered, since demand is weakened. The “household budget” argument, in turn, grounded on the motto “you cannot spend more than you earn”, completely ignores the fact that, unlike households, which have no power to define how much they collect, the government has the power to increase or reduce its revenue, that is, to “earn more in order to spend more”, in addition to determining the interest rate charged on its debt. (ROSSI; DWECK; ARANTES, 2018, p.18-21, our translation)

The term “austerity” itself is not originally economic; it was appropriated by economists in order to carry a moral charge associated with rigor, discipline and sacrifice. (ROSSI; DWECK; ARANTES, 2018, p. 15) Whenever there is an economic crisis arising from the very contradictions of capital, the bitter remedy is always, in the words of Mattei (2022, p.134), thrift (in the sense of cutting spending – by the government and by households) and hard work. Rigor, discipline and sacrifice are applied only to the most vulnerable part of the population: the working class. This class suffers the consequences of austerity in three layers: i) the degradation of public services resulting from government spending cuts, ii) the limitation of household consumption, since austerity, by

restricting Government spending, puts pressure on the conditions of labor remuneration and tends to reduce the real disposable income of households, and iii) the much-touted flexibilization of the labor market which, in practice, strips away hard-won rights and facilitates the fall in the wage bill.

Beyond its function expressed in class power, the consolidation of austerity only becomes possible in the face of the depoliticization of the economy. Distributive decisions are gradually removed from democratic scrutiny and delegated to technocracy through the construction of an economic theory that legitimizes it through an alleged neutrality. (MATTEI, 2022, p. 11) This neutrality is not natural, but a historical construction naturalized as the discipline consolidated its scientific authority. Myrdal (1997, p. 46) argues that theoretical sophistication, the incorporation of empirical elements and the success of certain applications strengthened the reputation of economics and made its political premises less visible. Robinson (1962, p. 1) shows that the discipline has always been, simultaneously, a vehicle of the dominant ideology and a method of scientific investigation; thus, its categories carry political premises that the scientific form naturalizes. Furtado (1976) also points out that the sophistication of economic tools took place “in the direction of ahistoricity, thus opening a gap between the global vision derived from history and the particular perception of problems” (FURTADO, 1976, p.11, our translation), that is, it takes on a form through which economic theory overshadows the power structures it should explain. It is in this acquired characteristic of economic theory that austerity finds its main substratum. Its technical garb limits democratic deliberation on the distributive impacts and social costs of austerity. The political cost of an anti-democratic policy is absorbed by the appearance of scientific necessity.

The presentation of austerity as a technical instrument transforms this distributive reorganization into economic necessity. For Mattei (2022, p. 8), austerity has combined, since its origin, consensus and coercion, and coercion took, above all, the form of excluding the public from economic decisions, delegated to technocratic institutions, especially central banks. “Pure” economics, by dissociating the economic process from the political process, restored an illusion of consent and allowed relations of domination to present themselves as economic rationality (MATTEI, 2022, p. 11). This shielding remains: the independence of central banks, the constitutional obligation of a balanced budget and the prohibition on the financing of national deficits by the European Central Bank express the same impulse to protect economic decisions from the political pressures of the majority (MATTEI, 2022, p. 298-300).

The heterodox critique of efficacy remains indispensable, but becomes insufficient when it accepts that growth and stabilization are the only relevant criteria for evaluating austerity. By demonstrating that the policy fails on its own terms, without investigating the power relations that

sustain its permanence, it runs the risk of producing a theory of error where a theory of political function would also be necessary. The proposal of this article is that depoliticization is the key that converts class interest into technical necessity. Austerity should not be understood merely as a failed remedy for stagnation. It constitutes a political form of managing it: it does not overcome demand constraints, but reorganizes their costs, disciplines labor and preserves positions of wealth. Its persistence does not stem exclusively from the mistaken belief in its efficacy, but from the function it performs in the reproduction of the capital order. Stagnation matters, therefore, unequally: for those who depend on labor income and social spending, it is a cost; for the holders of financial wealth, its austere management is a condition for preserving their positions.

Conclusions

For whom does stagnation matter? Our article starts from this question, which is recurrently relegated in macroeconomic theory. In light of the analysis presented in the text, it is possible to systematize three results. The first concerns the diagnosis of stagnation. Through the post-Keynesian lens, stagnation is read as a state of the economy in which effective demand is insufficient to mobilize productive capacity. In a monetary economy, investment decisions rest with the wealth holders, who allocate their resources under radical uncertainty and with the objective of obtaining profits. Income concentration and financialization break the link between profits and investment and deepen the circuit of low economic dynamism and widening inequalities. The Kaleckian legacy adds to this diagnosis the dimension that the article aims to recover – opposition to full employment can convert stagnation into a political trend beyond the macroeconomic result.

The second result refers to the orthodox response to stagnation. Articulated with the New Macroeconomic Consensus, the expansionary austerity thesis prescribed fiscal contraction as a remedy for stagnation through the restoration of agents' confidence and the opening of space for private investment. This prescription, which does not consider the centrality of aggregate demand in economic dynamism, is confronted by theoretical and methodological problems that highlight its dysfunctionality. In economies with idle capacity, austerity restricts demand even further by limiting spending and compresses income, consumption and investment. The evidence that supported the expansionary austerity thesis has proven, over the years, to be methodologically fragile, and the very institutions that bet on this prescription acknowledged that they underestimated the recessionary effects of austerity. Even so, it is astonishing that austerity remains (ubiquitously) in contemporary economic policy!

The third result derives from this point. The heterodox critique of austerity sheds light on the criteria of efficacy and correctly concludes that it does not work on the terms in which it is

enunciated – those of growth and stabilization. This critique responds to austerity on the technical terrain, the one in which it is born and grows, and ends up explaining why it should be abandoned, but does not explain *why it persists*. Lerner's functional finance and Modern Money Theory demonstrate that austerity is not an accounting necessity and that the State has instruments to confront stagnation. However, they say little about the State's political disposition to use such instruments. Answering the question about the persistence of austerity requires a shift from the field of macroeconomic theory to political economy. It is from Kalecki and, later, from Mattei that austerity sheds the form of a failed remedy and takes on the position of class policy. Austerity does not overcome demand constraints, but moralizes their costs, disciplines labor and preserves the capital order.

This shift requires caution. The moral charge that accompanies austerity – discipline, sacrifice, penance after the “party” – is part of its form of legitimation. In the tradition of the critique of political economy, the capitalist is not an object of moral judgment. He is the conscious bearer of the movement of capital, capital personified, value in constant search of valorization. For Mattei (2022, p. 304), austerity is a political project for preserving the bourgeois class's relation of domination over the exploited classes.

The shift from macroeconomic theory to political economy that we propose opens two fronts of investigation, that go beyond the scope of the text. The first of these is the persistence of austerity, which finds its substratum in the depoliticization of the economy. It is through this inadmissible separation that pro-austerity discourses convert class interest into technical necessity, politically shielded. The alleged neutrality of economic theory materializes in fiscal rules, inflation targets, independent central banks and limits on indebtedness, which remove from democratic scrutiny decisions on employment, distribution and material reproduction. Brown (2019, p.82) points out that the divorce between democracy and popular sovereignty is part of the neoliberal project that crowned technocracy as an essential element of the State.

The second concerns de-democratization. The relation between austerity and democracy has a paradoxical character: austerity depends on a prior depoliticization of the economy in order to be presented as a technical necessity and, once institutionalized, deepens this depoliticization by further restricting the alternatives available to popular sovereignty. By producing its deleterious effects on the structure of the State, it makes citizens perceive that collective demands find no answers and seek individual solutions (DARDOT; LAVAL, 2013, p. 341). Resentment towards the public sphere and towards collective demands, never met, feeds back into the depoliticization that made austerity possible. Dardot and Laval (2013, p. 342) take up from Brown the neologism

“de-democratization” to designate this emptying of democratic substance without its formal abolition.

It is in this sense that Clara Mattei's reading becomes pivotal. By reconstructing the genesis of austerity in the interwar period, the author shows that it must be understood as an anti-democratic reaction to threats of social transformation from below (MATTEI, 2022, p. 7) and that, through austerity, both British liberalism and Italian fascism found fertile ground to prosper (MATTEI, 2022, p. 14). Contemporary reality demands that this reflection be recovered for the field of political economy. Today, the disintegration of society and the discrediting of the public good promoted by the neoliberal order have prepared the ground for the mobilization and legitimacy of ferociously anti-democratic forces (BROWN, 2019, p.7). If stagnation is managed by austerity, and if austerity deepens de-democratization, the question of for whom stagnation matters unfolds into another: what political form does the austere management of stagnation produce?

The new questions derived from our analysis open an interesting research agenda. The results presented allow us to affirm that, in an era of global transformations and chronic stagnation, macroeconomic theory is not sufficient to answer for whom stagnation matters. This and other questions urgently need to be shifted to the field of political economy. This is how the critique of the efficacy of austerity must become a critique of the class power it produces. Recovering political economy does not mean abandoning the rigor of macroeconomic theory, but restoring to it the questions that the garb of scientific neutrality has repelled.

This task does not start from scratch. Researchers such as Clara Mattei demonstrate that there are already open paths towards a political economy capable of placing class, power and democracy back at the center of economic analysis. This commitment is also manifested in initiatives such as the *Forum for Real Economic Emancipation* (FREE), which brings together researchers, organizers and communities around the construction of economic knowledge linked to the concrete problems of social life. FREE advocates an economics that serves people, not power. Knowing and strengthening agendas such as this one means recognizing that scientific rigor does not require indifference in the face of injustice, but courage to investigate the interests that the appearance of neutrality keeps hidden.

Recovering political economy therefore means returning the economy to those who concretely live its effects. The question “for whom does stagnation matter?” opens a research agenda committed to transforming the structures that produce stagnation and benefit from its permanence. **When economics refuses to ask whom it serves, it has already chosen whom to serve.**

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