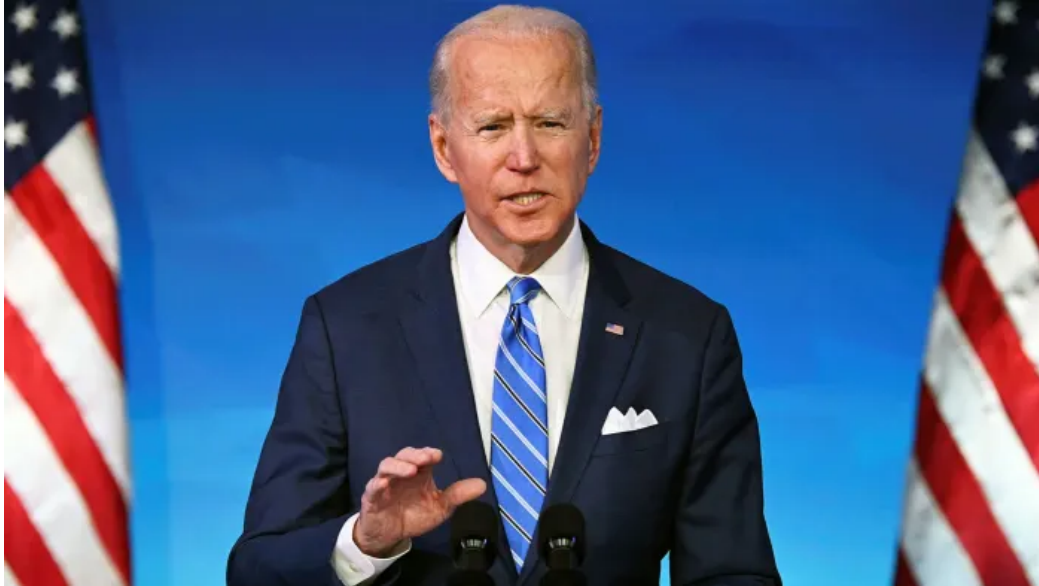


Opinion **US politics & policy**

## Joe Biden's experiment could revolutionise economic thinking

US president's rescue plans upend the framework we use to understand the role of policy

**MEGAN GREENE**



Joe Biden's proposals may be exactly what we need to prevent scarring and hysteresis from pushing the economy to a lower steady state © Jim Watson/AFP/Getty

**Megan Greene** 3 HOURS AGO

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Joe Biden's very first proposal as US president was to spend \$1.9tn on pandemic relief, a massive programme that even [Democratic stalwart Larry Summers](#) called "the least responsible fiscal macroeconomic policy we've had for the last 40 years".

Biden then gave fiscal conservatives angina by proposing to spend an additional \$4tn on his American Jobs and American Families plans. While the administration's public justification is that the risk of doing too little exceeds that of doing too much, this isn't really about fiscal stimulus. Instead, it underscores a much larger debate about the framework we use to understand the economy and the role of policy. The Biden folks are running an experiment that could revolutionise that thinking.

When the administration announced the price tag on its jobs and families plans, economists across the globe got busy plugging assumptions into their traditional [dynamic stochastic general equilibrium model](#) to figure out the impact on the US and global economies. At the heart of this model is the idea that there is a single equilibrium around which the economy fluctuates.

Given free and open markets, an economy will naturally adjust and revert towards this equilibrium. In its simplest form, this is where supply meets demand. It is where growth is at its long-term potential.

Based on this framework, the role of policy is to move rigidities out of the way and nudge the economy back towards its self-reinforcing steady state. A well-designed fiscal stimulus plan would seek to fill the economic hole from the Covid-19 crisis exactly, so the economy reverts to potential growth. But Biden's \$6tn spending fills this hole several times over, causing many to worry the economy will overheat and inflation will accelerate persistently.

The Biden administration isn't concerned because it has adopted a different framework in which the economy could converge towards a number of different regimes. Because it is a complex system with actors who update their decisions in an evolving environment, it could jump from one plane of potential growth to another. The planes themselves may move over time as well.

The role of policy is therefore much bigger than to nudge the economy towards its steady state. It is to prevent it dropping down to a fundamentally lower equilibrium or push it up to a higher one. The [American Rescue Plan](#) and proposals to invest in infrastructure and human capital may be too big if the aim is for the economy to go back to where it was before the crisis. But they may be exactly what we need to prevent scarring and [hysteresis](#) from pushing the economy to a lower steady state, or boost it to a higher one. As Biden has said, he is not just looking to build back; he is looking to [build back better](#).

These notions of multiple equilibria and complex systems are mainstream in just about every major science except economics. The OECD's [New Approaches to Economic Challenges](#) initiative has shown how this framework is applied in [physics](#), [epidemiology](#), ecology and anthropology. The idea has been slowly gaining traction in economics as well. But the rescue and jobs and families plans bring this revolution straight on to centre stage, and it's about time.

Success is not guaranteed. Governments have failed many times to identify an equilibrium and have under or overshoot with their policy responses. Now there are multiple equilibria, and they are moving targets. But if the administration's spending plans can shift the economy to a fundamentally better plane, the Biden administration could reverse the [Washington consensus](#) preference for small deficits and market efficiency, in favour of a much bigger role for the state and policy. That would be an economic revolution.

