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When things fall apart

Anatole Kaletsky | GaveKal | 01 April 2016

All over the world today, there is a sense of the end of an era, a deep foreboding about the disintegration of previously stable societies. In the immortal lines of W.B. Yeats's great poem, "The Second Coming":

> "Things fall apart; the center cannot hold
> Mere anarchy is loosed upon the world...
> The best lack all conviction, while the worst
> Are full of passionate intensity...
> And what rough beast, its hour come round at last
> Slouches towards Bethlehem to be born?"

Yeats wrote those lines in January 1919, two months after World War I ended. He instinctively felt that peace would soon give way to even greater horrors.

Almost 50 years later, in 1967, the American essayist Joan Didion chose Slouching Towards Bethlehem as the title of her collection of essays on the social breakdowns of the late 1960s. In the 12 months following the book's publication, Martin Luther King, Jr. and Robert Kennedy were assassinated, inner cities across the United States exploded in riots and French student protesters began the rebellion that toppled President Charles de Gaulle a year later.

By the mid-1970s, America had lost the Vietnam war. The Red Brigade, the Weather Underground, the Irish Republican Army, and Italian neo-Fascist terrorists were staging attacks across the US and Europe. And President Richard Nixon's impeachment had turned Western democracy into a laughing stock.

Another 50 years have now passed, and the world is again haunted by fears about the failure of democracy. Can we draw some lessons from those earlier periods of existential self-doubt?

In the 1920s and 1930s, as in the late 1960s and 1970s and again today, despair about politics was linked to disillusion with a failed economic system. In the inter-war period, capitalism seemed doomed by intolerable inequalities, deflation, and mass unemployment. In the 1960s and 1970s, capitalism appeared to be collapsing for the opposite reasons - inflation and a backlash by taxpayers and business interests against the redistributive policies of "big government."

To note this pattern of recurring crises is not to claim that some law of nature dictates a near-collapse of global capitalism every 50 or 60 years. It is, however, to recognise that democratic capitalism is an evolving system that responds to crises by radically transforming both economic relations and political institutions.

So we should see today's turmoil as a predictable response to the breakdown of one specific model of global capitalism in 2008. Judging by past experience, a likely outcome could be a decade or more of soul-searching and instability, leading eventually to a new settlement in both politics and economics.

This is what happened when the elections of Margaret Thatcher and Ronald Reagan followed the great inflation of the early 1970s, and when the American New Deal and the "rough beast" of European rearmament emerged from the Great Depression. Each of these post-crisis settlements was marked by transformations in economic thinking as well as politics.

The Great Depression led to the Keynesian revolution in economics, alongside the New Deal in politics. The inflationary crises of the 1960s and 1970s provoked Milton Friedman's monetarist counter-revolution, which inspired Thatcher and Reagan.

It therefore seemed reasonable to expect the breakdown of deregulated financial capitalism to trigger a fourth seismic change (Capitalism 4.0, as I called it in 2010) in both politics and economic thinking. But if global capitalism really is entering a new evolutionary phase, what are its likely characteristics?

The defining feature of each successive stage of global capitalism has been a shift in the boundary between economics and politics. In classical nineteenth-century capitalism, politics and economics were idealised as distinct spheres, with interactions between government and business confined to the (necessary) raising of taxes for military adventures and the (harmful) protection of powerful vested interests.

In the second, Keynesian version of capitalism, markets were viewed with suspicion while government intervention was assumed to be correct. In the third phase, dominated by Thatcher and Reagan, these assumptions were reversed - government was usually wrong and the market always right. The fourth phase may come to be defined by the recognition that governments and markets can both be catastrophically wrong.

Acknowledging such thoroughgoing fallibility may seem paralysing - and the current political mood certainly seems to reflect this. But recognising fallibility can actually be empowering, because it implies the possibility of improvement in both economics and politics.

If the world is too complex and unpredictable for either markets or governments to achieve social objectives, then new systems of checks and balances must be designed so that political decision-making can constrain economic incentives, and vice versa. If the world is characterised by ambiguity and unpredictability, then the economic theories of the pre-crisis period - rational expectations, efficient markets, and the neutrality of money - must be revised.

Moreover, politicians must reconsider much of the ideological super-structure erected on market fundamentalist assumptions. This includes not only financial deregulation, but also central bank independence, the separation of monetary and fiscal policies, and the assumption that competitive markets require no government intervention to produce an acceptable income distribution, drive innovation, provide necessary infrastructure, and deliver public goods.

It is obvious that new technology and the integration of billions of additional workers into global markets have created opportunities that should mean greater prosperity in the decades ahead than before the crisis. Yet "responsible" politicians everywhere warn citizens about a "new normal" of stagnant growth. No wonder voters are up in arms.

People sense that their leaders have powerful economic tools that could boost living standards. Money could be printed and distributed directly to citizens. Minimum wages could be raised to reduce inequality. Governments could invest much more in infrastructure and innovation at zero cost. Bank regulation could encourage lending, instead of restricting it.

But deploying such radical policies would mean rejecting the theories that have dominated economics since the 1980s, together with the institutional arrangements based upon them, such as Europe's Maastricht Treaty. Few "responsible" people are yet willing to challenge pre-crisis economic orthodoxy.

The message of today's populist revolts is that politicians must tear up their pre-crisis rulebooks and encourage a revolution in economic thinking. If responsible politicians refuse, "some rough beast, its hour come at last" will do it for them.

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