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Can We Rebuild the Economic Consensus?

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There are times in history when the consensus about our economic system breaks down. It happened after the Long Depression, also known as the Great Depression of the 19th century, and again in the 20th century around the Great Depression of 1929-1933, as well as after the Great Recession of 2008-2009 that followed the global financial crisis. The Covid-19 great crash, which carries the risk of a deep downturn, has led governments to take extraordinary measures in all areas of our lives. This has further fuelled the need to discuss how to rebuild the consensus about the most appropriate economic system for the 21st century as the great question of our time.

This is a reflection piece invited for the Dahrendorf Symposium.

INTRODUCTION

The dissatisfaction over the past decade and for many years before then stems from a number of factors that are difficult to generalize about. But they seem to have in common an anti-establishment sentiment—that is, that the current economic system does not work well enough for the middle class, wage growth, or the environment. This has manifested as a backlash against globalization, a dissatisfaction about a system with high levels of inequality, and a desire to reform or even to reject the current capitalist system.

After all, globalization does lead to "losers" even if the economy as a whole gains. This impact on society has led to discontent in advanced economies. Also, developing countries have not benefited as much as developed ones, which resulted in the late 1990s protests against the World Trade Organization (WTO). The launch of the Doha Round in 2001 was an attempt to liberalize global markets in a more inclusive fashion. That round has stalled after nearly two decades of discussions.

Furthermore, inequality is a huge concern, particularly with the top 1 percent getting ever richer while those in the middle class see their incomes stagnate across major economies. According to some measures, the United States is as or in some respects more unequal than during the Gilded Age of the late nineteenth century, which coincides with a previous period of breakdown in consensus.

Unsurprisingly, these and other factors, including not doing enough to address the climate crisis, have contributed to discontent with the current economic system.

This discontent leads to the great question of our time, which is how to rebuild the most appropriate economic system for the twenty-first century to make it more inclusive and equitable and to protect the environment. Otherwise, the current system risks being discarded in favor of an alternative. The resurgence of interest in socialism is one example.

Just as the factors contributing to the breakdown in consensus are complicated, it is complex even to define the current economic system, much less to reform the entire way the economy works. Yet, for society to come together again, it is imperative that we address this question of how the economic consensus can be rebuilt.

One step to help rebuild that consensus is to look to lessons from history and learn from previous periods when the economic consensus broke down and was rebuilt. There are four key lessons on how the past can inform our present debate and suggest solutions.

First, there is an urgent need to explore reforms to the current economic system; for example, is there a twenty-first-century equivalent to when the capitalist system was transformed into welfare state capitalism? Are there alternative economic systems that can address the myriad of concerns over inequality, the environment, and globalization, to name a few issues, which have been expressed in different ways over the past few decades?

For instance, in the nineteenth century, there was a seismic shift that provoked a search for an alternative consensus. The consensus shifted from protectionism to globalization, which provides the first lesson from history.

The repeal, in 1846, of the protectionist Corn Laws, which levied high tariffs on imports of grain that protected English landowners, seemed to mark a new era characterized by globalization. The previous consensus that countries should aim for trade surpluses, known as mercantilism, was rejected in favor of openness after much debate over the economic damage while landowners benefited from those protectionist measures.

However, that consensus did not last. Less than three decades later, the global economy was shaken by the Panic of 1873. A railroad speculative bubble burst, and the financial crisis that spread from the United States to Europe affected the global economy. It led to the Long Depression, also called the Great Depression of the nineteenth century. That was the first time that the word *unemployment* appeared in the Merriam-Webster dictionary.

This downside of global links and globalization added to the backlash against the economic system. The misery of

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unemployment and poverty were in stark contrast to the excesses of the Gilded Age. That period of the late nineteenth century was indeed a time of high levels of income and wealth inequality. The capitalist system seemed to work for the very rich but provided no safety net for the rest. This crisis led to a search for a new consensus in the early twentieth century.

We are again at such a point of backlash against the economic system, which is also characterized by high levels of inequality and people who are left behind. Although driven by different trends, a breakdown in consensus over the economic system is again apparent.

A second lesson is that it took a long time to form a new consensus.

Whether the historical breakdown in consensus is dated from the late nineteenth or the early twentieth century, it took the better part of a century for the battle of ideas between a reformed capitalist system and a communist or socialist one to be won by a changed market-based economy.

The nineteenth-century breakdown in consensus about the appropriate economic system led eventually to a significant reform of the capitalist economy through the creation of the welfare state. But it took decades to achieve that new consensus.

The late nineteenth century was also known as the late Victorian period, which had a social focus on helping the "deserving poor." There was growth in charitable organizations funded by private benefactors, such as the UK's first female peer, Angela Burdett-Coutts (Baroness Burdett-Coutts), who was recognized for her philanthropy and who worked with Charles Dickens.

But welfare supported by the state was initially resisted, particularly by economists. Neo-classical economists such as Alfred Marshall at Cambridge University were initially skeptical about creating a welfare state. Their concern was that giving people benefits would disincentivize them to work.

Therefore, Alfred Marshall initially did not support fiscal redistribution through taxes. He viewed income taxes as inefficient because of their disincentivizing effects on work. But he changed his mind with evidence and a recognition that more was needed in order to reduce poverty and inequality.

So, in the early twentieth century, neo-classical economists came to believe in the benefits of progressive tax rates and fiscal redistribution. This change in mindset helped pave the way for the introduction of the welfare programs that characterize advanced economies today; for example, Social Security in the United States and the National Health Service in the United Kingdom, among others.

Therefore, it took until the post–World War II period for welfare state capitalism to take hold. The second lesson is that it takes time to create a new consensus.

Third, the road in getting to a new consensus was not straightforward. There was a time before and during the Cold War when it was a battle for hearts and minds. During the early twentieth century, around 40 percent of the global population was living under communism and another 25 percent or so in at least partly socialized economies. The growth of communist and social regimes only gradually gave way to welfare state capitalism throughout the twentieth century until the late 1980s.

This lesson from history dates from the late nineteenth century, when Karl Marx advocated for an entirely different economic system altogether and won converts. For Marx, the end of the nineteenth century was when his communist theories gained traction. The last quarter of the 1800s saw frequent economic downturns, including the Long Depression or the Great Depression of the nineteenth century, which generated high unemployment, labor unrest, and strikes. During that period, nineteen socialist and labor parties were founded in Europe, as well as trade federations. So the downsides of industrialization paved the way for the workers' movement.

Marxism transformed the economies of some of the largest countries in the world. From Russia to China, communism took hold in some form as these nations sought an alternative to the capitalist model. The notions of economic equality and communal effort were among the reasons Russia turned to Marx. Russia's communist revolution in 1917 led to the establishment of the Soviet Union, which vied with the capitalist United States as the economic model du jour during the Cold War, which lasted from the end of the Second World War until the fall of the Berlin Wall in 1989.

The rise of Marxism in the twentieth century led other economists to argue for a reformed capitalist system or risk losing the battle of ideas.

The Austrian economist Joseph Schumpeter was one of them. His 1942 *Capitalism, Socialism, and Democracy* began as a series of essays, which reacted to a time of turmoil. It encompassed the Great Depression of the 1930s; the rise of Marxism, which challenged capitalism; and the Second World War. *Capitalism, Socialism, and Democracy* became popular because it captured the great debate of the time.

He wasn't alone. Another Austrian economist, Friedrich Hayek, published *The Road to Serfdom* in 1944. It would make him one of the world's best-known thinkers. The Great Depression before the war had shaken belief in the capitalist system, and people had even become used to centrally planned wartime economies. Hayek warned about the dangers resulting from government control of economic decision-making, whether communist or fascist. In his view, government-imposed centralized planning was undemocratic because the will of a small number was imposed on the people, and the rule of law and individual freedoms were sacrificed.

The volume was to make Hayek famous, and not just in economic or academic circles. Hayek's influence was notable behind the Iron Curtain and contributed to the shift in opinion against the communist regimes that eventually ended with the collapse of the Soviet Union in the late 1980s and early 1990s. The former Soviet states reintegrated with the global economy, and many joined or sought to join the European Union—for instance, Poland, Hungary, Romania, and Bulgaria. These nations embraced marketization and openness to international trade. Even those economies that did not abandon communism, such as China and Vietnam, still introduced market-oriented reforms during the 1980s and 1990s.

By that point, the capitalist system of the twentieth century was not the same as the nineteenth-century one. In the post-war period, some form of welfare state was found across advanced economies and changed the economic system into one characterized by welfare state capitalism.

With the Soviet Union disintegrating and communist China adopting market-oriented reforms, there was seemingly a new consensus by the late 1980s. This new consensus was not without exception. But most major economies were characterized by welfare state capitalism. The role of the market, with a social safety net, was deemed to be better than the previous system and the alternative communist and socialist approaches.

With the former Soviet Union states adopting democracy along with marketization that completely transformed their previous communist and planned economies, this period of the 1990s onward seemed to be characterized by liberal democracies that embraced free trade and a welfare state.

This new consensus was captured by Francis Fukuyama's 1992 book, *The End of History and the Last Man*, which described the ascendancy of liberal democracy and the reformed capitalist economy over the alternatives. But the consensus did not last. The excesses of the capitalist system were captured by movies like *Wall Street (1987)* and the dot-com bubble in the early 2000s. Throughout this period, inequality continued getting worse in the United States and elsewhere.

Then the 2008 global financial crisis struck. A bubble in the US housing market sent shock waves across the global economy, linked closely to the American financial system. The slow recovery from the Great Recession that followed highlighted the many ways in which the economic system did not seem to work. The inadequacy of the social safety net in many economies was revealed when unemployment skyrocketed.

Therefore, we need to forge a new consensus once again.

The fourth and final lesson is that agreement on this consensus will require a robust debate that involves all in society. A consensus cannot be achieved by economists or specialists alone. They play an important part in proposing economic reforms, but the concerns around the environment, inequality, and globalization need to be addressed by a wide range of stakeholders and those from other fields.

For instance, in the nineteenth and twentieth centuries, creating a welfare state was advocated for by trade unionists and by economists who engaged with the general public through popular writings to incorporate late Victorian social attitudes.

In the late twentieth century, a wide range of stakeholders have already challenged the consensus. For instance, the late 1990s protests against globalization at the WTO meeting in Seattle involved the general public. The 2000s have been characterized by movements such as Extinction Rebellion and activists like Greta Thunberg who have grown impatient with the inability of the current system to address the climate crisis.

Just as the recovery appeared to be taking hold and the end of austere economic policies were in sight, the COVID-19 pandemic struck in early 2020. This crisis was not only a demand shock but also a supply shock, which further revealed the global linkages that meant that health and economic disruptions in one country could quickly affect others. This crisis has again highlighted the inadequacy of the social safety net to cope with a pandemic, which meant that governments quickly devised and put in place new benefit and loan programs to help people and businesses. Seeing what can be done has reignited the debate over whether governments should do more for the welfare system in normal times.

We are again at a point in history where the economic consensus has broken down. There is a backlash against the current economic system. It doesn't adequately address environmental concerns and permits too much inequality. There is also a backlash against globalization and an interest in alternative systems, such as a form of socialism proposed by the economist Thomas Piketty in *Capital and Ideology*.

STEPS FORWARD

How can we work toward a new consensus?

It requires learning the lessons of history. Notably, it takes a wide range of stakeholders to become engaged in the debate. The public and their expectations play an important role in coming to a new consensus. Also, the path forward may not be straight. There may be tangents and diversions before we as a society can agree on how our economic system should be fashioned. Third, it can take a long time. Most importantly, there must be both a search for alternatives to the status quo and a debate over whether the existing system can be reformed. It is only through public engagement and a battle of ideas that a new consensus can be shaped.

It will take time, but history tells us that it can be done and that there are lessons we can learn from those who did it before us. Perhaps Mark Twain was right when he reportedly said: "History doesn't repeat itself, but it often rhymes."

This reflection piece draws on my 2018 book, The Great Economists: How Their Ideas Can Help Us Today, *published by Viking.*

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