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Political Economic Analysis, Consulting & Strategies

THE GREAT RESET

Economic regime shifts and problems of reform

Abstract

The paradigm is dead, long live the paradigm. The concerted change in direction away from the – based on their track record in the past decade – dysfunctional neoliberal policy recommendations is a welcome development. But are these announcements too early, mere lip service perhaps, or do they herald a shift in our guiding economic orthodoxy? In this dossier, we explore the essence of an economic paradigm and the conditions under which it changes. We study the current crisis and its effect on the prevalent doctrine, explore the 'varieties of capitalism' that different countries exhibit – making an argument for a variety of reforms – and point out the difficulty of publicly funding supply-side adjustment.

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May 2021

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1. Of paradigms and changes

The paradigm is dead, long live the paradigm. Politicians and policymakers are busy designing and negotiating massive government-financed Covid-relief programmes, paired with public infrastructure investment and suggested (global) corporate tax rises to support the decarbonisation of the economy and 'build back better'. Meanwhile, central banks such as the ECB or the Fed have not just continued, but even increased their liquidity injections into the money market, or quantitative easing (QE). What's striking though, is that monetary policymakers and other international financial institutions that were advocates of neoliberal reforms, including the IMF or the World Bank, now seem to endorse higher government spending and (corporate) tax rates – in effect endorsing the return of a strong Keynesian state.

Naturally, some commentators have been quick to proclaim a paradigm change, with economic policymaking moving back onto Keynesian grounds. The concerted change in direction away from the – based on their track record in the past decade – dysfunctional neoliberal policy recommendations is a welcome development. But are these announcements too early, mere lip service perhaps, or do they herald a shift in our guiding economic orthodoxy?

While the balance of this dossier establishes a nuanced diagnosis of the problem, potential solutions and key reflections regarding their implementation, this short introduction focuses on the underlying question: What is a paradigm and under which conditions does it change? We summarise relevant theoretical accounts and apply their findings to analyse whether the prevailing economic doctrine is fading. In essence, we argue that the old paradigm of neoliberalism is slowly dying, but that a new dominant political-economic doctrine does not exist yet. To avoid a potentially wasteful interregnum – Keynesian policymaking can't yield the expected outcomes under neoliberal implementation strategies – a wider debate, between relevant actors and with citizens, of future economic strategies is called for.

Back to basics: What's a paradigm?

Let us start at the beginning. The Cambridge dictionary definition reads as follows: '*A paradigm is a set of theories that explain the way a particular subject is understood at a particular time*.' In line with many other commentators, we therefore define an economic paradigm as an interconnected series of principles and models that hold enough persuasiveness to develop a political dynamism that forecloses certain policy options and privileges others. Political-economic actors, including academics, politicians, policymakers, businesses and interest groups, are hence not just mere paradigm-takers;

their actions and thoughts inform, shape and manifest economic doctrines that determine the policy environment we all inhabit.

When do economic paradigms change?

Most approaches to economic paradigm changes take their cues from Thomas Kuhn's (1962) influential essay on scientific revolutions, but usually add social, political and ideological dimensions that are more or less necessary conditions.

Walter Salant (1989) – inspired by philosopher of science Kuhn's theory – argues that the rationale for economic theorising is to solve so-called puzzles, or empirical anomalies, which existing concepts fail to explain. The simplified version of Salant's economist-centred approach is that whenever there is a set of economic theories with a better explanation of these apparent 'irregularities' and a higher overall explanatory power than its predecessor, it is accepted as the new guiding doctrine.

Peter Gourevitch (1987), on the other hand, begins with the simple statement that 'policy needs politics' or, in other words, interest groups determine the choices of policymakers. This leads to two interesting observations: An economic paradigm can only be dominant as long as it (1) is seen as a functioning and commonly accepted explanation of the world, and (2) serves a large enough coalition of political supporters through its implied policy choices and outcomes. Importantly, though, Gourevitch adds that we only come to realise this in times of crisis, when 'patterns unravel, economic models come into conflict, and policy prescriptions diverge.'

Peter Hall's (1989) trailblazing contribution unites economist-, state-, and coalition-centred approaches into the analysis of paradigm shifts. He attributes value to the economist-centred approach in the sense that 'generally, it takes a theory to kill a theory'. In this view, the existence of a challenger doctrine is hence a necessary condition for change. While Hall supports Gourevitch's proposition of the importance of political coalitions, he also introduces elements from a state-centred analysis and puts significant emphasis on the role of policymakers in paradigm changes. Thus, identifying three broad conditions for a paradigm change to occur, Hall argues that economic ideas can only attain political power, if:

1. The academic economic concept can be translated into an idea that policymakers find more useful than the old notion,
2. Bureaucratic elites can work with the new ideas and see a role for themselves in the new regime, and
3. Political interest groups and constituencies favour the new paradigm, so politicians can mobilise support.

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In summary, a paradigm change is more likely to occur in times of crisis and when a new theory emerges that challenges the old doctrine. A true shift in paradigmatic thinking, however, can only succeed if the new paradigm appears practically feasible and valuable to policymakers and politicians can mobilise a large enough group of supporters.

Are we witnessing the demise of the old paradigm?

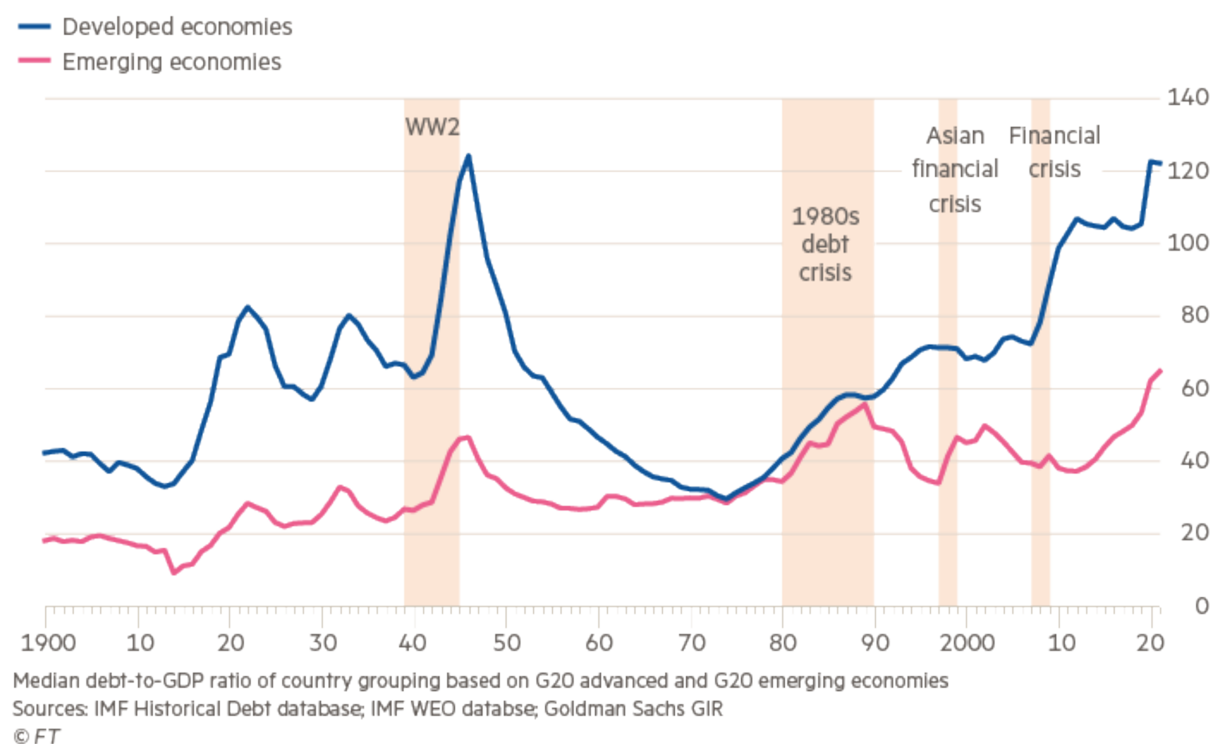
To explore whether we are experiencing a paradigm shift at the moment, we analyse the current political-economic environment against the background of the above conditions.

Times of crisis. For more than a year, our lives have been dominated by Covid-19. The major global health crisis – creating an almost simultaneous supply and demand shock – has also led to tremendous economic turmoil due. A sharp rise in health expenditure for lifesaving hospital and care services, personal protective equipment (PPE), testing regimes, and, lately, vaccines has instantly pushed government budgets out of balance. The economic costs of multiple lockdowns or other attempts to stop the virus from spreading had to be compensated by economic mitigation, such as furlough and business support, stretching public finances to the highest peace-time levels ever. These immediate measures were nothing less – but also nothing more – than a lifeline for our economies; returning to pre-crisis growth levels will require much more.

Interestingly, few of the usually relatively large group of hawkish critics have called to stop the deficit spending. The Washington Consensus is clearly dead, judging by the noises recently coming out of traditionally firmly neoliberal institutions like the IMF. Moreover, Covid has had a significant impact on global trade flows and has revived discussions about protectionism (most prominently PPE and vaccines), reshoring of production and strategic autonomy (e.g. semiconductors and car batteries). The sheer destruction Covid has left us with does indeed unravel patterns and has put our old paradigm of small states, deregulated markets and hyper-globalisation into question.

Additionally, it is now widely believed that wildlife encroachment has at least facilitated if not provoked the outbreak of the virus. It is therefore the first global black swan event directly related to the effects of anthropogenic climate change. This is important, because it lends legitimacy to ideas that aspire to mitigate climate risks through an overhaul of our existing economic paradigm. 'Climate change is a result of the greatest market failure the world has seen', Nicholas Stern once famously remarked, and it seems as though policymakers have embarked on a quest to correct unsustainable re-

source allocations and negative externalities with updated regulation and public investment in decarbonisation efforts.



Source: Financial Times (2020)

The unsolvable puzzle. In line with the currently prevalent neoliberal paradigm, most advanced economies have put their fiscal policy in a straitjacket, while governments tasked independent, conservative central banks with steering the economy by means of monetary policy. The underlying logic was simple: since, according to neoliberal theories, actors have rational expectations, fiscal expenditure fails to produce economic growth and only leads to unsustainable inflation rates. Thus, governments shouldn't waste their time spending money but rather make the labour market more efficient by applying supply-side reforms that, for instance, make it easier for businesses to lay off workers – which would encourage hiring them in the first place. Central banks will moderate economic growth via interest rate movements, in line with the overarching inflation targets of about two percent.

However, since the global financial crisis of 2008-09, the ensuing Great Recession, and the sovereign debt crisis in Europe's Economic and Monetary Union, the grand neoliberal theories seem to be unable to produce valid explanations and functioning recommendations for policymakers. Economic growth has been low and unemployment high,

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regardless of the prolonged period of liquidity injections and extremely low interest rates. The link between the money economy and the real economy is broken and the current doctrine appears to have run out of steam. Even worse, the past decade of neoliberal austerity programmes – with cuts in government spending and taxes as well as structural labour market reforms – has had significant negative effects on the real economy, not least on the number and quality of available jobs. Far from spurring growth, austerity has produced recessionary effects in the most crisis-stricken countries, forcing governments to take up more even debt as life support for struggling businesses and citizens. This destruction of life chances for increasingly large, marginalised groups has also led to a political shift towards left- or right-wing parties, challenging the traditional political arrangements in most advanced economies.

Fresh ideas for policymakers. Evidently, we are in the midst of a crisis that questions the old ways of thinking – in particular, because the current paradigm fails to equip policymakers with practicable alternative solutions. But is there another paradigm ready to take the reign – Hall's theory that kills the theory? The good news is that policymakers and politicians have a clear policy objective: use the Covid-recovery funds to support the large-scale green transformation, which should decarbonise our economy. This dual challenge, combining a short-term (hopefully) temporary shock with long-term restructuring efforts could lend legitimacy to a new paradigm that gives the state a larger role in economic management. The scale of the current economic shock and the time pressure to achieve the long-term policy goals – we have less than 30 years to reach net zero emissions if we want to limit global warming to 1.5 degrees – also warrants more interventionist industrial policies, as markets would simply take too long to produce the desired outcomes.

The bad news is that, as of yet, we lack a comprehensive theory that unites the many aspects of reform agendas. Evidently, most signs point to a new doctrine that endorses demand management and deficit spending, alongside a new industrial strategy and updated regulations. However, without an unequivocal definition of the new paradigm, including well-defined tasks, recommendations and adjustment tools for policymakers, the risk of half-baked outcomes remains high. It is also far from evident that a return to some form of Keynesianism would be attractive to all bureaucrats. While technocratic central banks momentarily support massive countercyclical public spending programmes, a larger role for the state usually comes at the expense of the power and independence for central bankers. More generally speaking, much of the Keynesian policy menu quite simply won't work as long as influential actors, such as the Fed, ECB, IMF or World Bank, hold on to fragments of the now-defunct Washington Consensus and its combination of restrictive macro- and tightly reformed supply-side eco-

nomics. For the world to move on, these technocrats (also) need to move on, jettison the failed policies of the last thirty years and think of new goals and new instruments. We may slowly be getting there – but we are definitely not quite there yet.

Political support from social groups. The lack of a coherent new doctrine makes it difficult to assess the arising cleavages and potential for dominant coalitions. Nevertheless, identifying players that were left behind by the neoliberal orthodoxy is a good starting point in the search for proponents of a new paradigm. The group of marginalised labour market outsiders and unemployed has been increasing steadily since the deindustrialisation waves of the 1980s and the concurrent deregulation of financial and labour markets. Trade unions have suffered sustained attacks from neoliberal agendas and unionisation rates have plunged in most countries over the recent decades. The lack of organisation of the former groups and the sometimes strict boundaries that the latter have thrown up by protecting relatively well-off insiders, however, makes a 'natural' coalition between the two hard to envision – which probably explains why less institutionalised independent unions do well with the marginalised workers, but also encroach upon the terrain of the much stronger, and better organised, traditional unions. A renewed promise to strengthen labour in their endeavour to secure decent and stable jobs could mobilise a large group of working-class supporters, but it would have to entail a very different sense of identity of both the old and new workers and their respective unions.

In addition, an ever-growing share of socially and environmentally conscious voters – currently largely represented by Green parties in Europe – could be mobilised to support the new paradigm. But that, too, produces its own new cleavages: many workers in 'brown' sectors refuse to see their skills, which are tied to the polluting manufacturing processes and their products, devalue almost overnight. And since they are organised in strong trade unions that have the ear of governments in many northern European countries, a possible fruitful alliance between Greens and trade unions may also be some way off. Few things are absolutely impossible, as we have learned since the combined Brexit and Trump votes in 2016, but this seems to be a very tall order.

Traditional politics and political economy play a role too. Opposition to a new doctrine that promotes demand-side economics and a strong role for the state is likely from more conservative voters. In the EU, these opponents are usually well-represented by the more hawkish governments of Northern European states (especially the 'frugal four', including Austria, Denmark, Sweden, and the Netherlands). Moreover, lasting political support for a new Keynesian-style paradigm will depend heavily on the (inter)national and regional capacities to implement the updated economic policy re-

gime. This capacity is partly contingent on the existence of industrial relations systems that govern (regional) economies, including skills production and business coordination networks. These (in)formal institutions, however, have been identified as market-distorting under the neoliberal reform agenda and were subject to (partial) demolition in recent decades; rebuilding them requires much more work than most politicians like to admit.

And now?

There is no doubt that the pressure for a paradigm shift is mounting. We are in the middle of one of the biggest economic shocks in history and the old paradigm of neoliberalism has lost its capacity to prescribe credible, let alone successful, economic policy options. After almost a decade of near-zero interest rates and liquidity injections from central banks, growth, investment and inflation remain (too) low, while unemployment and precarious employment are on the rise. As a result, policymakers have become attentive to alternative propositions from academics and it there is a chance that politicians can gather a large enough coalition of supporters for a new paradigm. Even though there is a lack of a dominant coherent set of theories – currently there is only a loose collection of Keynesian-inspired policy suggestions – the updated doctrine will be a negotiated outcome and will, in a Kuhnian way, emerge more clearly in this process. To implement any new paradigm successfully, however, we must leave the neoliberal Washington Consensus behind and embark on the difficult task of rebuilding the (in)formal institutions that facilitate cooperation and (labour) market governance.

Building on the pointers in this short introduction, the remainder of this dossier establishes a detailed account of the challenge at hand. Section 2 presents a nuanced analysis of the current crisis and its effect on the prevalent paradigm. Section 3 explores the 'varieties of capitalism' that different countries exhibit and thus makes an argument for a variety of reforms. Section 4, looking at the practical implementation of a new doctrine, identifies key issues of publicly funded supply-side adjustment, such systems that facilitate training or R&D. Section 5 points out the dangers of getting stuck in a paradigm 'interregnum' and concludes.

2. Paradigm lost: The old order is dying and the new cannot be born

We live in interesting times, having reached, it seems, a point in political-economic history in which central banks are running up against the limits of their own powers and now have to ask political authorities to spend more and then hope that economic growth and even inflation will pick up again. This feels remarkably like the moment just before a Kuhnian paradigm shift. The notion of omniscient and omnipotent independent

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central banks is close to exhaustion and can only be kept alive by what the great philosopher of science Lakatos called ancillary hypotheses: Yes, we remain independent and fundamentally non-accommodating, but we will also – temporarily, of course – keep interest rates at or close to zero, print shedloads of money, ask governments to spend on the back of our implicit guarantee, and are concerned about a lot more than our usual low inflation target. There is nothing wrong with changing your mind when the facts change, of course, but let's at least call it out for what it is: a significant shift in what has become the broad consensus in economic policymaking.

The policy assignment: Central banks pushing on a string

Today, after more than a decade of QE, most of which ended up on the balance sheets of banks and not in the pockets of households, and with a Covid-related demand shock hitting the OECD economies, central banks are indeed pushing on a string, as Keynes put it. They can lower interest rates and add money to their balance sheets all they want, it won't make much of a difference in the real economy: Household spending has collapsed – both because there is no money and because there are no shops to spend it. Central bankers, IMF and OECD are therefore asking for a fiscal push. When monetary policy fails, government spending takes over.

Let's avoid *Schadenfreude*; the situation is dire. We are facing a quasi-permanent depression, in which very modest upturns are followed by deflation, possibly leading to a collapse of stable democracies as a result. We probably walked too eagerly into the trap that central bank independence set for us and now we are paying the price for that misplaced trust in monetary technocrats – ironically as a result of their own pleas, and it is particularly satisfying to see central banks fall off their perch and beg for more public spending and higher wages (where on earth would these come from after several decades of beating up trade unions and workers?). But that is a symptom, not the cause of the problem.

What we have learned in today's and last decade's great financial crises is that only governments can sort out the mess when push comes to shove. The prevalent response – central banks flushing the economy with money has its root in the (then revolutionary but now very orthodox) analysis of the Great Depression for which Milton Friedman and Anna Schwartz became famous. The Great Depression was so great and so depressed, because monetary authorities refused to inject liquidity into the economy. After 2008, all policymakers, especially those like then Fed chairman Ben Bernanke who had studied the 1930s in detail, rapidly opened the cash tap and inundated the economy, via the banks (in theory, at least) with cash. While that was a good idea as far as it went, the limit of a policy solely based on monetary action is now painfully visible. In effect, by concentrating on monetary policy, pretty much at the expense of every other instrument in the macroeconomic toolbox, policymakers, including cent-

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ral banks, seemed to have made things worse – less by supporting zombie firms (an *ex-post* concept anyway: telling the difference between an insolvent and an illiquid firm is almost impossible in a financial and economic crisis of this magnitude) than by precluding an early fiscal and consumption response.

Our leaders have been so enamoured by this 'policy assignment', which handed macroeconomic governance responsibility to central banks (and thus allowed politicians to stay away from difficult decisions), that they are now caught in their own contradictions. How can you be an active and activist government when you have unlearned that, often on the basis of flimsy evidence, dogmatic policy prescriptions and wild accusations of caving in to rent-seeking interest groups?

What went wrong?

The evidence: it is almost impossible to think of central banks keeping inflation low on their own. We have known this for a long time in fact. As Peter Hall, Rob Franzese, Torben Iversen and David Soskice pointed out over twenty years ago, price stability requires that every other actor, and especially trade unions, understand what the central bank is trying to accomplish and behave in accordance with that goal. If each possibility of rising inflation has to be countered by draconian interest rate hikes, the central bank would quickly run out of steam and, more importantly, out of legitimacy for its actions. What produces low inflation is the discipline of trade unions and governments against the background of a last-mover induced credible threat that is at the basis of price stability, not the meetings of the governing board that sets interest rates. Much of what has become axiomatic macroeconomic policy is based on an incorrect understanding of the logic of the political economy of advanced capitalism. This social alchemy has led to a lot of unnecessary problems.

Dogmatic policies

Two dogmatic policy prescriptions in particular that follow from this upside-down political economy come to mind: neutrality of money, the idea that monetary operations have no real long-term effects on an economy; and structural reforms, the logical corollary that, therefore, economic performance is the result of allowing market forces to play out uninterruptedly. We can disagree about the so-called neutrality of money doctrine; however, the theory's proponents then should have the intellectual honesty to explain why anyone would even want to be a central banker in that case – if money does not matter, it will all come out in the wash anyway in that neutral-money world. To be sure, inflation is a real danger under certain circumstances, but since the early 1980s, it is no longer the endemic problem that it was the previous decade – and the jury is still out anyway on whether the low inflation since the early 1980s is actually a product of central bank interventions or deeper, structural developments, such as China's labour force entering the global labour market, shifts in the preferences of median voters, or

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simply a more careful alignment of the monetary policy options of governments after mistakes in the early 1970s, as Torben Iversen & David Soskice suggest (esp. pp. 441-447). Most intriguingly, perhaps, if money were neutral, why are central bankers now suggesting that fiscal policy should take over?

As if a misguided policy based on neutral money wasn't enough of a problem, the prescriptions that followed were often surprisingly simple too – and not based on persuasive evidence either. 'Structural reforms' became the go-to solution for any problem that emerged. Usually that involved labour market reforms, welfare reforms and other one-sided policies addressing workers, trade unions and poorer households (structural reforms in finance invariably seem to have entailed higher rewards for herd-like risk-taking; we saw how well that worked in 2008). But, as with so many arguments in this debate, the policy prescription of structural reforms has essentially no backing in systematic empirical material, as the late Andrew Glyn pointed out in his forensic review fifteen years ago.

The political economy of economic policies

Finally, the politics of economic policymaking. All economic policies have distributive consequences – it is one of the key reasons for political economy as an analytical tool, and possibly its central maxim. Unsurprisingly, organised groups affected by those consequences will fight their corner. But that struggle is rarely a raw battle between 'naked' adversaries. Depending on wider political-economic circumstances, dominant ideologies and institutional frameworks that set the rules for the fight, some groups have easier access to policymakers and policies than others and thus are able to lay tracks for their victory. In addition, while no one can speak for everyone, some organisations are considerably more representative of wider interests than others, and often recognised and regulated as such. Even the most stubborn neoliberal would have a hard time arguing that the Davos crowd is more representative of wider social interests than trade unions have been (in fact, they might argue that the CEOs' non-representativeness is actually beneficial as it implies that they can exclusively direct their attention to economic performance). The investor Warren Buffett captured the situation quite well when he stated that 'There's class warfare, all right, but it's my class, the rich class, that's making war, and we're winning.'

The rich class won because it built its gains on our changed understanding of how economies work, the institutional reconfiguration that came with it, and backed up by (the deliberate policies of) globalisation and the lifting of capital controls after the deregulation of financial markets in the early 1980s. Trade unions in sheltered sectors may have taken a large slice of the pie in the past, no doubt, but it is not as if investors were looking out for the common good.

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No free lunch

There was no free lunch after all, in other words. The world inaugurated about four decades ago, symbolically represented by the Thatcher-Reagan axis of policy reforms, is imploding under its own contradictions. Central banks are clamouring – against their dominant ideology – for a more expansive fiscal policy; conservatives are proposing higher wages and new rights for workers; billionaires like Buffett are fighting for a fairer tax system; and Davos woman is concerned about inequality, environmental degradation and a host of other problems that 'unleashed' capitalism has created.

The Covid crisis has primarily been a catalyst in that regard, forcing the symptoms in the open. Every dimension of sometimes deep injustices has been exposed in the last year, from the low-wage worker who is forced to go to work, risking severe illness, over the non-whites whose death rates are higher and vaccination rates lower, down to the unequal distribution of housework and the outright violence that women have faced during the lockdowns. These social problems have always been there, but they are now staring us in the face.

The world after

But that also suggests that we can and should use the necessary post-Covid reforms to rethink our economic model. Some things run deep and require more time. But we can exploit the new-found modesty of central banks to change track and impose a more socially (and environmentally) just economic model. If our taxes have to bail out economies every ten years or so, we might as well have a say in how they work: After all, those who decide that sort of thing now have not exactly done a brilliant job. If we can make central banks independent (and relatively conservative) overnight, as we did around 1990, it should not be too difficult to scale that back (or, like Roosevelt did with his ultra-conservative Supreme court in the 1930s, threaten to do so, thereby producing the desired outcome of a more accountable and transparent monetary policy without high political costs).

In a democracy such regime changes that benefit most (and therefore all, since people whose livelihoods are more secure also commit fewer violent crimes, which makes the streets safer for everybody) should not be very difficult to agree. It might be harder to persuade all democracies to raise taxes (on internet-based corporations, the wealthy and those with an income in the top 10%), while rethinking education and welfare at roughly the same time so they have more egalitarian effects. But collective action problems lurk everywhere. We know that the need for such coordinated action always invites free-riding: if even OPEC cannot keep all its members in line all the time, imagine what governments of different colours would do. The hot breath of the populists in their neck ought to make everyone, even the remaining strong centre-right parties, aware of

the need for a socially and environmentally just reset, however. The first secures safe lives now; the second does the same for future generations.

Difficult or not, such a debate about policy options that benefit the 90%, and especially the bottom half of the income distribution, is necessary so that we can move on. The alternative of not even trying is very, very dangerous. Antonio Gramsci immortalised the problem in his *Prison Notebooks* in 1930: 'The crisis consists precisely in the fact that the old is dying and the new cannot be born; in this interregnum a great variety of morbid symptoms appear.' That is exactly how things feel right now. And the openness that comes with such a crisis offers the chance to shorten this 'interregnum', but without, let us hope, a replay of the 1930s and 40s.

3. Reforming capitalism(s)

Capitalism as we know it today needs to be reformed. If that was not clear after the financial and economic crisis of the late noughties, it was driven home during the Covid-19 crisis, which turned the entire system on its head. Bankers stayed at home, while rubbish collectors, shop assistants and nurses became indispensable, 'essential' workers. Meanwhile governments propped up their economies with financial interventions that pale only in comparison with what Paul Krugman often sarcastically calls the 'fiscal stimulus' of six years of total global war between 1939 and 1945. If it was not working all that well before, these twin crises have left little doubt that neo-capitalism simply has no future.

This is the conventional wisdom, shaped by the (soon) lost decade and a half since the financial and economic crisis of 2008-09, the Covid-19 crisis of 2020, and reflected in the popular discontent and populist, anti-system politics of the *Rassemblement* (erstwhile *Front*) *National*, *Alternative für Deutschland*, the *Vlaams Belang*, *Cinque Stelle*, and on the Left *Podemos* and *Syriza*. 'If not now, when?' has been the central question on the centre-Left (a question which, in a deep irony, secured a series of electoral losses to parties that governed the major European economies for a good part of the booming 2000s); the centre-Right, in turn, is rediscovering its 'one nation', Gaullist, popular party credentials, sometimes implementing a good deal of the proposals that cost the Left the elections. The main tenets of reform look remarkably similar across the previously stark ideological divide: curbing corporate excesses, particularly excessive pay and bonuses; redistributing income from the top to the lower middle and bottom of the income and wealth distribution; increasing social and other protection, including health care and other benefits for precarious workers; rethinking the role of the state in the economy; and developing a sharper sense of the ecological limits to economic growth. (Let us ignore the rear-guard actions, primarily by elitist European technocrats, to go back to the good old days of budgetary discipline, monetary rigour

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and unfettered competition; or its Covid version, targeted, competitiveness-enhancing spending).

Most of the proposals for reform that are circulating make a lot of sense, of course. The deregulated capitalism of the last four decades has not produced the high economic growth rates of the more regulated, negotiated form of capitalism that preceded it. Unemployment rates are now both empirically and normatively higher, with a full employment target of 4% (a rate that would probably have required a lot of soul searching and government intervention in the 1960s). Inflation rates are now so deeply entrenched below the target of 2% that almost all OECD economies are struggling to escape the looming deflationary trap. And the system has become more fragile, primarily as a result of the dominant position of global finance in the economy, the importance of global supply chains, and the retrenchment of the state as a social buffer in open economies. Meanwhile many people in the advanced capitalist world are considerably worse off today than their historical counterparts were in the 1960s and 70s. The capitalist economy does not perform all that well anymore, and it now produces more uncertainty, inequality and, therefore, unhappiness than before, as Angus Deaton & Anne Case have argued. Reform is necessary for the economic system, and the population that it is supposed to serve, to survive.

Varieties of Capitalism…

There is one significant problem with this diagnosis, however. 'Capitalism' is not a single system – unless you think of it only as a global exchange mechanism that sucks every economic actor and economic system, from the simplest to the most complex, and from the local baker to the IMF into its vortex. The image of the all-conquering capitalist system that Marx and Engels sketched in the Communist Manifesto was a possible future at the time; their emphasis on the 'laws of motion of history', however, as if actors fundamentally did not matter in that history turned it into the sole possible future.

That monolithic view of capitalism has never been very persuasive. Marx himself had to invoke a mysterious 'Asian mode of production' when looking at something very different from the dominant Anglo-Saxon capitalism of his time. And even Alfred Marshall, one of the founding fathers of modern neo-classical economics, studied non-market forms of (efficient) economic organisation: industrial districts, he claimed, were based on very different principles from the market-based contractual order that economists studied.

The big shock following the collapse of the Soviet system in the early 1990s has again made us see the trees for the capitalist forest. Throughout the 1990s, we became more sensitive to what had initially looked like relatively small, retrograde variations within capitalism and especially to the effects they had on the life chances of the population,

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on the efficiency of the economy and its long-term sustainability, and on how all that was articulated with the role of government in the economy. We discovered, or often rediscovered in fact, that being a worker in Japan, Sweden or Germany was a very different experience from being one in the UK or the US. We noticed again that despite all these economies being nominally 'capitalist', the state played a very different role across them, from (still) steering large parts of the economy as in France to 'light-touch' regulation as in the UK.

Turning to finance, we discovered again (see Zysman 1983) that banks, insurance companies and generally patient capital played a critical role in providing industrial credit in countries like Germany and France, while more nervous and short-term oriented stock markets were far more important in the Anglo-Saxon economies. Even after decades of financial globalisation, these differences were significant when the survival of business depended on the capacity of financial systems to act as a public utility after the coronavirus struck. The rather unglamorous local savings banks were the main channel for finance during the crisis in Germany, not the famous big banks. Britain lacked such a deep, decentralised structure and its economy suffered considerably more as a result.

Cooperation between companies was yet another area with important differences: in continental Europe companies are almost encouraged to closely work together in areas such as training, innovation and supply chain management while essentially being prohibited from doing so in many other advanced capitalist nations. And most intriguingly, perhaps, while all these arrangements have undergone significant changes in the last thirty years, much of these systemic differences remained important. In short, the genus of capitalism covered many species: while all socialist economies may have looked the same to the casual observer, every capitalist economy was capitalist in its own way.

…and varieties of reforms

That puts our need for reforms into a very different light. Not only do we need to develop a sense of the goals of reforms; if there are systematically different 'varieties of capitalism' (to use both the academic marker and the intuitive idea), then reforming capitalism ought to reflect that diversity. If a country's economic system is, for example, built on a set of tightly interlocking subsystems in which high-wage, high-skill labour operating in protected labour markets is part of that institutional arrangement, and these economies do very well, then it makes little sense to argue for deregulatory 'structural reforms' (usually a euphemism for labour market deregulation and increased flexibility from workers).

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But if your external competitiveness is built on a vast number of firms involved in cutting-edge innovation – and of which only a small number are likely to succeed at any time – imposing tight regulations on the provision of finance, on employment security or even on corporate governance and business ethics may be equally deeply counterproductive. For reforms to succeed, in other words, they have to be compatible with the rest of the system, including and reflecting its underlying logic. In fact, their compatibility with the rest of the political economy is a *minimum* necessary condition in this view: for reforms to have the desired effects, they should, somewhat counterintuitively perhaps, actually reinforce the existing systemic logic, not produce revolutionary change.

That may lead to some strange outcomes, none of which can easily be accommodated in the worldviews of the reformers. It could mean, for example, that rather than freeing management from institutional and regulatory constraints, the most appropriate ways to marshal support and expertise for shifts in company strategy requires imposing more curbs on management through employee voice and hard floors on wages. If no one knows the future, as in the emerging sector of electric vehicles for example, but everyone is aware of the costs of the transition, confrontations involving mass redundancies of those workers who have 'legacy' skills that may soon be obsolete will almost certainly lead to a social 'bloodbath'. Bringing all interested parties on board in the spirit of constructive discussion of goals and means, mapping out a transition trajectory together and introducing a mechanism to flexibly revisit milestones has many unexpected advantages that may well outweigh the short-term costs imposed on the company, the sector or the region. It exploits the advantages of existing institutions, builds more trust in response, and assures that the future will balance the interests of different stakeholders.

But for a small biotech start-up, the ability to rapidly shift its resources when a particular product line looks like a dead end, laying off those engineers who have deep but now irrelevant knowledge of the defunct R&D in the gene, enzyme or molecule, is a crucial part of its business development. Strict employment regulation would assure the demise of that company and potentially, given the vagaries of such science-based product development, of the biotech sector as a whole.

Reforms, but not under conditions of their own choice

This does not mean that the employment regime in those rapidly moving high-tech sectors could not be improved – but that is probably best done or even already taking place in different ways. For example, in knowledge-intensive sectors like biotech, companies simply have to rely on the insights of their employees to thrive. This spans the whole gamut, from investment and basic choices in the area of technology to broader issues of strategy and even joint ventures or mergers and acquisitions. Diversity is equally a must: if your competitive advantage relies on small differences in your ability to

harness intelligent contributions, particularly in a very uncertain, fast-moving environment, any form of discrimination is deeply counterproductive (admittedly quotas may be necessary because this functional need may not be enough of a force in itself for some of the dinosaurs).

Interestingly, the highly flexible labour market with relatively low hire and fire thresholds does not only confer advantages to employers: the skills of employees allow them to be relatively rapidly deployed in other companies, giving employees a significant exit option (and, thus, bargaining power). In fact, the spread and development of applied knowledge in these types of sectors often runs through these 'job-hopping' employees, a bit like the industrial districts that Alfred Marshall discovered, where knowledge was 'in the air'. Ditto for gig workers: like lawyers, doctors and architects, I would also do well in a gig economy where my skills are desired; but an Uber driver or even a cleaner on a precarious contract would not. The gig arrangement is not bad in itself but because its costs and benefits are distributed in a deeply asymmetric way. A lightly regulated labour market, which would probably lead to a significant drop in skills in more traditional manufacturing sectors because workers would no longer be certain that they can amortise their investment in specific skills, is an absolute necessity in the vibrant, effervescent sectors that thrive on exploring uncertainty.

The same reform would have opposite effects in both cases, therefore; or put slightly differently, reforms that are very different – in many ways each other's opposites – would lead to outcomes that are much better suited to the needs of these companies and employees in their respective institutional settings. If the German or Swiss manufacturing sector works best with a tightly organised labour market, clamours for deregulation there ('structural reforms') in response to a set of economic performance problems are bound to make an already bad situation worse. And while there is no doubt that today's, post-Covid, 'essential workers' would certainly benefit from a more regulated regime in the Anglo-Saxon economies, the science-heavy knowledge sectors in these countries will have to explore other ways to address employment and social protection.

In sum

If capitalism needs reform, diversity within capitalism suggests variety in reforms. This has always been the case – the adjustment trajectories of France, Germany and the US diverged in the past, and they are likely to do so in the future as well. Economic integration has, on the Ricardian principle of comparative advantage, produced more diversity in capitalism than ever before. If the post-war period could still be seen as small variations on a common theme, increased trade between advanced capitalist economies and between the OECD and the rest of the world means that both our analysis of problems and our ideas for solutions have to be rethought. Where our parents and grand-

parents could think of reform of capitalism regardless of where they lived, we need to think of deep reform in a context that is different. We can learn from each other, sure, but an Austrian, an Italian and a Brit face different constraints on feasible reforms – lest they destroy the entire economy.

Intelligent reforms require a good sense of domestic institutions and where they produce gains for the system as a whole, of the strategies of interest groups and where they lead to beneficial constraints that impose long-term economic viability, and of policies that balance the different claims that actors articulate against those contexts. But they also suggest experimentation: the days of change orchestrated in the centre for once and for all are – pace Macron – over. And, as a result, they suggest being sensitive to the diverse effects of similar reforms in different settings. The world may have become more complicated recently, but if we want it to last and us to thrive in it, we need to think a little deeper than we have done so far.

4. The pot of gold warning: Why publicly funding supply-side reforms is difficult

The €750 billion Next Generation EU Fund, approved by the European Parliament in February 2021, is there to help EU member states adjust to a post-Covid economy from summer 2021 onwards. There are many interesting things that can be and have been said about this, and its organisation throws up many important questions – for example, what do states need to be able to dispense their share of the fund, are the funding and disbursement keys fair and efficient, or – the topic here – is it more like Keynes's 'pot of gold'?

Keynes famously said that having workers dig up a pot of gold and then bury it again, paying their wages with the gold in the pot makes more sense than saving it or spending it in many other ways. The money multiplier, thus his crucial insight, would assure that one coin of gold turns into much more in actual terms because the pot-digger pays the baker and the butcher, who pay the tailor and the carpenter, etc. You could do the maths of how much consumption is left after costs are covered, but the essential point is that €10 turn into several multiples as the money circulates, thus increasing demand in an economy. He added – an often-forgotten part of the statement – that this was the best option if nothing else could be done AND that, if possible, the money should be put to construct something useful. If it goes into infrastructure, skills, or new, greener energy and buildings, productivity would rise and thus lift the medium-term feasible growth rate. We can make more with the same number of workers, can pay them more as a result, without fear of wage inflation. And along the way, that extra

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growth might even refund a large part of the initial outlay through increased tax revenue. A free lunch, in other words.

The issue with the pot-of-gold argument is that coda of doing something useful with it. After several decades of publicly funded supply-side adjustment policies, we begin to understand better that targeting such policies so that they produce the beneficial outcome is actually quite difficult. While that has not stopped many governments and commentators to repeat that more innovation or training is needed to prepare companies and workers for the jobs of the future, it is a lot harder to say what exactly the R&D investment and that training should consist of.

Take training: Which types of knowledge will be necessary for the good jobs of the future? Mainly jobs relying on specific skills even if those are broader than what we now think of when we say that, or should we instead build up high general skills as a solid basis for the flexible deployment of workers, leaving it to companies to top them up? If robots will take over much of the actual assembly in cars, for example, training in software debugging, statistical process control, quality management and shopfloor human resources may make a lot more sense, both for workers and for companies. The latter can start with a high skill basis, while the former can easily move jobs if necessary.

A lot of money and lives can go to waste if we are wrong, though. Imagine we went for specific skills on the grounds that they offer more stable, well-paying jobs than general skill-based jobs – as they historically have done. However, companies pursuing their short-term interests, can and often do make mistakes and industries can change quickly, as is happening today with the automotive sector because of the combined pressures of automation, electrification and shifting value chains; workers suddenly find themselves unable to use these skills and are, in human resources terms, as good as bankrupt. Governments, companies, trade unions and workers would need to think through what makes most sense in terms of such an investment in skills. Much of the public funding for training, however, is organised to involve these actors mainly in the implementation stage but rarely in design, where their informational advantages could more easily be deployed.

Bridging that gap between the supply and the needs of the future requires a stable, trust-based mechanism to gather and process relevant information on the skills needed, and which allows for experimentation, thinking outside the box and, indeed, mistakes. Such an information-clearing mechanism could then allow the interested parties to decide how to organise the relevant training and where to try out new approaches.

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The active involvement of non-governmental actors is critical in this process, since such designs rarely work that well if organised by the government, or at least not the state alone, as the many attempts by French governments since the 1970s to emulate the German training system testify. French policymakers (in the quite formidable French state) have literally tried everything: a training levy that companies lost if not used, later topped up by matching funds; decentralised training systems organised by the newly empowered regions; training boards at the sectoral level; and company-level 'expression groups'. In fact, the only arrangement the French government technocrats never tried was the one that works so well in Germany, and which combines employers' associations and sectoral trade unions to discuss and negotiate contents, and local Chambers of Commerce who are responsible for organisation and delivery. The French Chambers are weak and have no authority over local firms, and employers and unions refuse to talk to each other. Under the circumstances, it is hardly surprising that nothing produced the desired results.

The analytical problem of information clearing, interest aggregation and negotiation is crucial, as these examples suggest. But here is the snag: companies and other private actors are reluctant to build such an arrangement because it imposes costs on them while benefitting everyone else as well as them. Put differently, building such a complex forum is a question of first-order and second-order collective action problems: the process of building institutions to help the actors overcome the initial collective action problem is itself subject to collective action hold-ups. It costs the actors that are building them resources to do so, while those who do not contribute also benefit.

Training in Germany works well, in this perspective, because unions and employers are well-organised, their bargaining institutions stable, and they can therefore draw on those institutional resources to hammer out the contours of new job definitions and the training required for them. And it fails in France because the state cannot substitute for the required organised capacities of French (under-organised) unions and employers. The end result is lots of money spent with little to show for it.

Innovation policy offers an interesting contrast. These days governments rarely intervene directly in R&D; instead, they invest in broad horizontal innovation policies that benefit all companies: biotech departments in universities that nurture clusters of spin-offs, for example, or regional staff functions (such as HR, marketing, regulatory support and market access), which would be too expensive for many small biotech companies to build on their own but makes perfect sense to pool among a regional cluster. Governments fund what is known to be necessary, and do not directly intervene in the sub-

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stance of the innovation, at least not much beyond funding basic research in universities.

The organisational deficit in skill production explained earlier, now helps us understand better why many supply-side policies are often so difficult to organise successfully. Some reforms simply won't work as well in the host country as they did in the home country, often for deep historical reasons that limit the ability of actors to overcome equally profound collective action problems. That circumscribes our ambitions in planning supply-side interventions quite sharply. The upshot is that we may have to live with the minimal ('pipeline') version of Keynes's pot of gold that works in innovation policies: hand over the cash, allow the actors to think of new ways of determining substance and organisation, and make mistakes along the way – but essentially hope rather than plan for results.

5. Conclusion

This dossier has examined the state of the political economies in the West – both the actual world and the lenses that we use to make it intelligible. Our conclusion at the end of these reflections is that we are in the dangerous 'interregnum' that Antonio Gramsci described so well in the *Prison Notebooks*, and which not only cost him a large chunk of his adult life, first in Fascist prisons and then a young death, but set the world on the path to the most horrible wars and genocides in human history. It pays to think about this crisis moment, therefore, if only to see where parallels emerge and where alternative paths might exist. In that vein, the conditions for change are objectively here – the prevailing paradigm is producing its own contradictions, the institutional carriers of the old paradigm are weakening while experimentation with alternatives is slowly getting underway, and a growing part of the population is not only worse off but expressing their discontent through anti-system politics. Missing in this mix are a coherent alternative that goes well beyond a stopgap and a reformist social-political coalition that can shift the world from the defunct equilibrium to the new one.

This might be too optimistic, of course. Even if all actors were on board, producing a well-functioning 'green' Keynesian political economy will be difficult. In a deeply ironic parallel to the way 45 years of Communism left an empty shell in Central Europe once the Communist parties and states disintegrated, many of the underlying institutions and systems necessary for a series of fundamental reforms have been destroyed by neoliberal policies over the past four decades. A new doctrinal framework and a strong political coalition are necessary, but perhaps not sufficient, for the paradigm shift that we are expecting. 'The old is dead but the new cannot yet be born', in Gramsci's prescient

words, because – we discover now – the outcomes of historical processes are sometimes irreversible. Take just two examples: the UK pre- and post-Thatcher; and Italy under Berlusconi.

In the case of the first: it is now impossible to think of the UK as even potentially becoming a successful highly organised political economy, where business coordination follows associational rules, trade unions and employers work together in a 'conflictual partnership', and where relatively low inequalities secure access for all to inexpensive high-quality housing, and important and life-changing public services such as education and welfare. The Thatcher reforms, regardless of what you may think of them, have closed the door to the UK ever becoming a corporatist political economy of the type that we find in north-western Europe (again). That particular ship has sailed, and the most important contributions of New Labour was to accept that inevitability and start to rethink economic policy within the confines of the rather wilder, Anglo-Saxon model of capitalism that they inherited (even the considerably more left-wing Miliband Labour party essentially tried to make UK capitalism more social-democratic on the terms that it was handed over).

Similarly, and perhaps more tragically, there is an argument to be made that Italy was an increasingly well-adjusted political economy between the 1993 Social Pact, the political vehicle for macroeconomic reforms that paved the way for Italy's entry into the Eurozone only a few years later, and the second Berlusconi government of 2001. Wages were tied to productivity by mutual agreement between employers and unions, which incentivised both to search for increases. Local social pacts complemented the national social pact with training, cooperation and other regional initiatives that filled in the productivity blanks. For the first time in Italian post-war history, inflation fell, productivity rose, industry moved up in terms of value added, and the central bank played a benign supporting role as long as the country was on track to meet the Maastricht criteria. Berlusconi's intervention in 2001 simply destroyed the pact, undermined the mutual trust between labour and capital, and offered employers an opportunistic way out of the package; since Italy had entered EMU, there was only a low price to pay. The Social Pact was dead, and the catastrophic last twenty years in the Italian economy, with high inflation, stagnating productivity and wages, low growth and high debt as a result can easily be understood as the outcome of the collapse in 'social concertation'.

This leaves us with one important conclusion in relation to the link between the recent history of capitalism and the possibilities for a paradigm shift of the sort that has inspired us in this dossier. Labour market institutions that govern the political economy in a sector are not just pieces of legislation that can be switched on and off at the gov-

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ernment's convenience. They are carefully designed and developed systems based on formal rules and trust between informal coordination groups, interest representations, and their members. Once this originally strong, but eventually delicate framework is destroyed in its core (e.g. de-industrialisation or de-unionisation), it is very difficult to revitalise. Rebuilding the industrial set-up requires overcoming (nested) collective action problems, as shown by the examples of skills production, R&D pooling and innovation, or symbiotic product development (e.g. from primer to drug on the market through a network of firms).

The road to a new, greener, more equitable economic model might be long, therefore. If we took a wrong turn and just kept going, we might not even get there but remain stuck in the catastrophic interregnum: a permanently depressed economy with increasing inequalities (low growth is not bad for everyone – ask the rentiers), a hapless state caught between the need to intervene and the shackles of the old ideologies, and social actors that lack the organisational capacity to mobilise around a new economic model. Equally importantly, perhaps, if the strategic levers of capitalism vary in different types of capitalism, and different actors (can) play that mobilising role, there may not even be one silver bullet. Even if we knew where to go, getting there might be a matter of considerable experimentation. The road might be long, indeed.