

15. The Implications for Theory and Policy

A. The Power and the Dangers of an Interpretation Based on Recurrence

When reading the accounts of the 1870s and 1880s written by those who lived through them,²³³ one is inevitably struck by the similarities between the evolution of compound engines and ships and that of chips and computers, between the process of generation of a world economy through transcontinental transport and telegraph and the present process of globalization through telecommunications and the Internet. By making the relevant distinctions between that context and this one, the power of those technologies and of these, the worldviews of that time and our own, we can learn to distinguish the common and the unique in all such processes. The same happens when reading the glowing accounts of economic success in the 1920s²³⁴ and the similar writings about the ‘new economy’ in the 1990s. If one is willing to accept *recurrence* as a frame of reference and the uniqueness of each period as the object of study, then the power of this sort of interpretation comes forth very strongly.

In the author’s own experience, not being a historian or a finance economist, the historical record became a laboratory for testing the hypotheses of the model.²³⁵ In essence, the job was one of conducting genuine experiments in regularity. After identifying a phenomenon that could be part of the recurrent sequence, it was possible to ‘test’ for its appearance again and again in each similar historical phase, following the preliminary model. In this manner, by successive approximations, the various elements of the process could be either dismissed or modified or tentatively confirmed. In some instances, there were strong differences, such as the absence of a crash in Britain in the 1890s or the prominence of finance in the ‘Progressive Era’ in the United States or the extraordinary length of the 1930s depression in that same country. Those cases forced the author to delve further and, in the end, served to reshape and enrich the hypotheses. A model built on the basis of four and a half cases requires bold stylization and open-minded testing. Naturally, the job is far from

233. See, for example, Wells (1889:1893).

234. See the Introductory Summary of the so-called Hoover Report. Hoover (1929) pp. i–xxi.

235. That is the point made by Gustav Schmoller, the main exponent of the German Historical School in Economics, about the use of history. Schmoller (1893) pp. 261–269.

complete and further research is likely to help modify and strengthen these tentative results. For the moment it is for the reader to judge the usefulness of the general framework.

Obviously, any dogmatic or rigid application of the model will defeat its purpose. Its main value is serving as a tool to help organize the richness of real life but not to hammer facts into tight boxes.

With the particular proposal being made here, there is great danger of wanting to find exact dates for the end or beginning of a phase or period, when in fact most of the processes involved are overlapping and do not allow such precision. The dating used in this book is basically a working approximation to help transmit the ideas. The peril is further compounded when analyzing different countries because of the uneven spread of each revolution and the sequential displacement of phases as propagation advances from one country to another.

There is also the risk of exceeding the limits of determinism beyond what could be considered reasonable in a real historical setting. Though technology takes pride of place in the explanation, it is as much determined by social and institutional factors and by the economy and finance as it, in turn, influences them. As Chris Freeman has shown, the relative autonomy of science, technology, politics, economics and culture has to be taken into account in any attempt at explaining the processes of development as they actually occur.²³⁶ In particular, even though wars and civil wars are certainly related to the processes that have been discussed, they have their own dynamics. The Napoleonic Wars and both the First and Second World Wars obviously dominated some phases of economic development and accounted for many of their specific features. The same may unhappily be true of the present conflicts, which Mary Kaldor has called *new wars*.²³⁷ So, even though the explanatory hypotheses presented here involve unavoidable simplification, the full complexity of the feedback loops has to be kept constantly in mind when using the model for analyzing specific historical cases.

An additional difficulty is the interdisciplinary nature of the model. Looking at it from the standpoint of any one of the many disciplines, into which the social sciences have come to divide social reality, will diminish the value of the framework and move away from its intention.

Finally there is the question of the level of abstraction. The proposed model refers to long-term dynamics and cannot explain individual events. Obviously to analyze particular financial crises one is better advised to use Minsky's or Kindleberger's models.²³⁸ What this framework can be used for is to enrich the

236. Freeman (1995) pp. 11–19 and Freeman and Louçã (2001) pp. 123–35.

237. Kaldor (1999).

238. Minsky (1975 and 1982), Kindleberger (1978).

understanding by providing the wider context within which a particular panic occurs. The same can be said about individual radical innovations or the introduction of any single regulatory institution. This is a bird's-eye view where the bulk of phenomena are roughly ordered in terms of the general gist of the times.

The justification for an exercise that claims to give order to the historical record at the expense of its infinite complexity and richness is its heuristic value. Having a structure with which to ask questions and against which to assess regularity and to fully value uniqueness is all that one can expect. It can be no more than a very blunt and fuzzy instrument and its power depends on an intelligent and flexible use.

B. Changing Times; Changing Views

If what is proposed here reasonably approaches the way the system works, then one could expect to find traces of these changes in the history of economic thought. To begin with, it can throw light on the recurring and varying interest in certain economic topics. Kindleberger's later editions of *Manias, Panics and Crashes* open with the following paragraph:

There is hardly a more conventional subject in economic literature than financial crises. If few books on the subject appeared during the several decades after World War II, following the spate of the 1930s, it was because the industry of producing them is anticyclical in character, and recessions from 1945 to 1973 were few, far between and exceptionally mild. More recently, with the worldwide recession of 1974–75 and the nervous financial tension of the 1980s, the industry has picked up. When it first appeared in 1978, this work thus reflected a revived interest in an old theme, a theme that became increasingly salient in the decades that followed.²³⁹

The model may also serve to explain the changing intensity of certain debates and the ebb and flow of certain views. For instance, if the relationship between financial and production capital really goes through some stages of clear collaboration and others of tense decoupling, the heated debates about the link between the real and the money economy would be temporarily 'won' by one side or the other. Such changes of view were observed by Pigou when he remarked how money was alternately viewed as a mere wrapper of production or as a powerful 'evil genius,' following the changes from Deployment to ruthless Installation and to Deployment again, around the two great wars of the twentieth century.²⁴⁰

239. Kindleberger (1978:1996) p. 1.

240. Pigou (1949) pp.18–19. Quoted in Part I, Ch. 1, p. 6 of this book.

Though Greenspan's early warnings against 'irrational exuberance' were correct, his later claim about the arrival of a 'new economy', understood as non-cyclical growth, came just as the euphoria was about to give way to the NASDAQ collapse. This echoed the assertions of Irving Fisher, the brilliant economist, who had the misfortune of declaring in mid-1929 that 'stock prices had reached what looked like a permanently high plateau'.²⁴¹

The *Methodenstreit* between the historical school and the neo-classicals, which in practice expelled the state, Society and the historical context from economic theory, occurred in the period of installation of the third surge, which in the periodization proposed here is parallel to the installation period of the fifth, when the monetarists defeated the Keynesians.²⁴²

With a longer time frame, in Heilbroner's classic about the 'worldly philosophers',²⁴³ where he locates each of the great economic thinkers in the context of his times, we get a glimpse at the possible experiential source of some of their interpretations. If David Ricardo had not been a successful stockbroker living in the midst of the maturing first surge, he might not have realized the threat to industrial profits coming from the protective Corn Laws and the rising cost of land, so he might not have come up with a theory of rents. If Veblen had not lived through the 'savage world' of the 1880s and 1890s he might not have developed his views about the negative role of financial capital in contrast with that of the engineers. If Keynes had not experienced both the turbulence of the 1920s and the 'sick world' of the 1930s he might not have searched for an explanation for depression and a recipe for getting out of it.

Capitalism, as an object of study, evolves through successive and distinct surges of growth, which in turn evolve through different phases, some chaotic, others more synergistic, none everlasting. So asking when and where a theory was developed, and especially when and where it gained acceptance, may turn out to be a very relevant question.²⁴⁴ Furthermore, the expectation of a change in the tide – from one 'orthodoxy' to another – can be firmly rooted in an understanding of the nature of capitalist society and its functioning.

If the specific nature of 'what is going on' has some influence upon the way economists and others interpret the world, this may underpin the transient fortunes of different theories at different times. The extremely long period of installation since the 1970s, characterized by increasingly globalized free competition, nurtured the idea that markets were all that counted and that the state was incompetent and its influence undesirable in the economic sphere. After the collapse of the NASDAQ bubble, and the onset of uncertainty and reces-

241. Cited by Galbraith (1990) p. 80.

242. See Hodgson's (2001) *How Economics Forgot History*.

243. Heilbroner (1953).

244. As reported by Toporowski (2000), this point was made in methodological terms by Chick (1992) and by Kregel (1995).

sion, this view began to change. Already the unbearable situation in a great number of ‘economies in transition’ and developing countries – or rather ‘undeveloping’ countries²⁴⁵ – was leading to a questioning of this temporary dogma. As time moves on and free competition is replaced by global oligopolies, as has occurred in past surges and has been happening in many sectors, more widespread doubts are likely to arise. Gradually, with or without a truly deep depression, it is quite probable that institutions and regulation will again be deemed necessary. Perhaps then those economists and other social scientists that propound the importance of combining state and market may once more find a good place under the sun.

C. Changing Times, Changing Policies

The ultimate test of usefulness of a model such as the one presented here is in relation to policy making, be it in business, in social organizations or in government.

Although no strong claims are made with regards to its predictive ability, the model does suggest that the near future is often not an extrapolation of the near past and that, through a reasonable approximation to the stage of the sequence we are in, the direction of the next change can be roughly gleaned. So, this framework may give some guidance and criteria for action in times of significant change. It is at those times that help is needed in asking the proper questions both of the present and of the longer-term past in order to construct a better future. As Eric Hobsbawm has remarked, it is the power to recognize the turning points that will help economists, politicians and businessmen to prepare for the next war, not for the last.²⁴⁶

This is no small task. If we look back into recent history we can have a measure of the amount of audacity required to visualize the future, even a decade or two ahead. How easy do we think it may have been for people in the depression of the 1930s to conceive the possibility of effective policies for full employment and for the control of business cycles? How many would have believed in the early 1940s, when empire building was still on the agenda, that most developing countries would soon gain independence? Or, in the mid-1920s, how realistic would proposals have seemed for strict regulation of financial capital and for the official recognition of labor unions? How many in the 1960s could have envisaged the collapse of Bretton Woods, stagflation, deregulation and the decline of the welfare state? Yet, with hindsight it is pos-

245. For a particularly tragic example of this process see the case of Mongolia in Reinert (2001).

246. Hobsbawm (1997) p. 162.

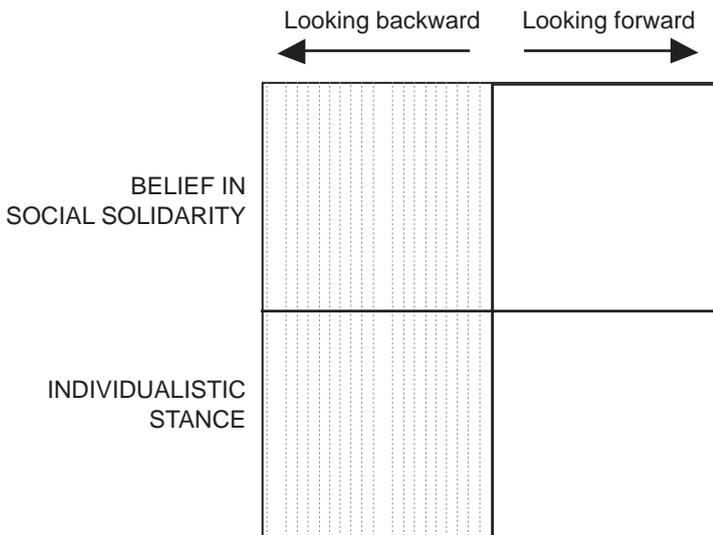
sible to locate all those events in an understandable sequence in relation to the two great surges involved.

Therefore, the main practical implication of the proposed model is to take advantage of what the past can teach us in order to see policy as responding to a moving target. At each turn, the range for creativity in terms of viable responses would be shaped by the nature of each successive technological revolution and its paradigm, as well as by the character of each phase of its unfolding. Whether the actual responses are timely or delayed, adequate or inadequate, will depend on a multitude of cultural, political, economic and other factors, including the specific conditions of the national and world economy and the previous decisions of the more influential actors.

The design of appropriate policies at each turn requires identifying the direction of change by understanding the paradigm and identifying the phase of the surge. Neither task is simple and both the willingness to understand and the goals pursued when responding are politically conditioned.

At the same time, political ideas in terms of their policy translations are not immune to paradigm changes. In political terms, the periods of installation are times of cleavage inside political and ideological groupings. Whatever specific forms they had taken in the previous surge, whatever their location in the rough distinction between the individualistic and the socially responsible positions, an internal divide begins to cross each group (see Figure 15.1).

Figure 15.1 Paradigm shift and political cleavage



Source: Perez (1998).

The new line is drawn between those who look back with nostalgia, trying to hold on to past practices, and those who embrace the new paradigm and propose new institutions to fit the new conditions. This blurs the previous connection between certain values or goals and the specific means of attaining them. Though the goals may remain unchanged, the adequate and viable means to pursue them change with each paradigm shift. This can lead to temporary confusions, internal confrontations, divisions, revamping of traditional parties, new movements and other forms of realignment, which are likely to redefine the political spectrum for the following few decades.

So, the complexities involved in policy making during these periods of change can lead to emotional and political havoc in what had been apparently stable territories and well-defined ideological frontiers.

Yet if this model is a reasonable approximation to the way the system works then it is wise to try to engage in the design of regulations and institutions so they will be ready and in the arena of debate when the moment comes for them to be accepted. This is particularly relevant in the frenzy phase when the economy appears dominated by the interests of the financial world, which also has the power to impose them, until the resulting economic tensions and political pressures make them untenable or a major crash wipes out the source of confidence. This idea is behind Triffin's position, who when proposing changes to the international monetary system, said: 'My alternatives may not be feasible now but perhaps one day, after the necessary catastrophe, they may be rediscovered and made use of.'²⁴⁷ Soros also, when proposing the creation of an international credit insurance corporation for guaranteeing loans to developing countries, remarked that it could be an acceptable idea only when creditors and debtors alike were seriously scared.²⁴⁸

Proposals can only be effective, however, when bearing in mind that institutional change is much slower and culturally more complex than technological or economic change. Overcoming the inertia of vested interests, long-held prejudices and dogmas, cultural views, practical routines and ingrained habits, especially when they had previously been successful, requires impressive events and powerful political pressures. In addition, during the installation period, attention tends to concentrate on the 'destruction' half of the process of institutional creative destruction. The inefficacy of the old institutions to handle the emerging technological revolution and the drive of financial capital for free-wheeling action come together to dismantle the restraining regulatory framework. The confrontation between the defenders of the old regime and the aggressive new deregulators – strong from riding on the high waves of the

247. Reported by Strange (1998) p. 20.

248. Reported by Strange (1998) pp. 189–90.

technological revolution in the midst of a sea of economic troubles – leaves little space for the proposal and acceptance of the required new and modern rules. Indeed, it is difficult to even design the appropriate framework before the paradigm is fully configured. The potential to be fostered begins to be recognized only after considerable diffusion. Similarly, the problems to be overcome can only be identified after having experienced them.

It is then possible to envisage the present model as an early-warning tool, providing criteria to guide policy making. Yet, effectiveness would demand a very profound and subtle understanding of the nature of the system and its driving forces. Could the bubble and its consequences be avoided? Could some institutional agent – or the capitalists themselves – identify the onset of maturity and facilitate the next revolution and its flourishing? Could the decline of the old industries be forestalled by conscious modernization? Could the shift of power at the turning point be engineered without the recession and the social tensions involved? Would all that imply modifying the nature of capitalism? Or, could it be – as Karl Polanyi's notion of the Great Transformation,²⁴⁹ or Beveridge's version of the Welfare State²⁵⁰ – a set of reforms for the construction of another stage of more humane capitalism? The answers to those questions do not merely require research but a very deep understanding of the many human and social complexities involved.

In a more modest way, the model can simply serve as a frame of reference for social actors within the system as it now operates. Under those circumstances, those who grasp the sense of the times, correctly interpret the potential and the direction of change and deeply understand the characteristics of the relevant paradigm, are more likely to be able to pursue their goals with viable and realistic proposals.

249. Polanyi (1944).

250. See Beveridge (1944:1967).