Capitalism 4.0

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As the world moves from the life-threatening to the convalescent phase of the financial crisis it is becoming clear that, although it wasn't destroyed by the near-death experience of 2008-09, global capitalism will have been permanently transformed.

The crisis marked the fourth systemic transformation of the global capitalist system, comparable to the upheavals that followed the great inflation of the 1970s, the great depression of the 1930s and the period of geopolitical turmoil that culminated with Wellington's victory over Napoleon in 1815. The new politico-economic system emerging from the crisis can therefore be described as the fourth distinctive version of capitalism: Capitalism 4.0.

The defining feature of each previous systemic transformation has been a change in the relationship between government and markets, and especially in what might be called the fundamental question of political economy: the balance between political decisions based on one-man-one-vote and economic decisions based on one-pound-one-vote.

Capitalism 4.0 will be marked by a new recognition that market economies cannot function without competent and active government. This is now obvious in the financial sector, but another essential economic function of government has been demonstrated just as clearly by the crisis. Governments and central banks must now actively manage economic cycles, because inflation targets—the main tool of macro-economic management in recent decades—are not enough.

The dominant economic theories of the 1980s, which assumed rational expectations and efficient markets, left only one important role for government economic policy: to keep inflation under control. But if markets are recognised as inherently fallible and subject to financial swings and Keynesian economic depressions, governments and central banks must again accept responsibility for managing growth and employment and maintaining financial stability that they abandoned in the 1980s. The Bank of England, instead of merely aiming to hit a 2 per cent inflation target, will be set a tolerance range for inflation, unemployment and financial risks, and will be expected to intervene to prevent the economy moving into dangerous territory by focusing on whichever economic variables are flashing "red" at any point in the economic cycle. At the same time, recognising that market forces cannot always be trusted to create price signals consistent with broader social objectives will mean that governments play a greater role in setting energy prices, managing currencies and creating the right environmental incentives.

The politics of the post-crisis period will defy left-wing hopes of a return to the stateism of the 1960s and 1970s. But it will also frustrate the right-wing demands for reversion to the market fundamentalism of Capitalism 3.0. The new environment will demand that government must expand and contract at the same time.

The simultaneous need for more government and smaller government will demand a reassessment of political priorities on a scale not seen since the 1980s. In comparison with these existential choices, the rows over bankers' bonuses and financial regulation will appear inconsequential.

As a result, the public will in turn be forced to accept that government revenues are not sufficient to pay for the health and pensions entitlements they have been promised. In the US, the dominance of these "entitlements" in public spending is so extreme that even if the government's entire "discretionary" non-defence spending—everything it does in homeland security, education, science, transport, and so on—were cut to zero, the federal budget would still be deeply in deficit, with an unsustainable long-term outlook for public debt.

The only scope for debate about the long-term fiscal outlook, therefore, will be over the nature and speed of reductions in public spending. In drawing the new dividing lines between government and private enterprise, politicians who appeal to a priori ideologies—either more government or more market—will be displaced by pragmatists who follow Franklin Roosevelt's call for "bold, persistent experimentation." And even better than experimenting on the citizens of one's own country is to observe the experience of others.

Healthcare, however, represents the greatest challenge to government finances and is the sector where dysfunctional relationships between government and private enterprise have done most damage to economic efficiency and stability.

It is far from obvious whether the British are right to view medicine as a public good, to be provided equally to all citizens by the government like law enforcement, or whether it should be treated as it is in the US—as a private purchase, not very different in principle from the consumption of food, clothes or housing, which are left to private enterprise even though they are essential human needs. But such theoretical and moral issues will no longer be the driving forces of health reform as governments start to clear up the fiscal debris of the crisis.

Whether or not voters experience a Damascene conversion in their attitudes to sickness and health, the US and Britain will become increasingly aware that their healthcare systems are unaffordable. Both countries will have to redraw the boundaries between the market and the state—albeit in opposite ways.

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