

Economic thinking is at a crucial inflection point

di Martin Sandbu

Soaring energy prices have encouraged another form of inflation, this one rhetorical. Comparisons of our current challenges with the world's economic and political struggles in the 1970s are now a dime a dozen.

The comparisons are apt as far as they go. Oil prices quadrupled in 1973 and doubled again in 1979. While they have “only” about doubled in the last two years, European gas prices have jumped five to 10-fold since before the pandemic. Overall inflation is the highest in decades, and many fear we face a repeat of the 1970s scourge of stagflation.

The similarities end with the effects for political and economic thinking. Once the turmoil of the 1970s had discredited the mixed economies of the postwar era, it paved the way for the market-liberalising transformations pioneered by Margaret Thatcher and Ronald Reagan.

Back then, economic failure produced something approaching a consensus that “government is the problem”, as Reagan put it. But today the opposite is the case. Energy prices, the rising cost of living and worsening tensions in labour relations are fuelling calls for the government to come to the rescue. The economic ailments that in the 1970s led the state to withdraw are today dragging it back where, for almost half a century, it has feared to tread.

The market-friendly governing philosophy that triumphed in the 1980s is on the defensive. Government-administered prices are now the order of the day, from car and heating fuel to electricity and, of course, carbon emissions. The pressure for windfall taxes on fossil fuel companies seems irresistible, and governments across Europe are digging deep into their coffers to help hard-pressed households.

Even direct cash payments to households, with few strings attached or none, are in vogue, in an echo of the North American experiments with universal basic income in the 1970s.

This raises two questions. Why this difference in the political consequences of seemingly similar economic crises? And is today's turn to a more interventionist state permanent or a flash in the pan?

The simplest answer to the first question is that when things feel intolerable, people blame the status quo and demand change. In the 1970s that meant deregulating a rigid economy. Today it may mean re-regulating an unchained one.

But the return of the state predates today's sudden rise in inflation and its main causes — the pandemic, energy price jumps and Vladimir Putin's attack on Ukraine. Confidence in the post-1980 socio-economic model was already fraying under pressure from, as it were, both the past and the future.

The populism of Donald Trump, Brexiters and others (including some on the left) represents a nostalgia for a previous social settlement remembered (rightly) as more controlled and (wrongly) as more prosperous. Meanwhile, the rise of the climate agenda responds to a widely held conviction among voters that current economic arrangements imperil their future.

There are enormous differences between these two stances, of course. For one thing, a decarbonised economy is possible, whereas returning to the 1950s is not. But however realistic their goals, they both presuppose a more interventionist and controlling state.

This helps to explain the changing conceptions of how to run the economy among centrist politicians and the guardians of economic orthodoxy. A greater emphasis on securing social cohesion and actively reshaping the structure of the economy is more than a temporary response to emergencies.

For now, 2022 feels like a 1945 or 1979 kind of moment — a historical hinge point or paradigm shift. Yet the transition to a new economic governing philosophy could still be derailed. The pandemic years made for state interventions unlike any seen in decades — with rapid recoveries in incomes and jobs being proof of their success. But a revisionist view is taking hold that aims to discredit the policies that produced a historically speedy recovery.

In this narrative, the current inflationary surge overshadows the triumph of a labour market that makes it easy to find better jobs.

So thoroughly have we forgotten what a good labour market looks like that we risk thinking it is an aberration. Certainly, central bankers have been browbeaten into adopting a more hawkish attitude than is wise.

The current economic debate is about much more than managing cost of living pressures. The question is whether we will finally put the last 40 years behind us and settle on something better.