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Zeitgeist in Transition: An Update to *How rich countries got rich and why poor countries stay poor*

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This paper represents a slightly modified version of the introduction to the French translation of the author's book *How rich countries got rich…and why poor countries stay poor*. Paris, Éditions du Rocher, forthcoming 2012.

I am very pleased that this work is being made available in French. As is made clear in the book, many of the ideas in the book also have French origins, as in the prototype national strategy of *Colbertism*. Indeed, the first clear discussion of the need for national industrial policy in any language is probably in Barthélemy Laffemas' 1597 *Response aux difficultez proposees*, containing 8 questions and answers, found as an appendix in some copies of his publication *Reiglement general pour dresser les manufactures en ce rayaume, et couper le cours des draps de soye, & autres merchandises qui perdent & ruynent l'Estat*. The Colbertian principles of nation-building through the establishment of manufactures and the construction of infrastructure later formed the guidelines for the building of modern Europe.

When the latest words in this book were written – during the last days of December 2006 – I formulated three predictions on the next to last page:

> 'First of all, a major financial crisis is increasingly likely, and Keynesianism shall have to be re-invented in a new and global context. 'Free trade' as the centerpiece of the present world economic order is likely to delay the solution to future problems in much the same way as a stubborn belief in the 'gold standard' delayed Keynesianism in the 1930s.'

The *first part* of this prediction proved correct, the West had a major financial crisis in the private sector in 2008. As part of solving this crisis, the debt was taken over by the respective governments, opening up for the financial crisis which is still unfolding as these words are written. However, the *second* part of the prediction – that Keynesianism needs to be reinvented on a global scale – is not taking place, in spite of some early discussions in that direction in 2008.

What we have mostly been seeing, both in the US and in the European Union, is the opposite of Keynesianism: the political gut feeling has been a monetarist one – cutting budgets and reducing national demand – rather than the Keynesian one of attempting to keep production, demand, and employment up. Europe and the United States are now experiencing the same kind of initial policies seen during the 1998 Asian crisis – a dress rehearsal for the present crisis, from which the West learned nothing – the intuitive reaction is to destroy industry in order to save banks.

The verdict is still out on the *third part* of the prediction, the need to remove 'free trade' as the centerpiece of the world economic order. The Euro has proved to constitute a new version of the 'gold standard', impeding what European nations previously solved by frequent adjustment of exchange rates: economically 'irresponsible' nations have traditionally been forced to devalue. This had two beneficial effects: a) their economies were made

internationally competitive again, and b) the value of the national debt, which was typically issued in the national currency, was simultaneously reduced. Italy has e.g. traditionally had a large public debt, but in lire.

So far 'free trade' has survived, and instead of 'trade wars' we have 'currency wars'. Currency wars, however, promote huge speculative activities and gains in the financial sector, while so-called 'trade wars' mainly affect employment and the real economy.

The present economic strategy has already caused much harm in the European periphery. Greek protests are in focus, but in Latvia –another country in the European periphery – the economic hardships have generally gone unnoticed. A so-called 'internal devaluation' has cut real wages by up to 30 per cent. Unemployment and low living standards force people to leave the country, and the population has decreased by 20 per cent, from 2.38 million to 1.9 million since 2000. Latvian birth statistics reveal a culture under extreme pressure, as people stop having children. In 1987 42,000 children were born in Latvia, in 2010 only 18,000. Latvia follows the classical sequence of economic decay: 1. Deindustrialization (in the 1990s), 2. De-agriculturalization (death of agriculture), and 3. De-population.

A similar trend towards de-industrialization coupled with falling real wages could first be observed in the Third World periphery, as expressed in Figure 14 in this book, using Peru as an example. After the 1989 fall of the Berlin Wall, the same mechanisms spread to the former Second World, the ex-communist sphere. Mongolia is used as an example in the book, but the same development – falling real wages and a fall in real wages as a percentage of GDP – also took place in Russia. Now, finally, this crisis created by a defective economic theory neglecting the important role of manufacturing and production in general is hitting the core of the First World itself: in the United States and in the European Union. The destructive forces of the neoliberal revolution first struck in the Third World, then in the Second World, only now to hit the First World.

The technology and innovation-based strategy of Ireland, starting around 1980, is praised in this book. Its success was indeed startling. From 1986 to 1996 the Irish growth rate was more than twice that of the OECD average, 5.1 per cent annually vs. 2.4 per cent, and in 1996 the government budget deficit was virtually zero. Then, however, the Irish economy embarked on a speculative building spree, a bubble that burst, including the major mistake of the Irish government to bail out two leading banks, Anglo Irish Bank and Irish Nationwide Building Society. For this reason, Ireland's general government deficit increased to the unheard of figure 32 per cent of GDP in 2010. So my analysis of the success of the Irish technology strategy still stands. This strategy also created an unusual case of 'brain gain', of qualified émigrés actually coming back to work in Ireland. Now this is all turned on its head again, not

due to a failure in industrial strategy, but because Ireland entered into a speculative bubble and bailed out banks that should have been allowed to fail, as Norway and Sweden did a few years back.

At this point in time the West – Europe and the United States – appear to be locked in the remnants of the Cold War debate, in empty ritual fights between 'left' and 'right', all equally imprisoned in the toolshed of mainstream economic ideology. Political extremes blame the government or big business respectively for the lack of economic dynamics, and the financial sector is in the driver's seat both in Europe and the United States. In the West the belief in 'the free market' came with a stowaway, with an unwanted passenger: the 'free market' came to include the right of the financial sector to create as much money as they wanted, to lend this money to individuals (e.g. for subprime loans) and to nations (e.g. Greece) who should not have received the loans, and to send the bill for the defaulted loans to the taxpayers in the real economy. In other words, the 'free market' was defined as allowing the financial sector to create Ponzi schemes with implicit guarantees from the real economy. In this way the financial sector, which normally operates as an important scaffolding for the real economy – as a 'bridge in time' to use Keynes' expression – instead became a parasite feeding on purchasing power in the real economy. Greece, which has had to reduce real wages permanently in order to pay banks, is but an early example of this economic parasitism.

An interesting aspect of the financial crisis is that at one point in time financial crises, and the consequent need to control the financial sector, were well understood over the whole political spectrum from left to right. Marx – in volume 3 of *Das Kapital* – clearly understands financial crises, Lenin sees the end of capitalism when finance capital becomes dominant over industrial capital, and – although they differed in their policy recommendations – also politically conservative writers like Schumpeter and Keynes understood crises well. Figure 4 in this book essentially differentiates between Schumpeter's *Güterwelt* – the world off goods and services – and the *Rechenpfennige* – the accounting units or jetons that inhabit the world of the financial sector. Also Hitler's and Mussolini's economists understood the importance of differentiating between *schaffendes Kapital*, capital that creates value, and *raffendes Kapital*, capital that only amasses wealth without creating anything. This Nazi typology was tragically used not only to picture England as an enemy, but also to create the murderous rhetoric towards Jews. Ironically, arguably the most important theoretical contribution to the understanding of financial capital was written by a Jewish social democrat who was killed by the Gestapo: Rudolf Hilferding, in his book *Das Finanzkapital* (1910).

Remarkably, then, the understanding of financial crises was lost all along the political axis – from the extreme right to the extreme left. The understanding was lost when neo-classical economics – based on David Ricar-

do's economics with no financial sector – became the only game in town. The present European crisis is so insurmountable in Europe because the ideologies neither to the political right nor to the political left have the necessary professional understanding of what is happening. Those who saw a financial crisis as a possibility found professional refuge only at a very few institutions, like The University of Missouri – Kansas City, and the Levy Institute outside New York. As we shall see later, this was not the only knowledge lost to present mainstream economics.

When neoclassical economics – in the tradition of Quesnay and Ricardo – stopped distinguishing between the financial sector and the real economy, the economics profession in effect abdicated from studying financial crises. Not only that, the profession came to focus on trade and financial variables rather than on production and technology. These two theoretical defects – the failure to understand financial crises and the failure to have a realistic theory of technology and production – combine to be increasingly destructive to the Western economies. The pragmatic focus on the productive sector which characterizes China, India, and other Asian countries is now largely missing in the West. In Europe and the United States the financial sector has become the tail wagging the dog, i.e. the real economy.

Partly as a consequence of the loss of relevant theory, the West now faces the double challenge described above, 1) a financial crisis and 2) rapid technological upgrading from Asian countries that now essentially follow the Schumpeterian / Colbertian principles presented in this book. The West is being outcompeted in what used to be their own game. *This used to be us* is an appropriate title of a recent book on the challenges now facing the Unites States[1]. In 2010 the newspaper *China Daily* – quoting Kishore Mahbubani, Dean at the National University of Singapore – provided a devastating, but in my view accurate, description of the problems of the West:

> "The world is entering a new era, an era marked by two major changes. The first is the beginning of the end of Western domination - not the end of the West, though. The second is the Asian "Renaissance", because the 21st century will be the century of Chinese and Indian economies.
>
> This is a Western financial crisis because the problems are the results of Western leaders' failure to understand that they faced a new competition. Western minds couldn't think that other societies were becoming more successful than them. People in the US and the EU live beyond their means. Does *Western wisdom* say keep borrowing despite mounting budget deficits? The West has to "relearn" Western wisdom from the East.

[1] Thomas L. Friedman and Michael Mandelbaum, London, Little, Brown, 2011.

> Asian societies are doing well (today) because they understood and absorbed the main pillars of Western wisdom, including the market, science, education and rule of law. But Western societies are gradually walking away from these pillars."

What has protected Asia from the woes of Europe and the United States? One explanation may lie in the sheer size of China and India. These countries – like Brazil – experienced a kind of internal ideological inertia, so that before neoliberal ideology ever became fashionable there, the destructive powers of this ideology had become evident. Victim of a cruel shock therapy, Russia was not that lucky, and democracy arrived there concomitant with real wages being reduced by 50 per cent.

Another important explanation for Asian exceptionalism seems to lie at the intersection of economic theory and political action. When Joseph Schumpeter wrote the foreword to the 1937 Japanese edition of his book *The Theory of Economic Development* he made a very important point. A politically very conservative person himself, Schumpeter felt the need to inform his Japanese readers how similar his understanding of economic dynamics was to that of Karl Marx. They both looked for "the source of energy within the economic system which would of itself disrupt any equilibrium that might be attained". These forces are entrepreneurship and technical change. Schumpeter also comments that both Marx and himself have a similar theory of interest, to Marx constant capital does not produce any surplus value, to Schumpeter the interest rate under perfect equilibrium would be zero.

Arguably Japanese and East Asian economic strategy after World War II was achieved by a pragmatic blend of political left and right, of intellectuals who knew their Marx well and businessmen who understood Schumpeterian dynamics. This prevented East Asia from pursuing a strategy of a comparative advantage in being poor. This strategy spread across the region as a flying geese strategy of sequential economic upgrading (as is explained in chapter 4 of this book). This fortunate blend of left and right – of understanding Marxian-Schumpeterian dynamics – seems to have dominated the Asian scene ever since and produced excellent results. It could also be added that an additional Asian source of this way of thinking was that of Sun-Yat Sen in China of the 1920s, which apparently survived in Taiwan. This contrasts sharply with the political fault lines in the US and Europe, presently dominated by non-constructive confrontations between left and right. Since, by now, both the political right and the political left in the West are based on a static Ricardian conception of the world, the debates tend to degenerate into discussions of income distribution rather than of how to create new wealth and jobs. Ricardo's failure to include the financial sector as a unit of analysis is another defect of this theory that now proves disastrous to the real economy.

The West is losing wealth and power, then, because we started believing in the propaganda version of our own economic theory. This has happened before. In England David Ricardo's trade theory from 1817 was a tool by which England attempted to keep its virtual monopoly in manufacturing. Less than one hundred years later, after the first wave of globalization, English agriculture and industry had been seriously damaged by free trade. The same theory which originally had been created in order to further England's own economic interest had boomeranged. With the United States story history is now repeating itself. The same Ricardian trade theory that erroneously portraits free trade as a machine producing automatic economic harmony has now seriously weakened also the US economy. Real wages have hardly risen compared to the early 1970s. In some cruel way, perhaps deservedly, the propaganda theory that the West used against their overseas colonies – that it was not necessary to industrialize and innovate – is boomeranging again. Twice, first with England and now with the Unites States and Europe, the loss of Western hegemony occurs when the West itself starts believing in an economic theory which – as was so well expressed by a US politician in the 1820s – originally had been produced for export purposes only!

China's and Asia's new economic power create new dilemmas. Getting back to my *third prediction*, old fashioned tariffs are likely to prove less disruptive to the world economy than the present 'currency wars'. Although created for the same reasons – in order to protect national production – these two types of 'wars by other means' have different collateral effects. Tariffs tend to increase production, increase wages, and thereby increase the size of the national pie, while currency wars cause huge speculative gains. Mainstream economists fail to understand that the tariffs that allowed other nations to emulate England's industries hugely increased world welfare, compared to what would have occurred if England had succeeded in its 'winner-takes-it all' of remaining the only industrialized country on the planet. Similarly, letting too much of Western manufacture end up in Asia will in effect be another 'winner-takes-it-all' strategy. this time in the disfavor of the West.

What brought the West into the present confusion and disorder is a mainstream economic theory that abdicated from studying key aspects of capitalist dynamics, including the dynamics of technology and financial crises. The failure to understand dynamics led to a 'tyranny of good intentions' that frequently produced disasters. Instead of developing Africa through industrialization – as had been the Post World War II project – well-intentioned aid brought the continent from traditional colonialism into an equally humiliating 'welfare colonialism'. The failure to understand what are basic economic principles made it possible for European politicians to create a "united Europe" on foundations that could not withstand normal eco-

nomic gravity. The noble intention of including the peripheral EU countries – like Greece – into the common currency, has turned out to be an economic nightmare to the Greeks. In both situations noble intentions in a simplistic neo-classical economic framework created disasters. On the other side of the Atlantic, the presidency of Barack Obamo increasingly appears to be another massive fallacy of noble intentions. The reasons are the same: a dysfunctional economic theory that fails to provide the tools that used to make change happen.

The same unfortunate combination of noble intentions and lack of understanding of real-world economic dynamics also haunts European technology policy. Having been engaged in a project for the EU *Institute for Prospective Policy Studies* (IPTS) my conclusion in the 2006 IPTS report was that the technology policy of the EU essentially was a laundry list of good intentions, which – because the analysis was framed in a neo-classical framework – failed to come to grips with the real dynamics of world capitalism:

> 'In the 42 points of the European Council Conclusions on the Stability and Growth Pact and the Lisbon Strategy from March 22 and 23, 2005, the underlying problems of the present situation of Europe are not raised. The discussion appears as a long list of good intentions which – it seems implicitly to be assumed – necessarily will lead to success. The Lisbon Strategy appears to have been superimposed on the neo-classical economic framework dominating in the 1990s, where the market is a great equaliser and creator of economic order and harmony. In many parts of the global periphery it is increasingly clear that globalisation creates more poverty, not less. It is reasonably clear that such trends – exemplified by East Germany – may be found within the EU. As I see it, the further debate ought to be based on an analysis of what went wrong in the past, and it should move away from the neo-classical tradition of discussing policy void of its context. A policy may be excellent in one set of circumstances, but counterproductive in another. I argue for bringing back the Continental European economic tradition that created Rhine Capitalism: a society where the market is a tool rather than a goal in itself, and where economics is defined as the study of the economy as a real object in a specific context, not defined in terms of the adoption of core assumptions and techniques.'[2]

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[2] Reinert, Erik S., 'European Integration, Innovations and Uneven Economic Growth: Challenges and Problems of EU 2005', Paper prepared for FISTERA (Foresight on Information Society Technologies in the European Research Area), in Compañó, R, C. Pascu, A. Bianchi, J-C. Burgelman, S. Barrios, M. Ulbrich, I. Maghiros (eds.), *The Future of the Information Society in Europe: Contributions to the debate*, Seville, Spain, European Commission, Directorate General Joint Research Centre. Institute for Prospective Technological Studies (IPTS), p. 129. Working paper version at http://tg.deca.ee/files/main//2006042407120202.pdf

Both in terms of *financial* and of *technological* dynamics the European Union has lived in a fairytale world of simplistic neo-classical economics. Many problems have been evident for a long time, and the specific European Union issues are have been covered in detail in two joint papers by my colleague Rainer Kattel and myself. The first paper, from 2004, warns against a creeping 'Latinamericanization of Europe'[3], and was followed by a paper written in 2006 and published in 2007, claiming that the instant extension of the European Union with a deindustrialized Eastern Europe could amount to an economic suicide[4].

There are strong parallels, then, between the failures in *financial and monetary policy* and in *technology policy*: quoting from my chapter, written for the European Union's own research unit, both these discussions appear as 'a long list of good intentions which – it seems implicitly to be assumed – necessarily will lead to success'. In both aspects – in the financial crisis and in terms of deteriorating ability to employ its population in well-paying jobs (also referred to as 'competitiveness') – Europe has hit a wall. In parallel, the decades of focus on 'limits to growth' have for many Europeans mutated into a belief in 'limits to innovation', at times almost a yearning for some kind of technological retrogression. However, what we measure as GDP and growth is relatively arbitrary. If the clean energy that in the future will substitute oil initially is more expensive than its dirty predecessor, cleaning op the planet will necessarily appear as economic growth.

The 1972 book *Limits to growth* unfortunately coincided with the rise of neoliberalism. Although the two movements are totally unrelated – the book warned against the destructive forces of markets whereas neoliberalism argued the exact opposite – these two forces nevertheless combined to weaken the dynamic Schumpeterian view that the story of mankind had been to invent itself out of problems. Although not necessarily intended so by its authors, *Limits to Growth* came to be understood in a framework which defined growth as more of the same – more fumes from petrol-driven cars and more refrigerators with the same old technology – rather than seeing growth also as innovations. If we are against growth *per se* we will also easily be against the innovations we need in order to solve the crises of the environment and of energy. The Renaissance was partly prompted by observing a 'Green Economy': at the site of Ancient Rome travelers found sheep grazing where civilization once reached a high point. This type of 'greening by retrogression and primitivization' is not the kind we want.

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[3] Reinert, Erik S. & Rainer Kattel, 'The Qualitative Shift in European Integration: Towards Permanent Wage Pressures and a 'Latin-Americanization' of Europe?', Praxis Working Paper no. 17, Praxis Foundation, Estonia. http://www.praxis.ee/data/WP_17_2004.pdf

[4] Reinert, Erik S. & Rainer Kattel, 'European Eastern Enlargement as Europe's Attempted Economic Suicide?', Working Paper No. 14, The Other Canon Foundation – Tallinn University of Technology Working Paper Series, 2007. http://tg.deca.ee/eng/working_papers/

This situation calls for new approaches that are really old approaches. New challenges call for a new *zeitgeist*, and I can think of no better introduction to what ought to be the new zeitgeist of the West than Keynes seminal article – *National Self-sufficiency* – written in 1933.[5] Like today, 1933 was a time of rude awakening, and the situation requires a zeitgeist recognizing the need for de-globalization: that goods to a larger extent must be 'home-spun' and that finance also ought to have a more national character. This of course does not mean literally mean autarky or self-sufficiency, but it means returning to the extremely successful world model of development that ruled from 1945 until about 1973: the visions that world prosperity requires that manufacturing industries and advanced service sectors are distributed to all nations.

Keynes' 1933 article didactically takes the reader through the necessary change in *zeitgeist* – the gestalt-switch – which was embarked upon in 1933 and upon which the West now again needs to embark. Keynes first takes us through the reasoning necessary to free the mind from a belief in free trade as a matter of 'moral law':

> "I was brought up, like most Englishmen, to respect free trade not only as an economic doctrine which a rational and instructed person could not doubt, but almost as a part of the moral law. I regarded ordinary departures from it as being at the same time an imbecility and an outrage. I thought England's unshakable free trade convictions, maintained for nearly a hundred years, to be both the explanation before man and the justification before Heaven of her economic supremacy. As lately as 1923 I was writing that free trade was based on fundamental "truths" which, stated with their due qualifications, no one can dispute who is capable of understanding the meaning of the words".

Keynes gives us compelling arguments for de-globalization, why globalization had gone too far: ideas ought to travel freely, but goods need to a larger degree than hitherto, to be homespun, and finance should be primarily national:

> 'But experience is accumulating that remoteness between ownership and operation is an evil in the relations among men, likely or certain in the long run to set up strains and enmities which will bring to nought the financial calculation.'
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> I sympathize, therefore, with those who would minimize, rather than with those who would maximize, economic entanglement among nations. Ideas, knowledge, science, hospitality, travel –

[5] Reprinted in John Maynard Keynes, *The Collected Writings*, Macmillan / Cambridge University Press, vol. XXI, pp. 233-246, 1982.

these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national. Yet, at the same time, those who seek to disembarrass a country of its entanglements should be very slow and wary. It should not be a matter of tearing up roots but of slowly training a plant to grow in a different direction.'

'For these strong reasons, therefore, I am inclined to the belief that, after the transition is accomplished, a greater measure of national self-sufficiency and economic isolation among countries than existed in 1914 may tend to serve the cause of peace, rather than otherwise. At any rate, the age of economic internationalism was not particularly successful in avoiding war; and if its friends retort, that the imperfection of its success never gave it a fair chance, it is reasonable to point out that a greater success is scarcely probable in the coming years.

Global free trade did not deliver on its promise of global peace, although this was once a key argument for free trade. Obviously today's context is different than that of 1933, but my argument is that since the very same type of economic forces are at work today – although in a different context – the solution to the problem lies in the same recommendations Keynes had. I am suggesting that this is the direction we need to move, but the recommendations should not be taken literally. We must keep in mind that the policies here outlined by Keynes – NOT a religious belief in free trade – became the foundations for the policies that produced unprecedented high economic growth in the world until the mid-1970s. Confessing to possible bias because the author is my son, a recent book in my view convincingly shows that European economic growth over the centuries has always been based on the principle of emulation rather than on the principle of free trade, suggesting that the history of economic thought in this aspect needs to be re-written[6].

Keynes then turns to what we today would call environmental issues:

The same rule of self-destructive financial calculation governs every walk of life. We destroy the beauty of the countryside because the unappropriated splendors of nature have no economic value. We are capable of shutting off the sun and the stars because they do not pay a dividend. London is one of the richest cities in the history of civilization, but it cannot "afford" the highest standards of achievement of which its own living citizens are capable, because they do not "pay."

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[6] Reinert, Sophus A, *Translating Empire – Emulation and the Origins of Political Economy*, Cambridge, Mass, Harvard University Press, 2011.

> The decadent international but individualistic capitalism, in the hands of which we found ourselves after the war, is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous—and it doesn't deliver the goods. In short, we dislike it, and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed..... We are – all of us, I expect – about to make many mistakes. No one can tell which of the new systems will prove itself best.

The road ahead is now better defined than in 1933, when a planned economy was one of the possibilities open to the world. However, as a starting point we still have to get rid of what Keynes called the 'bundle of obsolete habiliments one's mind drags round'. A key obsolete notion is that all economic activities should be seen as being qualitatively alike, as is implicit in Ricardian trade theory. Since economic activities in reality differ so widely in terms of their ability to create welfare – which this book attempts to explain – a strategy to maximize world real income and welfare requires very different policies than the present economic strategy that instead maximizes international trade.

A new course could therefore, in my view, also be beneficial to the nations which at first glance may appear to be losing for a new and Colbertian economic order. As I stated in the foreword to the Chinese translation of this book: "It may initially sound illogical, but as wages and employment rates in many European countries and in the United States slide, it may in fact be in China's long-term interest to allow some protectionism in these countries. Protecting parts of the industrial system of the United States and Europe would safeguard the future size of overseas markets for Chinese goods."

The devastating effects of the present crises are a direct result of the loss of a whole theoretical tradition based on qualitative understanding of the economy – of economics as an *Erfahrungswissenschaft*, a science of experience – based on an understanding of history rather than on mathematics. In this Continental European tradition – from Karl Marx to the left to Joseph Schumpeter to the right – financial crises are a normal feature of capitalism. Because this type of theory also carries with it an understanding of the role of technology, this Continental European type of theory also explains uneven economic development. It is my hope that this kind of experience-based economic theory – in the tradition of which this book is written – again will become influential in Europe. It is our turn not to criticize, but to emulate China's investments in new technology and infrastructure.

We face a quadruple challenge: a financial crisis, an energy crisis, an environmental crisis, and a crisis of unemployment. There is also a serious crisis of unbalance between the core and peripheral countries of the European Union. Either the uncompetitive peripheral countries become at the receiv-

ing end of Colbertian economic policies – including a break-up of the Euro – or a large number of the inhabitants of these countries will physically move to the core countries. However, Greeks moving to Germany is a solution wanted neither by the Greeks nor by the Germans. There are important lessons to be drawn by Europe from how Argentina escaped from its crisis a decade ego, default and exchange rate flexibility are two important ones.

Capital must be channeled from financial speculation into the employment of underutilized human resources to solve the energy and environmental crises. Polluting oil is just as unlikely to be mankind's last source of energy as horses were, but as the age of complete dominance on oil is approaching an end we face similar uncertainties as when the age of horse-drawn carriages was coming to an end. The 1890s saw prototypes both of steam cars and electrical cars, but the solution came from an outsider, from Karl Friedrich Benz and the gasoline-powered car. Today we are facing similar technological uncertainties and therefore need to throw resources at many possible solutions. If inflation is a necessary part of quelling the dominance of the financial sector, so be it. The financial crisis of the 1970s – normally called the oil crisis – was also solved partly though inflation.

Today's economic theory has lost key features of what built Western civilization, both of the Renaissance and of the Enlightenment. The core of what I call *The Other Canon of Economics* lies in qualitative features of Renaissance societies that are not compatible – not possible to include – in the excessively formal structures of today's mainstream economics[7].

The core of the Renaissance was über-Schumpeterian: the *magna facere* that created great innovations in art and in the production of everything from weaponry to irrigation canals was a way of thinking big that went far beyond profit-making. What came to characterize the Western economy was that building organizations did not stop when the owner had enough money to feed his family. Renaissance *magna facere* went far beyond greed, and – as described in this book – already in the 1200s the wealth of Florence was seen as emerging from a *ben commune*, a synergic common weal that was in itself a unit of analysis.

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[7] See Reinert, Erik & Arno Daastøl, 'The Other Canon: The History of Renaissance Economics. Its Role as an Immaterial and Production-based Canon in the History of Economic Thought and in the History of Economic Policy'. In Reinert, Erik (ed.), *Globalization, Economic Development and Inequality: An Alternative Perspective*, Cheltenham, Edward Elgar, 2004, pp. 21-70. We have argued that the key to European execptionalism lies in the Renaissance *duty to invent* which contrasts the *inertia of status quo* typical of traditional societies: Reinert, Erik & Arno Daastøl, 'Exploring the Genesis of Economic Innovations: The religious gestalt-switch and the *duty to invent* as preconditions for economic growth' in *European Journal of Law and Economics*, Vol 4, No. 2/3, 1997, pp. 233-283, and in *Christian Wolff. Gesammelte Werke*, IIIrd series, Vol. 45, Hildesheim, Georg Olms Verlag, 1998. The implications of this for government policy is outlines in my 'The Role of the State in Economic Growth.' in *Journal of Economic Studies*, vol. 26, No. 4/5, 1999, pp. 268-32.

Renaissance Florence also understood the need to prevent speculation. Transporting food out of the city was prohibited, this could feed speculation. Renaissance cities also managed to create what John Kenneth Galbraith dubbed a balance of countervailing power. The Florentine government – the *signoría* – consisted of nine members, representing different professions, and only one of them represented the financial sector. Renaissance cities also frequently rotated their elected administrators to prevent corruption, and Florence specifically cultivated its urban culture – of manufacturing and trading – by keeping the producers of raw materials, the big land owners, away from any political power. In the world of today we still see how the absence of a manufacturing sector is part of a pattern of undemocratic governments, even if the raw material is as valuable as oil.

Two key features of the Enlightenment are also lost in today's economics: the ability to build classification systems, as Linnaeus did, and to understand the limits that need to be set for private greed[8]. As I argue in this book, a key feature of mainstream economics is its inability to qualitatively distinguish between economic activities. The apparent accuracy of neoclassical economics is a direct result of its failure to make qualitative distinctions. We all understand that if all medical doctors of Paris are put in one country and all the people who wash the floors of Parisian hospitals in another, we get one rich country of medical doctors and one poor country of cleaning ladies. This common-sense proposition is unfathomable in Ricardian trade theory, because world trade is modeled as the bartering of labour hours, all assumed to be of the same quality. This was the English way of trying to convince the colonies to stay with their comparative advantage in being poor and ignorant. Now this same theory is boomeranging and making the West poorer.

With the coming of neoliberalism the key Enlightenment debate on the limits of self-interest – a debate which lasted virtually through the whole of the 18th century – was lost. Having unlearned the wisdom that came out of this debate, the present discussion more often than not totally misses the point by discussing greed *per se* as an evil. The conclusion of the Enlightenment debate was boiled down to one sentence by Milanese economist Pietro Verri in 1771: '…the private interest of each individual, when it coincides with the public interests, is always the safest guarantor of public happiness'. In other words, greed – or *magna facere* for any other reason – is good as long as the end effect contributes to making the eco-

[8] A more detailed argument on the subject of taxonomies is found in my paper 'The Terrible Simplifers: Common Origins of Financial Crises and Persistent Poverty in Economic Theory and the new '1848 Moment'', UN DESA Working Paper No. 88, December 2009, and in Sundaram. Jomo Kwame and Anis Chowdhury, *Poor Poverty. The Impoverishment of Analysis, Measurement and Policies*, London, Bloomsbury in association with The United Nations, 2011, pp. 11-37.

nomic pie larger. With neoclassical economics the public interest – society – ceased to exist as a unit of analysis. This opened up for today's view that all greed is good, even the present greed of the financial sector which creates huge private wealth while shrinking the real economy to the detriment of the public interest.

At its nucleus, mainstream economics describes Adam Smith's savage who has learned to barter, not Schumpeter's savage who has learned to innovate. Like new medicines which fail to get government approval, sophisticated economic models that may approach reality generally fail to reach policy level. The world is mostly ruled by the crudest of economic models.

Now is the time to rediscover the 18th century science of economic decline, which came into being as formerly immensely rich city states – like Florence, Venice, and the Dutch Republic – were losing wealth and power to increasingly successful nations-states like England and France. The present choice of the West is between declining like Venice, an absolute decline into a type of museum, or to decline like the Dutch Republic, no longer being the wealthiest, but still wealthy. In order to achieve the latter goal, we must selectively deglobalize, bring back Colbertism, and with it an economic understanding that entails all the key principles that made Europe unique in the first place: the Renaissance and the Enlightenment. After all, free trade has only ruled the world in two very brief periods of human history, the late 1800s and the late 1900s and early 2000s. In both periods the cult of free trade came to an end for the same reasons: not only did free trade as a goal rather than a tool create intolerable poverty in the world periphery, it started an economic decline at the very core of capitalism.

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