Ideas That Conquered the World

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Date : Jan 22, 2016

A weakness for big ideas led me to purchase Michael Mandelbaum's *The Ideas That Conquered the World* (2002). It had been sitting on a bookshelf in the Saint Joseph house for some time, and I am pleased that I finally got to it. A noted foreign-affairs expert, Mandelbaum focuses on fundamental ideas that helped shape the world in the half-century after WWII. From his relatively contemporary history, he deduces global fault-lines that had developed by the beginning of the 21st century. His seminars at Johns Hopkins must be lively.

As Mandlebaum sees it, three ideas became preeminent in shaping the modern world: "peace as the preferred basis for relations between and among different countries, democracy as the optimal way to organize political life, and free markets as the indispensible vehicle for the creation of wealth. While not practiced everywhere, they have – for the first time in history – no serious rivals." I am, of course, most interested in the treatment of free markets, which the author boldly assesses to be the most widely accepted institution in human history.

He describes how economies organized around decentralized markets, getting a big boost from the Industrial Revolution, and how they have demonstrably outperformed, with respect to living standards, the centralized-control alternatives. That outcome plausibly justifies free markets' status as a conquering idea. However, while Mandelbaum has an unusually sure grasp of shifts in the economic trends, his treatment of the cyclical side of the story, i.e., periodic episodes of market instability that significantly damage to employment, output, wealth, and general well-being, is less satisfactory. *Ideas* would benefit from more in-depth scrutiny of market economies' vulnerability to broad, persistent market failure that became especially characteristic after the Second Industrial Revolution and the advent of large corporations. The effective public management of episodic welfare loss associated with recessions and depressions is an interesting, still developing part of the market-economy story that is largely absent in *Ideas*.

Mandelbaum recognizes that his third conquering idea has two parts. The first, for which the remarkable contribution of Adam Smith should always be recognized, asserts the genius of decentralized markets that is rooted their capacity to collect and use information necessary to efficient exchange. Spontaneously organized markets, supported by the classical liberal agenda of property rights and free trade, feature the wonderful alchemy of varied self-interest that adds up to the public interest, providing the core content for Mandelbaum's conquering idea.

The second part, for which the author does properly acknowledge Keynes, is equally fundamental. "It was the achievement of John Maynard Keynes, the most influential economist of the twentieth century, to discover how to moderate, if not abolish, Western capitalism's downward swings. Before Keynes, the market was understood as a self-regulating mechanism, with downturns that could not be prevented but that would ultimately correct themselves." (p.296) After identifying that crucial issue, Mandelbaum largely abandons it, depriving his analysis of the insightful content characteristic of the two other conquering ideas. He tells us little about how to deal with the debilitating instability problem. Many of his readers probably do not know that the key idea of Keynes and the Keynesians, who dominated macroeconomics in the early postwar period, was to reverse then-mainstream macrodynamic causality, scrapping Say's Law. In postwar consensus modeling of highly specialized economies, nominal demand disturbances induce same-direction changes in employment, output, profits, wage income, investment, consumption, and wealth.

Digging deeper into Keynesian thinking, suppressed wage recontracting critically enables sufficiently adverse demand disturbances to generate involuntary job loss and associated costly market failures. An informed treatment of Mandelbaum's third conquering idea would identify the public management of total nominal spending as the means to ameliorate inherent, at times devastating, instability in highly specialized economies. Absent effective means to stabilize free markets, Mandelbaum would not have had a third conquering idea. Democratic governments galvanized by cumulating episodes of collapsing markets and damaged well-being would have been pushed to some version of centralized control of economic activity.

Why didn't Mandelbaum tell the complete story? It is, after all, more informative and interesting than the truncated version. The problem is his having been let down by modern economists, who famously have no consensus view, consistent with the evidence, on how to effectively tame periodic instability. Indeed, during much of the postwar period, we have lost ground on developing stabilization-relevant macroeconomics. Decades ago, we agreed that the Keynesian core idea that effective management of aggregate nominal demand via fiscal and monetary policies would to stabilize modern market economies. But mainstream macro thinking now (reasonably) requires micro-macro coherence in modern modeling and, given the longstanding inability to microfound meaningful wage rigidity, has no capacity to deduce causality from nominal demand disturbance to involuntary job loss. Today, the Keynesian emphasis on total spending, which they modeled by suspending coherence and simply assuming the labor-price rigidity needed to suppress wage recontracting, is either quietly ignored or explicitly rejected.

There is, of course, some good news for anyone attempting to explicate ideas that have already conquered the world. The GEM Project has derived the necessary wage rigidity. The critical innovation is the intuitive generalization of rational price-mediated exchange from the marketplace to inside big bureaucratic corporations, a restructuring of rational arrangements that resulted from the Second Industrial Revolution. Once the reality of significant rational exchange occurring inside large establishments is acknowledged and modeled, periodic macro instability becomes an understandable characteristic of market economies that can be ameliorated by the effective management of total nominal spending. The complete, compelling story of the economic idea that conquered the world is two-fold, free markets rooted in Smith and stabilization of those markets rooted in Keynes.

Blog Type: Policy/Topical Saint Joseph, Michigan