Enough tinkering. Only a revolution will do

Remodelling global capitalism is the big idea of 2012. But is the world brave enough to make the changes needed?

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Remodelling capitalism seems to be the big idea of 2012. In America, Barack Obama has turned his State of the Union message into a denunciation of inequality and this radicalised President suddenly looks like a sure-fire winner in November's election, largely because his likely opponent, Mitt Romney, is too rich and pays too little tax.

In France, François Hollande, the leading candidate in May's presidential election, declares that "my true adversary is the world of finance". And even for Mr Hollande's adversaries in financial Britain, the Government's efforts to stamp out "excessive" bonuses are at least a straw in the wind.

Then there are the expressions of conventional wisdom among the global elite. The World Economic Forum in Davos, which begins tomorrow, is called "The Great Transformation: Shaping New Models". The cover story in *Time* magazine this week is "How to fix global capitalism", while *The Economist*'s is "The rise of state capitalism".

It is striking, however, that most of the ideas for "transformation" that accompany the denunciations of the old model of capitalism are so timid they are better described as tinkering than serious reform.

Bill Clinton has proposed a greater role for private philanthropy, Vince Cable wants to strengthen boardrooms, Mr Hollande demands a new Franco-German treaty, and Davos calls for a "new model of decision-making to acknowledge that we live together in a multicultural, multi-ethnic and multireligious world". Most of the proposals are as relevant as arguments about what type of cement to use for the Maginot line were in repelling the German invasion of France.

It is natural enough for business and political elites to change the subject from truly radical reforms, but perhaps

> As useful as arguing about the cement in the Maginot line

the time for such denial is running out. In US politics, a genuinely radical debate is starting about taxes, public spending and the role of government. In Europe, the battle to save the euro means a genuine revolution in politics and economic management. Britain faces large spending cuts. To lead their nations through these challenges, politicians must offer voters a convincing narrative.

Truly radical leaders, whether Thatcher and Reagan or Roosevelt and Attlee, only succeed by presenting reform as an idealistic enterprise. Today's political rhetoric somehow misses this inspirational tone: "We must patch up our failed old system to avoid the disasters of the past."

What will a genuine transformation of global capitalism require? There are four broad headings — ideology, economics, business and politics — and I detailed ten possible reforms for each of them in a book, *Capitalism 4.0*, that I wrote two years ago.

First and foremost is the economic ideology that asserts that competitive markets are naturally efficient, rational and stable. Economic theory may seem marginal in comparison with issues such as bank bonuses and inequality, but all previous transformations of capitalism have involved new thinking about the relationship of markets and governments, and this is needed again.

If it goes unquestioned that markets are always better at allocating resources, determining income distribution and forecasting the future than governments, then serious reform is impossible. But once the fundamentalism of "markets are always right" is abandoned, radical transformation naturally follows.

Macroeconomic management is the second step. If a capitalist economy is not naturally self-correcting, governments and central banks must stabilise unemployment and banking, as well as controlling inflation. That means abandoning simplistic inflation targets and ending the independence of central banks, reforms necessary anyway to save the euro and allow orderly reductions of government debt.

Third, genuine reforms in finance and business become possible once society starts to question market allocations of capital and incomes. In bank regulation, counterproductive policies such as tightening capital and liquidity requirements, which have greatly aggravated the global recession, can be replaced with more direct regulation that recognises governments as sleeping partners in all banks in a modern economy, because depositors can never be allowed to lose

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money. Meanwhile, industrial policy, income distribution and investment in the environment, science and infrastructure become key to political decision-making, more important even than banking reform.

If the financial markets misallocated resources so badly in mortgage banking and European government lending, their decisions can also be questioned in long-term investments with far more complex and unpredictable outcomes, such as clean energy, science and higher education.

Once market fundamentalism is abandoned, "subsidies" and "picking winners" cease to be terms of abuse but objectives of public policy for which politicians must be held accountable. Big advances in science, energy technology, healthcare and culture have always been backed by subsidies, either from governments or wealthy patrons. The problem with industrial intervention is not "picking winners", but backing losers. To avoid this, much stronger mechanisms for accountability and discipline for economic intervention will be needed — which leads to the last area for transformation.

As governments engage more in economic management and regulation, they must also shrink in cost and size. There is only one way to do this. Freeing resources for investment in genuinely public goods such as technology and education will require drastic cuts in the hugely expensive pension and healthcare programmes that have become an incubus on all governments and must be steadily transferred to the private sector if capitalism is to be reformed. At present the opposite is happening, especially in Britain, where the elderly's welfare state of pensions and healthcare is ring-fenced while spending on education and children is cut.

That nobody has noticed how the traditional welfare state is now the enemy of equality and the younger generation is a good indication of how shallow discussions on reforming capitalism have been so far. The idea that government should become smaller and more powerful, or that more active government will require the end of the welfare state, may be too complex and ideologically ambiguous for magazine covers or Davos. But such complexity and ambiguity is what genuine reform of capitalism will need.