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ECONOMICS

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A Grand Unified Economic Theory?

NEW YORK – Last month's US government shutdown – the result of a partisan standoff in congressional budget negotiations – epitomizes the polarization that prevails in modern economic-policy debates.

On one side, John Maynard Keynes's cohort argues that government intervention can help any economy grow its way out of crisis by spurring aggregate demand and, in turn, raising the employment rate. A country's government, Keynesians contend, has the capacity – and responsibility – to solve many, if not all, of its economic problems.

On the opposite side, followers of the Austrian School of economic thought, especially the ideas of Friedrich Hayek, assert that limited government and free enterprise form the only viable path to liberty and prosperity. The market is the best arbiter of how to allocate scarce resources, and thus should serve as an economy's main driver.

In recent years, this long-running debate has become increasingly contentious – and the costs of stalemate are mounting. In order to restore growth in developed economies, while sustaining strong GDP growth and reducing poverty in the developing world, a more unified approach to economic policymaking that draws from both traditions is needed.

Official responses to the global economic crisis highlight the interventionist model's merits, proving that decisive government action can help to enhance efficiency and clear unbalanced markets, thereby protecting the economy from the demand shortfall caused by falling investment and rising unemployment. But the free market also has a crucial role to play, with longer-term, incentive-based policies catalyzing scientific and technological advancement – and thus boosting economies' growth potential.

In determining how to promote innovation without sacrificing social protection, economists and policymakers should take a lesson from the field of physics. For nearly a century, physicists have attempted to merge the competing ideas of the field's titans, including Wolfgang Pauli, the first physicist to predict the existence of neutrinos (the smallest particles of matter), and Albert Einstein, who explained the curvature of space-time. The so-called "theory of everything" would reconcile the inconceivably small with the unimaginably large, providing a comprehensive understanding of the universe's physical properties.

Policymakers should be working to unite seemingly disparate theories to align policy decisions with the business cycle and the economy's level of development. Such an approach should seek to protect economies from the destabilizing impacts of politically motivated policy changes, without impeding governments' ability to correct dangerous imbalances. Officials must be at least as vigilant about reducing expenditure and withdrawing stimulus measures during periods of growth as they are inclined to introduce such policies during downturns.

To the extent that this approach reflects the view that policymaking is an art, not a science, that is a good thing: the world needs more flexibility in economic policymaking. But some might consider it a cause for concern, especially given growing suspicion of incentive-based economic policies in the wake of the global economic crisis.

Many blame the crisis on the decades-long ascendancy of a *laissez faire* approach to economic policymaking, and rightly credit government intervention with facilitating recovery. The tremendous economic success of countries like China, where hundreds of millions of people have escaped abject poverty in a single generation, has reinforced support for state-led systems.

In developed countries, too, many advocate a greater role for the state, in order to ensure that promised social benefits are delivered to rapidly aging populations. In fact, in many countries, the government's capacity is already strained. As German Chancellor Angela Merkel has pointed out, though Europe is home to just 7% of the world's population and produces 25% of the world's wealth, it accounts for 50% of global welfare payments. When the United States is included, 11.5% of the global population receives 88% of the world's welfare payments.

But relegating free-market principles to the past would simply create a new set of imbalances. Rather than allow extremists to continue to hijack economic-policy debates, policymakers must work to bridge competing schools of thought. Only then will productive discourse – the kind that does not end in government shutdown – be possible.

Keynes once wrote that he agreed with "almost all" of Hayek's ideas. And Hayek found it "reassuring" to know that he and Keynes agreed "so completely." This raises the question: What is really preventing economists and policymakers from devising – or even seeking – a unified theory of economics?

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