INTRODUCTION

> The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air are distilling their frenzy from some academic scribbler of a few years back.
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> —***J. M. KEYNES,*** *The General Theory of Employment, Interest and Money*

Ideas are long lived, often outliving their originators and taking new and different forms. Some ideas live on because they are useful. Others die and are forgotten. But even when they have proved themselves wrong and dangerous, ideas are very hard to kill. Even after the evidence seems to have killed them, they keep on coming back. These ideas are neither alive nor dead; rather, as Paul Krugman has said, they are undead, or zombie, ideas. Hence the title of this book.

Before the Global Financial Crisis ideas like the Efficient Markets Hypothesis and the Great Moderation were very much alive. Their advocates dominated mainstream economics. Their influence, acknowledged or not, guided the thinking of the practical men and women whose decisions created a financial system without parallel in history. Tens of trillions of dollars of interlinked obligations were built on a foundation of speculative, or entirely spurious, investments. The result was a global economy in which both households and nations lived far beyond their means.

Today the Efficient Markets Hypothesis and the Great Moderation look like defunct ideas. Commentators who were proclaiming, a year or two ago, that the business cycle had been tamed, have admitted their error or, more commonly, moved on to talk of other things. The claim that financial markets make the best possible use of economic information and can never be subject to irrational bubbles is rarely made overtly and usually hedged with all kinds of qualifications and escape clauses. In this zombie state, such claims continue to lumber around the intellectual landscape.

But habits of mind and thought are hard to change, especially when there is no ready-made alternative. The zombie ideas that brought the global financial system to the brink of meltdown, and have already caused thousands of firms to fail and cost millions of workers their jobs, still walk among us. They underlie the thinking of those who are responding to the crisis and, to a large extent, of the commentators and analysts who assess those responses.

If we are to understand the financial crisis, and avoid the kinds of responses that set the stage for a new and even bigger crisis in a few years time, we must understand the ideas that got us to this point. This book describes some of the ideas that have played a role in the crisis. They are

* the Great Moderation: the idea that the period beginning in 1985 was one of unparalleled macroeconomic stability;
* the Efficient Markets Hypothesis: the idea that the prices generated by financial markets represent the best possible estimate of the value of any investment;
* Dynamic Stochastic General Equilibrium: the idea that macroeconomic analysis should not concern itself with economic aggregates like trade balances or debt levels, but should be rigorously derived from microeconomic models of individual behavior;
* Trickle-down economics: the idea that policies that benefit the well-off will ultimately help everybody; and
* Privatization: the idea that any function now undertaken by government could be done better by private firms.

Some of these ideas, such as the Efficient Markets Hypothesis and Dynamic Stochastic General Equilibrium belong to the realm of technical economic theory. Others, such as privatization are policy prescriptions, derived from these abstract ideas. Still others, like the Great Moderation and trickle-down economics, are catchphrases for claims about how the economy works, or at least, how it worked in the thirty years or so before the current crisis.

Together these ideas form a package which has been given various names: "Thatcherism" in the United Kingdom, "Reaganism" in the United States, "economic rationalism" in Australia, the "Washington Consensus" in the developing world, and "neoliberalism" in academic discussions. Most of these terms are pejorative, reflecting the fact that it is mostly critics of an ideological framework who feel the need to define it and analyze it. Politically dominant elites don't see themselves as acting ideologically and react with hostility when ideological labels are pinned on them. From the inside, ideology usually looks like common sense. The most neutral term I can find for the set of ideas described by these pejoratives is *market liberalism,* and this is the term that will be used in this book.[1]

The book is organized in a way that I hope will help readers understand how market liberalism depends on ideas that have failed the test of the Global Financial Crisis. If these ideas continue to influence policy, they will ensure a repetition of the crisis.

Each chapter deals with a single idea and begins by describing the birth of the idea, followed by a section on its life, focusing on theoretical and policy implications. The next section describes the death of the idea brought about by the global crisis, but usually resulting from weaknesses that were evident well before the crisis. A brief section on reanimation looks at attempts to raise these dead ideas from the grave as undead zombies. The next section, entitled "After the Zombies," looks at alternatives to the ideas of market liberalism. Finally, there are some suggestions for further reading.[2]

[1] There is a similar problem of terminology on the other side of the debate. Market liberalism emerged as a reaction against a set of ideas and policies commonly referred to as "social liberalism" or "social democracy" in Europe and simply as "liberalism" in the United States. These ideas included a commitment to full employment, based largely on Keynesian economic management, and a major role for the state in the provision of income security and services such as health and education. I will generally use the term *social democracy* to avoid the ambiguities surrounding *liberal.*

[2] For ease of reading, I have dispensed with the traditional apparatus of endnotes, which force the reader to keep the book open in two places to follow notes, many of which turn out to be nothing more than academic citations. Instead, I've made sparing use of footnotes

The final chapter, "Economics for the Twenty-first Century" looks more generally at the theoretical and policy ideas that will be needed in the light of the failure of market liberalism. A simple return to traditional Keynesian economics and the politics of the welfare state will not be sufficient. It is necessary to develop both theories and policies that respond to the realities of the twenty-first century economy.

It is clear that there is something badly wrong with the state of economics. A massive financial crisis developed under the eyes of the economics profession, and yet most failed to see anything wrong. Even after the crisis, there has been no proper reassessment. Too many economists are continuing as before, as if nothing had happened. Already, some are starting to claim that nothing did happen, that the Global Financial Crisis and its aftermath constitute a mere "blip" that should not require any rethinking of fundamental ideas.

The ideas that caused the crisis and were, at least briefly, laid to rest by it are already reviving and clawing their way through up the soft earth. If we do not kill these zombie ideas once and for all, they will do even more damage next time.

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like this one to cover points of tangential interest, notes about some of the economists whose work is discussed, and so on. The further reading section at the end of each chapter includes Harvard-style citations to books and journal articles that have been mentioned in the chapter, and detailed references are given in the bibliography.