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After Neoliberalism: Economic Theory and Policy in the Polycrisis[1]

MICHAEL JACOBS

Abstract

Mainstream economic theory and policy have struggled to address (and in some cases have made worse) the multiple economic crises since 2008—global financial crash, austerity, stalled productivity, wage stagnation, rising inequality, inflation, climate and environmental breakdown. At the root of this failure is the 'ontological individualism' which underpins neoclassical economic theory: the belief that individual households and firms are sovereign actors. It proposes in its place a premise of 'ontological institutionism'—the view that economic behaviour is primarily influenced by the institutional structures and rules within which it occurs. Commonplace in other social sciences, this view radically changes economic analysis and policy prescription. Based on an explicit ethical definition of policy objectives, the article offers an 'institutionally pluralist' view proposing different kinds of institutions for five different spheres of economic life. Arguing that economic policy should be seen as a process of institutional design (not simply making markets more efficient), it offers some illustrative policy proposals in key fields, from climate change to business investment.

Keywords: polycrisis, institutions, neoliberalism, institutionalism, neoclassical economics, economic policy

THAT WELL-KNOWN analyst of contemporary politics, V. I. Lenin, famously remarked that there are decades when nothing happens, and weeks when decades happen. In the last decade and a half, it can sometimes seem like an aeon has happened. A global financial crash, European sovereign debt crisis, austerity, rising inequality, Brexit, Trump, Orbán, Bolsonaro, global pandemic, war, energy price shock, inflation, climate emergency. We seem to have been in continuous, successive crisis since 2008.

I tell my students, most of whom were born after 2000, that there used to be years when not much happened: when the world did not seem to lurch from one period of dramatic turmoil to another; when the news was not dominated by shock and catastrophe. They have known nothing else. For them, crisis is normal.

Polycrisis

The term 'polycrisis' to describe our present condition has been popularised by Adam Tooze.[2] But as he notes, it was first coined by French complexity theorist, Edgar Morin, in the 1990s.[3] More recently Scott Janzwood and Thomas Homer-Dixon have offered the following comprehensive definition:

> We define a global polycrisis as any combination of three or more interacting systemic risks with the potential to cause a cascading, runaway failure of Earth's natural and social systems that irreversibly and catastrophically degrades humanity's prospects. A systemic risk is a threat emerging within one natural, technological, or social system with impacts

[1]This article was originally given as the *Political Quarterly* annual lecture in November 2023.

[2]A. Tooze, 'Welcome to the world of the polycrisis', *Financial Times*, 28 October 2022; https://www.ft.com/content/498398e7-11b1-494b-9cd3-6d669dc3e33

[3]Tooze provides a helpful account of the concept and its analysis in A. Tooze, 'Chartbook #165: polycrisis—thinking on the tightrope'; https://adamtooze.substack.com/p/chartbook-165-polycrisis-thinking

extending beyond that system to endanger the functionality of one or more other systems. A global polycrisis, should it occur, will inherit the four core properties of systemic risks—extreme complexity, high nonlinearity, transboundary causality, and deep uncertainty—while also exhibiting causal synchronization among risks.[4]

(So, nothing to worry about then.) Like Tooze I think it is helpful to have a concept which connects issues in different domains: the geopolitical, economic, environmental, technological and social. We are facing, patently, heightened geopolitical insecurity. The appalling events in Israel and Gaza have put the world on the brink of a new conflagration in the Middle East, at a time when there is war in Europe and the complete breakdown of relations between Russia and the West. And these come on top of tensions between the US and China, militarily in Taiwan and the South China Sea, and economically in trade and technology competition.

In the field of technology, the rapid development of generative artificial intelligence creates evident large-scale risks - yet of what, we don't exactly know, which is the problem. Western governments do not allow new foods, chemicals or genetic modifications to be introduced into the market without stringent safety checks and regulatory procedures. Yet, as Reith lecturer Stuart Russell has observed, they have allowed AI technologies to be released into the world with less oversight than a sandwich sold in a corner shop.[5] We have barely begun to understand the implications.

In the natural environment climate change is occurring more rapidly than scientists expected. 2023 was the warmest year on record by far, 1.483°C above the pre-industrial average.[6] (The Paris Agreement set a global goal for warming to be limited to 1.5°C above, which it expected to be reached in the second half of the century.) Climate scientists have been tracking 'off the charts' phenomena: record ocean temperatures, record loss of Antarctic Sea ice, more extreme heatwaves, more intense wildfires, hurricanes, floods and droughts. They say we are not yet at the 'tipping point' where runaway climate change can no longer be slowed, but we are getting closer to it.[7] Meanwhile, loss of biodiverse habitats may now have left 2 million plant, fungal and animal species at risk of extinction, according to new estimates.[8]

In the field of society and culture it is not clear whether we should call our current moment a crisis. But something is clearly happening as social media become all-pervasive. The increased prevalence of mental ill-health among young people—globally, the World Health Organization estimates that one in seven adolescents aged 10–19 now suffer a mental disorder—and the coarsened quality of public information and political debate are surely troubling, even if systematic analysis and remedy still seem some way off.[9]

The polycrisis stretches across all these domains. They interact. And this is what makes their governance so difficult. Politics finds it hard to deal with single crises, whether war or financial crash; they require unusual leadership. But simultaneous crises really

[4] S. Janzwood and T. Homer-Dixon, 'What is a global polycrisis? And how is it different from a systemic risk?', Cascade Institute, 2022; https://cascadeinstitute.org/wp-content/uploads/2022/04/What-is-a-global-polycrisis-version-1.1-27April2022.pdf

[5] Centre for Human-Compatible Artificial Intelligence, 'Stuart Russell testifies on AI regulation at U.S. Senate hearing', 11 September 2023; https://humancompatible.ai/blog/2023/09/11/stuart-russell-testifies-on-ai-regulation-at-u-s-senate-hearing/#stuart-russell-testifies-on-ai-regulation-at-u.s.-senate-hearing

[6] '2023 smashes record for world's hottest year by huge margin', *The Guardian*, 9 January 2024; https://www.theguardian.com/environment/2024/jan/09/2023-record-world-hottest-climate-fossil-fuel

[7] W. J. Ripple, et al., 'The 2023 state of the climate report: entering uncharted territory', *BioScience*, 2023; https://doi.org/10.1093/biosci/biad080

[8] A. Hochkirch, et al., 'A multi-taxon analysis of European Red Lists reveals major threats to biodiversity', *Plos One*, 2023; https://doi.org/10.1371/journal.pone.0293083. For a summary see 'Number of species at risk of extinction doubles to 2 million, says study', *The Guardian*, 8 November 2023; https://www.theguardian.com/environment/2023/nov/08/species-at-risk-extinction-doubles-to-2-million-aoe

[9] World Health Organization, 'Mental health of adolescents', 17 November 2021; https://www.who.int/news-room/fact-sheets/detail/adolescent-mental-health

strain the system, both in domestic and in international politics. We should not be surprised that over the last few years we have witnessed the growth of nationalism, racism and conspiracy theory. Populism is what happens when the political establishment can't cope. People are frightened. They turn towards their own, and against outsiders. They become susceptible to demagogues who tell them their problems are caused by immigrants and the liberal elite.

Economic crisis

But my focus is on one domain of the polycrisis: that of the economy. Here we can be more precise about what has been happening. In 2008, after a decade of record profits and growth, the western financial system very nearly collapsed altogether. The great financial crash revealed that a subterranean volcano of high-risk debt had built up pressure just under the surface of the system, and when it exploded it took the global economy with it. In turn, it destroyed the era that had come to be known as 'The Great Moderation', when globalisation, low inflation, rising employment and steady growth seemed to indicate that the macroeconomic problem had been solved.[10] Fifteen years later western economies have still not recovered.

In the thirty years before the financial crash (from 1978 to 2007) per capita economic growth in the advanced economies of the G7 averaged 2.1 per cent, even including three recessionary years. After the crash, between 2010 and 2019 (before the Covid pandemic), it averaged 1.4 per cent a year.[11] That's a fall in the core performance of the world's leading economies by one-third. During the same post-crash period, annual productivity growth averaged just 0.7 per cent, less than half of its average annual growth (1.7 per cent) in the previous two decades.[12] Even before the current inflation, in many countries, including the UK, real wages had more or less stagnated since 2007.[13] In the US average real earnings were, astonishingly, about the same in 2018 as they had been in 1968.[14]

But of course, not everyone's incomes have failed to grow. Income and wealth inequality have been on the rise throughout the developed world since the mid-1970s, with just a short hiatus after the financial crash. In western Europe the richest 1 per cent of the population took 7 per cent of national income in 1975; in the US, 9 per cent. By 2018 these figures had doubled, to 14 per cent and 20 per cent respectively. Wealth inequality has grown even more sharply. The richest 1 per cent of Americans owned around a quarter of all US wealth at the end of the 1970s. It's now 40 per cent, and half of that belongs to the top 0.1 per cent.[15]

In a number of countries, notably the UK, rising inequality has been driven in part by changes to labour and housing markets. Nearly a million workers in the UK are now on zero-hours contracts, and another 2.8 million in other forms of insecure work.[16] The average rent paid in the private rented sector in England is now 45 per cent of average income. Twenty years ago, it was 28 per cent.[17] Twenty years ago, 59 per cent of households led by someone aged 25–34 were homeowners. Today the figure is 41 per cent.[18]

[10] B. Bernanke, 'The Great Moderation', Speech to the Eastern Economic Association, 20 February 2004; https://www.federalreserve.gov/boarddocs/speeches/2004/20040220/

[11] OECD.Stat, 'Growth in GDP per capita'; https://stats.oecd.org/Index.aspx?DataSetCode=PDB_GR

[12] A. Dieppe, 'The broad-based productivity slowdown, in seven charts', World Bank blog, 14 July 2020; https://blogs.worldbank.org/developmenttalk/broad-based-productivity-slowdown-seven-charts

[13] D. Hendry, et al., 'The paradox of stagnant real wages yet rising "living standards" in the UK', VoxEU / CEPR blog, 21 January 2020; https://cepr.org/voxeu/columns/paradox-stagnant-real-wages-yet-rising-living-standards-uk

[14] D. Desilver, 'For most U.S. workers, real wages have barely budged in decades', Pew Research Center blog, 7 August 2018; https://www.pewresearch.org/short-reads/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/

[15] L. Chancel, 'Ten facts about inequality in advanced economies', World Inequality Database working paper, 2019; https://wid.world/document/ten-facts-about-inequality-in-advanced-economies-wid-world-working-paper-2019-15/

[16] Trades Union Congress, *Insecure Work*, 2021; https://www.tuc.org.uk/sites/default/files/2022-07/InsecureWork.pdf

[17] 'Proportion of income to rent hits 75% in parts of England', *Property Reporter*, 16 January 2020; https://www.propertyreporter.co.uk/landlords/proportion-of-income-to-rent-hits-75-in-parts-of-england.html

[18] House of Commons Library, 'Extending home ownership: government initiatives', research briefing, 30 March 2021; https://commonslibrary.parliament.uk/research-briefings/sn03668/

What exactly is this a crisis of? It's not a crisis of capitalism, in the sense a Marxist would recognise. The system is not collapsing under the weight of its own contradictions. On the contrary, capitalists have been doing rather well. Since around 2000 the value of capital—assets—has grown much faster than GDP. Equities and debt have grown nearly twice as fast; real estate by a third more.[19] Corporate profits in many sectors are at record levels, having risen during the cost of living crisis.[20] But if it isn't a crisis of western capitalism, it is surely a crisis in the promise held out by it. Anaemic growth, weak productivity, stagnant earnings, increasing inequality, rising labour and housing market insecurity: this is not what the system was meant to deliver. Periodic slumps perhaps, but seemingly permanent inability to make the majority better off, no.

This is why some people have hailed the present moment as above all a crisis of neoliberalism—even its death knell.[21] The promise of the free-market revolution initiated forty years ago by Thatcher and Reagan was that it would make people better off: deregulating financial and labour markets; cutting income, corporation and capital taxes; restricting the power of trade unions to enable a 'flexible' labour market; reducing the size and role of the state in public services. All this would free up private enterprise to generate growth and jobs, and the extra profit and wealth would trickle down to everyone. But it hasn't.

An important field of scholarship has defined and clarified the concept of neoliberalism.[22] It is both a political project, one primarily designed to serve the interests of corporations and the wealthy, and an economic and political ideology (and consequent set of policies) promoting freedom and markets. As Colin Crouch has helpfully explained, when these came into conflict, it was the political project which won out, creating the apparent paradox in recent years of a 'corporate neoliberalism' which is not much interested in free markets at all.[23]

The crisis in economics

But this is more than just a crisis of neoliberalism. It's deeper than that. What we have seen is not just the failure of free market, small state and deregulatory policies. There have also been profound failures in the economic theories underpinning them. Western policy makers in the neoliberal era have, broadly speaking, followed mainstream economic advice—the advice of international institutions such as the OECD and IMF, in turn based on the orthodox consensus of academic economics. But that advice has turned out to be largely wrong.

Financial deregulation was based on the economic theory of efficient markets. Having almost perfect information, the theory said, financial markets could never systematically misprice risk; maximum economic value would therefore come through minimal regulatory constraint. As the Chairman of the Federal Reserve in the period leading up to the great financial crash, Alan

[19] J. Mischke, et al., 'The future of wealth and growth hangs in the balance', McKinsey Global Institute report, 2023; https://www.mckinsey.com/mgi/overview/the-future-of-wealth-and-growth-hangs-in-the-balance

[20] 'World's 722 biggest companies "making $1tn in windfall profits"', *The Guardian*, 6 July 2023; https://www.theguardian.com/business/2023/jul/06/worlds-722-biggest-companies-making-1tn-in-windfall-profits

[21] See, for example, J. Stiglitz, 'The end of neoliberalism and the rebirth of history', Social Europe blog, 26 November 2019; https://www.socialeurope.eu/the-end-of-neoliberalism-and-the-rebirth-of-history; G. Sitaraman, 'The collapse of neoliberalism', *The New Republic*, 23 December 2019; https://newrepublic.com/article/155970/collapse-neoliberalism

[22] See, for example, T. Biebricher, *The Political Theory of Neoliberalism*, Stanford CA, Stanford University Press, 2018; Q. Slobodian, *Globalists: The End of Empire and the Birth of Neoliberalism*, Cambridge MA, Harvard University Press, 2018; J. Whyte, *The Morals of the Market: Human Rights and the Rise of Neoliberalism*, London, Verso, 2019; G. Gerstle, *The Rise and Fall of the Neoliberal Order: America and the World in the Free Market Era*, Oxford, Oxford University Press, 2022. The *Stanford Encyclopaedia of Philosophy* has provided a helpful survey: https://plato.stanford.edu/entries/neoliberalism/

[23] C. Crouch, 'The paradoxes of privatisation and public service outsourcing', in M. Jacobs and M. Mazzucato, eds., *Rethinking Capitalism: Economics and Policy for Sustainable and Inclusive Growth*, Chichester, Wiley Blackwell, 2016, pp. 156–171.

Greenspan, had to admit subsequently, the theory had a flaw.[24]

Likewise, austerity was based on mainstream economic views. In 2010 it was widely held, most influentially by the IMF and OECD, that high levels of government debt relative to GDP would have a seriously damaging effect on economic growth—and therefore that governments should seek to bring them down as rapidly as possible. A famous paper by Harvard economists Carmen Reinhart and Kenneth Rogoff, which apparently proved this empirically (but was later comprehensively debunked), was specifically cited by George Osborne as a justification for austerity in a speech in 2010 before he became Chancellor.[25] By the time IMF Chief Economist Olivier Blanchard admitted in 2013 that the economics was wrong, the damage to the British and European economies had been done.[26]

These failures of mainstream economics continued. The stagnation of productivity since 2008 was quaintly termed the 'productivity puzzle' by mainstream economists, who couldn't explain it.[27] There is an amusing, if rather sad, chart showing how the Office for Budget Responsibility (OBR) assumed every year in the 2010s that productivity would return to its pre-crash rising trend, but it never did, so every following year they had to revise their forecasts for earnings growth, GDP and tax receipts downwards. (It is to the credit of the OBR that they published the chart showing their own failure themselves.)[28]

And more recently, mainstream economists have failed properly to explain inflation. Focussed on the orthodox risks of a 'wage-price spiral' (when workers seek pay rises to keep up with inflation, and thereby fuel it) they ignored the fact that prices are actually a function not just of firms' costs, but of their profit margins. What has actually happened over the last two years—particularly in the US and continental Europe—is that many companies with monopoly power have used inflation as a cover to raise their profit margins. It took a heterodox economist, Isabella Weber, to explain this phenomenon of 'seller's inflation'; and for her pains she was roundly attacked by a number of mainstream economists before, in the end, the economics establishment (including the IMF and the OECD) reluctantly accepted that she was right.[29]

Obviously, the whole of mainstream economics is not getting everything wrong. But

[24] 'Greenspan—I was wrong about the economy. Sort of', *The Guardian*, 24 October 2008; https://www.theguardian.com/business/2008/oct/24/economics-creditcrunch-federal-reserve-greenspan

[25] R. Pollin, 'Public debt, GDP growth, and austerity: why Reinhart and Rogoff are wrong', LSE Politics and Policy blog, 8 March 2014; https://blogs.lse.ac.uk/politicsandpolicy/public-debt-gdp-growth-and-austerity-why-reinhart-and-rogoff-are-wrong/ For an account of the episode, see J. Cassidy, 'The Reinhart and Rogoff controversy: a summing up', *The New Yorker*, 26 April 2013; https://www.newyorker.com/news/john-cassidy/the-reinhart-and-rogoff-controversy-a-summing-up

[26] H. Schneider, 'An amazing mea culpa from the IMF's chief economist on austerity', *Washington Post*, 3 January 2013; https://www.washingtonpost.com/news/wonk/wp/2013/01/03/an-amazing-mea-culpa-from-the-imfs-chief-economist-on-austerity/ It is important to state that, although austerity was supported by the leading international economic institutions, it was by no means universally supported by macroeconomists. Plenty took a more Keynesian view that withdrawing government demand when the private and household sectors were retrenching would slow growth so that government debt to GDP would rise not fall. They were proved right. See, for example, S. Wren-Lewis, 'The austerity con', *London Review of Books*, 19 February 2015; https://www.lrb.co.uk/the-paper/v37/n04/simon-wren-lewis/the-austerity-con

[27] A. Haldane, 'Productivity puzzles', speech given at the LSE, Bank of England, 20 March 2017; https://www.bankofengland.co.uk/speech/2017/productivity-puzzles/. For alternative (Keynesian) analyses, see J. Smith, 'Productivity and potential 2003–2012: the UK decade that decayed', Policy Research in Macroeconomics, 18 May 2013; https://www.primeeconomics.org/articles/productivity-and-potential-2003-2012-the-uk-decade-that-decayed/ ; G. Tily, 'From false multipliers to "nonsense output gaps"', Progressive Economics Forum, 2019; https://progressiveeconomyforum.com/wp-content/uploads/2019/10/Tily-Multiplier-and-nonsense-output-gaps.pdf

[28] OBR, *The OBR's Forecast Performance*, 2023 (Chart 1.6); https://obr.uk/docs/dlm_uploads/WP19_The_OBRs_forecast_performance_Aug23.pdf

[29] I. Webber, 'Taking aim at seller's inflation', Social Europe, 18 July 2023; https://www.socialeurope.eu/taking-aim-at-sellers-inflation For an account of this episode, see Z. Carter, 'What if we're thinking about inflation all wrong?', *The New Yorker*, 6 June 2023; https://www.newyorker.com/news/persons-of-interest/what-if-were-thinking-about-inflation-all-wrong/

there are enough serious examples here—and elsewhere, in the fields of inequality, climate policy and beyond—to ask whether the discipline of economics might have a more general problem. These failures of policy analysis appear to indicate not just a crisis in neoliberal policy making, but in the economic theory and understanding which underpins it. This is now a sufficiently active field of discussion among some leading economists, along with political economists and sociologists of economics, that it cannot lightly be dismissed.[30]

This matters, politically, for one obvious reason and one less obvious. The obvious one is that if we are to devise more successful, non-neoliberal policies, they need to rest on better economic theory and analysis. Non-neoclassical economics has made considerable advances in the last decade and a half. Post-Keynesians have developed sophisticated understandings of the role of financial markets and uncertainty in macroeconomics, and propose new roles for central banks and governments in managing both recession and inflation.[31] Evolutionary and institutional economists have studied how firms and states collaborate in innovation, and propose new forms of industrial policy and state investment banking to promote it.[32] Economists studying inequality have identified its drivers and a variety of capital ownership, tax, housing and welfare system policies to reduce it.[33] Ecological economists have created biophysical models which integrate the monetary and material dimensions of economies, and have devised structural policies to drive sustainable levels of environmental impact.[34] We are not short of progressive policy prescriptions or the economics on which they rest.[35] The revival of public infrastructure spending and green industrial strategy in the US, now known as 'Bidenomics', is not just a new policy agenda, but has an explicitly 'alternative' theoretical underpinning based on Keynesian macroeconomics and a political economy analysis of corporate and labour power.[36]

The perhaps less obvious reason to take the crisis in economics seriously is that economic theory plays a critical role in politics and policy making. This might be regarded as surprising. No political scientist would ever claim that policy was determined by the output of academics. But the theory underpinning neoliberalism played an important part in its success. It was the *justificatory basis* for the free market project. Margaret Thatcher didn't just prefer deregulatory and small state policies. She pointed out that economic theory supported them. Regulations were inefficient, taxes stifled incentives and public borrowing crowded out private investment.

Justification plays a critical role in political discourse. We still live (for all it might sometimes feel as if this is no longer true) in a deliberative polity, where persuasion is a crucial part of the process. Politicians have to convince the media and the public—and they must do so in terms of the public good, not simply private interest. However much the free-market agenda was actually about serving the corporate world and the rich, that's not how Thatcher and Reagan—and those who followed in their wake around the world—got people to vote for it. They said it would benefit the majority; and, to make that

[30]See, for example, D. Rodrik, et al., 'Economics after neoliberalism', *Boston Review*, 27 February 2019 (and respondents); https://www.bostonreview.net/forum/suresh-naidu-dani-rodrik-gabriel-zucman-economics-after-neoliberalism/; S. Torracinta, 'Bad economics: how microeconomic reasoning took over the very institutions of American governance', *Boston Review*, 9 March 2022; https://www.bostonreview.net/articles/bad-economics/

[31]See, for example, M. Lavoie, *Post-Keynesian Economics: New Foundations*, 2nd edn., Cheltenham, Edward Elgar, 2022.

[32]See, for example, M. Mazzucato, *The Entrepreneurial State*, 2nd edn., Harmondsworth, Penguin, 2023.

[33]See, for example, A. Atkinson, *Inequality—What Can be Done?*, Boston MA, Harvard University Press, 2015.

[34]See, for example, M. Grubb, *Planetary Economics: Energy, Climate Change and the Three Domains of Sustainable Development*, London, Routledge, 2014.

[35]Jacobs and Mazzucato, *Rethinking Capitalism*, offers an overview. For a comprehensive analysis of why the UK has under-performed and over seventy recommendations for policy reform, see IPPR Commission on Economic Justice, *Prosperity and Justice: A Plan for the New Economy*, Cambridge & London, Polity / IPPR, 2018.

[36]F. Wong, et al., *Sea Change: How a New Economics Went Mainstream*, Roosevelt Institute, 2023; https://rooseveltinstitute.org/publications/sea-change/

convincing, they used a simplified form of the neoclassical economic theory on which it rested. This was where Thatcher's famous 'household budget' rhetoric came from: the need for government to live within its means as a family must. It is why right-wing politicians and their supporters so often say that individuals know better than governments how to spend their own money, and that governments can't 'pick winners' through industrial policy; only the market can do that. Similarly, it is the origin of the claim that, by reducing the returns to business, higher corporation tax will lead to lower investment. All these nostrums derive from simplified neoclassical economic theory.[37]

This justificatory function of neoclassical economics runs very deep in our political discourse. It is what has given neoliberal policies such traction in popular political argument—and such longevity. And that is the reason, I believe, that we not only need new post-neoliberal policies and better economic analysis, but a new theoretical foundation to underpin them.

Institutions

This foundation has been hiding in plain sight. It is *institutionism*: the view that the crucial building blocks of economies and societies are institutions, rather than individuals. I use the term institutionism to avoid implied attachment to any specific version of the 'new institutionalism', the field of social science scholarship which focusses on institutions in society, polity and economy. New institutionalism studies the ways in which formal and informal rules constrain and enable individual and group behaviour.[38] But the term now encompasses a number of different and not always compatible theoretical approaches. In political economy—the political study of economic behaviour—new institutionalist analysis has provided some of the most valuable recent insights into modern capitalism.[39] It is an empirically powerful framework in economic history.[40] But within economics is it is very much a heterodox view.[41]

Mainstream neoclassical economics is founded on what we might call 'ontological individualism'. This is the view that the fundamental actors in economies are individuals and their households, along with individual firms. These actors are sovereign: they have their own preference functions and they act in the economy—in general—to maximise their private utility (whether that is measured by profit, size, wellbeing or other metric) within the constraints of their income and assets, market prices, the available information, and so on. Aggregate economic behaviour is then the sum total of all the individual behaviours which go to make it up. Individual behaviours are not necessarily rational in the old *homo economicus* sense beloved of economics 101 textbooks (and their critics); modern

[37]In respect of political justification, it is a simplified form of neoclassical economic theory which plays the critical role. It is certainly possible to be a neoclassical economist and reject most or all of the policy claims made by neoliberals. See, for example, D. Rodrik, 'Rescuing economics from neoliberalism', *Boston Review*, 26 November 2017; https://www.bostonreview.net/articles/dani-rodrik-rescuing-economics-neoliberalism/. But my wider claim in this article is that the whole premise of neoclassical economics needs challenging. Rodrik himself takes a somewhat hybrid position: see D. Rodrik, S. Naidoo and G. Zucman, 'Economics after neoliberalism', *Boston Review*, 27 February 2019; https://www.bostonreview.net/forum/suresh-naidu-dani-rodrik-gabriel-zucman-economics-after-neoliberalism/

[38]V. Lowndes and M. Roberts. *Why Institutions Matter: The New Institutionalism in Political Science*, Basingstoke, Palgrave, 2010.

[39]See, for example, P. A. Hall and D. Soskice, *Varieties of Capitalism*, Oxford, Oxford University Press, 2001; K. Thelen, *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States and Japan*, Cambridge, Cambridge University Press, 2004; K. Thelen, *Varieties of Liberalization and the New Politics of Social Solidarity*, Cambridge, Cambridge University Press, 2014.

[40]See, for example, D. Acemoglu and J. Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, New York, Crown Publishers, 2012.

[41]There is a rich tradition of institutional economics incorporating thinkers such as Thorstein Veblen, Karl Polanyi, John Commons, J. K. Galbraith, Gunnar Myrdal and Elinor Ostrom, but it has consistently been pushed to the margins of the discipline by the neoclassical orthodoxy. For a survey see G. Hodgson, *The Evolution of Institutional Economics: Agency, Structure and Darwinism in American Institutionalism*, London, Routledge, 2004.

economics understands that human beings and firms use all kinds of behavioural short cuts and 'irrationalities'. But their individual self-determination and autonomy are not in question.

Ontological individualism is not a surprising assumption. We all look at the world through our own eyes, and no one else's; we are all individuals. In the modern world of urban lifestyles, targeted social media advertising and addictive narcissism, we are perhaps more extremely individualist than humans have ever been. But the kind of individuals we are is not wholly under our own control. We are the individuals that our social context has shaped us to be. 'Ontological institutionism' is the belief that individuals, households and firms are *not* fully sovereign or autonomous. They are, at least in part, products of the institutions within which they act and whose rules and constraints shape their behaviour. The same individual, that is, will behave differently in a different institutional context.

What is an institution? Geoff Hodgson has provided a helpful definition. Institutions are 'the systems of established and prevalent social rules that structure interaction'.[42] This definition is deliberately broad. It focusses on the *rules* that provide a structure within which social and economic interaction occurs, and which therefore shape it. This includes organisations, but is not limited to them.

Some institutions are organisations. The limited liability company is an institution in the sense of being a set of rules for structuring asset ownership, production and employment, and limited companies are organisations. Similarly, the Bank of England is an institution, both in the sense of embodying a particular set of rules to organise monetary policy and as a constituted organisation. But some social and economic institutions are not organisations: marriage, for example, is a set of rules which structure the organisation of families, and environmental law is a set of rules which structure the relationship between firms and their environmental impacts.

It's important to keep both kinds of institution within the overall definition, because both shape economic behaviour. Indeed, they do more than shape the behaviour. They shape the value systems, preferences and motivations of the individuals and firms which operate within them. This is the key point. Individuals and individual firms still matter. They have their own preference functions. How they behave determines overall outcomes—though not always in a simple 'aggregate' way. But the way they behave is not simply the result of their own autonomous choices. Those choices are constrained and shaped by the kinds of institutions they are, and the kinds of institutional context they find themselves in. In a different institutional context, they might—they very likely would—have a different preference function and behave differently.

Let us give a policy-relevant example of this. Over the last twenty years, in both the UK and US, elderly social care providers have increasingly been taken over by private equity firms. Economists in the US have compared the mortality of patients in nursing homes owned by private equity with those in homes in ordinary private ownership, controlling for all other factors. They found that going to a private equity-owned nursing home after an acute hospital stay increased mortality by 10 per cent against the overall average. This means that in a twelve-year period in the study sample, over 20,000 lives were lost owing to private equity ownership. Why is this? It isn't perhaps a surprise to find that firms owned by private equity have lower care standards and make more profit.[43] That is, in exactly the same situation, different kinds of institution behave differently.

To the economic analyst this might not matter. You look at whatever firms exist, take their preference functions as given and analyse the outcome. But to the economic *policy maker*, it surely does matter. If you want fewer deaths in elderly care, you might wish to think about the kinds of institutions you have working in the sector. In this sense, institutionism is most relevant to those elements of economics that deal with policy analysis and prescription.

[42]G. M. Hodgson, 'What are institutions?', *Journal of Economic Issues*, vol. 40, no. 1, 2006, pp. 1–25, at p. 2.

[43]A. Gupta, et al., 'Owner incentives and performance in healthcare: private equity investment in nursing homes', National Bureau of Economic Research, working paper, 2021; http://www.nber.org/papers/w28474

But that is quite a lot of economics, and it is the part that most affects the rest of society.

Institutions, ethics and policy objectives

So the core institutionist premise is that institutions shape preferences and behaviour. Individuals are not as autonomous and self-determined as they—or economists—might think. Two crucial insights follow.

The first is that maximising the satisfaction of current actors' preferences is not necessarily the moral objective. One of the core claims of neoclassical economics is that it is value-neutral, in the sense that it takes people and firms as they are and then tries to work out how their preferences can be satisfied to the greatest extent. For the more philosophically-minded among its adherents, such as Milton Friedman, this is a crucial feature.[44] It ensures that economics respects individual autonomy and liberty. It is not for the economist to tell people what preferences they should have; we should just take them as given. In turn, this means that 'maximising the satisfaction of preferences'—the fundamental goal of neoclassical economic policy making—is the appropriate ethical stance. It respects individual autonomy and liberty and then tries to achieve the maximum possible benefit to the individuals who exist. And, in general, this will occur, it is claimed, when markets are free to find the most efficient allocation of resources which maximise aggregate benefit over cost.

This was always an ethical sleight of hand, of course. The preferences of those individuals are functions of their income and wealth. Scott Fitzgerald is said to have observed once to Ernest Hemingway, 'You know, the rich are different from you and me', to which Hemingway replied, 'Yes. They've got more money.' To which we can then add: 'And this gives them different preferences.' It is therefore not morally neutral simply to maximise their satisfaction. One has to ask about the morality of the prior distribution of resources.

But the institutionist perspective allows us to go further than this. There might be another option then maximising the satisfaction of people's or firms' current preferences. That is to *change* their preferences by changing the institutional context. Let us take the social care example. If we want to improve the lives of elderly people in care, the neoclassical policy prescription would be to apply a financial incentive to nursing home contracts so that owners found that higher standards of care also led to higher profits. But another way would be to ban private equity companies from operating in social care altogether. That is, rather than taking the institutions and their preferences as given and trying to change the incentives they face, we could change the institutions.

Rejecting the neoclassical claim that the maximising of current preference satisfaction is the morally right policy objective—and therefore that market solutions which do this are not just the most efficient, but the most ethical—requires us to be more explicit about what our policy objectives are. This is a real benefit of the institutionist perspective. If in any policy field one option could be to change the kind of institutions that exist, then we must have a reason to choose or design an alternative. And that reason should be the kind of economy or society we want to see.

Unlike almost every other field of public policy analysis and prescription, mainstream economics has tended to assume that society's economic objectives are obvious and require very little debate. We want to increase general welfare, which means satisfying people's preferences, which generally means making them monetarily better off, which, in turn, generally means making markets work well to allocate resources efficiently. And this, in turn, will raise the rate of economic growth.

But it's fairly clear now that things are not that obvious at all. The experience of the last forty years tells us that economic growth of itself is not a sufficient indicator of progress. Growth may be environmentally unsustainable. It may be highly unequal. It may be accompanied by an epidemic of mental ill-health and a loss of social cohesion. It may leave economies vulnerable to shocks and instability. We really need to be more sophisticated than this. So let's acknowledge that, before we devise or recommend economic policies, we need to be explicit about what kind of society and economy we are trying to achieve: about our policy objectives. I can put mine on the table. In a report written recently for the OECD, some fellow economists and I

[44] M. Friedman, *Capitalism and Freedom*, Princeton NJ, Princeton University Press, 1962.

suggested that developed countries should now see economic growth as a possible means—but not an automatic one—to other more paramount ends.[45] These overarching policy goals are:

- Environmental sustainability—defined as a path of rapidly declining greenhouse gas emissions and environmental degradation, consistent with avoiding catastrophic damage and achieving a stable and healthy level of ecosystem services.
- Falling inequality—understood as a reduction in the gap between the incomes and wealth of the richest and poorest groups in society, a reduction in rates of poverty, and a relative improvement in the wellbeing, incomes and opportunities of those experiencing systematic disadvantage.
- Rising wellbeing—understood as an improving level of life satisfaction for individuals, and a rising sense of improvement in the quality of life and condition of society as a whole.
- System resilience—understood as the economy's ability to withstand financial, environmental or other shocks without catastrophic and system-wide effects.

Naming these goals does not make them easy to achieve, particularly simultaneously; there are inevitable trade-offs and difficult choices of priority. But it is much easier to achieve them if we know what they are.

Institutional pluralism

The second insight that follows from the institutionist perspective is that we need different kinds of institution for different spheres of life. Most of us would agree that it would be monstrous to treat our families like a market. We don't provide our children with food and clothing according to how hard they work for their parents' good. We don't judge whether or not to pay for care for our elderly parents according to how much pleasure they're giving their grandchildren. And the reason we don't is that in families we think that the core motivation to guide behaviour should be love.

Society is made up of different spheres of life.[46] The family is one. Another is the local community. In some parts of society today many people are not involved in their local communities, but everyone has to live among local strangers, and we are all dependent on those people's behaviour to make our lives safe and tolerable. ('Anti-social behaviour' is defined as such.) Local communities are, therefore, natural sites of voluntary and mutual activity, aimed at maintaining and improving social cohesion. But people don't enter into such activity looking to get the most out of it personally. We have an idea of the common good and human need, and wish to make a contribution to them. We expect other people to behave reciprocally. In non-local communities of interest, the same is true.

A third sphere of life is the public. This is the community writ large, but it requires a different kind of motivation and value system again. Here, impartiality, fairness and professionalism are the key principles. We expect public institutions to be run not to benefit those with the deepest pockets, but all citizens equally, with a specific focus on public and social goods that can't be bought individually, and a bias towards assisting the worst-off.

And then there's the sphere of commerce. Here, we generally do think markets and privately owned businesses should operate with their particular values and motivations. We expect firms selling goods and services to want to make a profit and to behave in self-interested ways. We don't expect them to behave charitably. We acknowledge that competitive behaviour is legitimate and even good.

The point here is evident. We need different kinds of institution for different spheres of life. We need institutions that are based on the values and motivations appropriate to the context. We do not think there should be a single type of institution for all contexts. And we are perfectly happy as individuals operating in all of them, because we're not unidimensional creatures with only one set of values and motivations. We can be a parent, volunteer, citizen and consumer all on the same day. This is what we might call *institutional*

[45]OECD, *Beyond Growth: Towards a New Economic Approach*, Paris, OECD Publishing, 2020; https://doi.org/10.1787/33a25ba3-en

[46]These ideas draw on M. Walzer, *Spheres of Justice: A Defense of Pluralism and Equality*, New York, Basic Books, 1983.

pluralism and it's important for a very specific reason. This is that the neoliberal project has wanted to extend market-like institutions, with market values and motivations, into more and more areas of society.[47] Sectors which were once organised according to public sphere principles, such as the water industry and the Post Office/Royal Mail, have been turned into commercial sector operations, with evident losses of part of their purpose. Other areas, such as social care, have been allowed to fall into the hands of private equity companies with motivations and values which are antithetical to the services being provided. Even charities have been turned into government contractors beholden to auditable key performance indicators.

Why has this happened? A plausible answer—the answer that sees neoliberalism as a political project—is that the falling rate of profit in traditional economic sectors in the 1970s required new areas of profit to be opened up, and privatisation of public utilities and services offered lucrative new markets from which profits could be made and rents extracted. It's hard to deny this explanation. But there's another dimension to the story. That wasn't how privatisation was justified by the politicians who introduced it, or the commentators and media which promoted and defended it. It was justified on the grounds that private companies operating in free markets make us all better off. This is because competitive markets and profit-making companies are efficient and innovative. Privatisation will therefore lead to better services, they said, and more productive resources freed in the economy for economic growth. In other words, they justified the policy on the basis of neoclassical economic theory. Theory does matter.

There's one more critical sphere of life, it should be said. Over the last sixty years we have gradually come to realise that human society rests on the biophysical functionings of the natural world. We will not survive and cannot thrive if we continue systematically to undermine the geochemical cycles and biodiverse ecosystems which support life on the planet. Nature is not a human institution. But we can, unfortunately, no longer rely on nature alone to manage the earth's life support systems. As a species, we and our economy have grown too large for that. So it is up to humanity now to manage our economy and society in such a way as to live within the planet's capacity to support us. That means creating human institutions which reflect and mimic natural systems. We need economic institutions which limit the harvest rates of soil, forests and fish stocks to their natural rates of regeneration; which preserve sufficient biodiversity to support essential food webs and pollination; which maintain the carbon and nitrogen cycles in balance, at levels that sustain the conditions for productive agriculture and a stable climate.[48] That requires another set of values and motivations. A fifth sphere of life, requiring a different type of institution from the others.

The implications for policy

How do these philosophical and theoretical arguments cash out in terms of policy making? How do they relate to the polycrisis? The answer will inevitably be different in different countries. Neoliberalism has been most successful and far-reaching in the US, UK and Australia. Market reforms went furthest in these countries; in other economies of western and eastern Europe old-established institutions were more widely retained. Yet in most of these countries too, neoliberalism was a powerful driver of policy change. In this final section, for the sake of specificity—and in light of a likely change of government—I shall focus mostly on the UK.

The simplest way of explaining the policy implications is to contrast a neoliberal approach to policy making, based on neoclassical economic reasoning, with one aimed at the four overarching policy goals (sustainability, lower inequalities, wellbeing and resilience), and using institutionist economic reasoning. A couple of examples will perhaps suffice.

How do we tackle climate change? A neoliberal or mainstream neoclassical economist will argue for a (global) carbon price. That's the

47 M. Sandel, *What Money Can't Buy: The Moral Limits of Markets*, London, Allen Lane, 2012.

48 M. Jacobs, *The Green Economy: Environment, Sustainable Development and the Politics of the Future*, London, Pluto Press, 1991.

most efficient mechanism, the theory says, to get firms and consumers to reduce their carbon emissions. Climate change is an externality, so internalise it in the price and get the market to work to find the cheapest ways of cutting emissions. But most capitalist economies have now tried this, and found it very difficult to get it to work. President Obama tried for eight years to get Congress to pass a 'cap and trade' permit system, and failed. There were just too many vested interests opposed. The EU did introduce an emissions trading scheme, but issued so many pollution permits—owing to industry lobbying—that for the first ten years their price was barely above zero. So the scheme had very little impact on EU emissions. What brought them down—and the same is true in the US, at state level—was a regulatory measure, mandatory renewable energy targets for power generators, supported by consumer subsides. They weren't what the neoclassical doctors ordered at all, but they worked.

How would an institutionist think about this problem? They'd want to design an institution which reflected and mimicked the limits of the natural world. The climate problem is essentially caused by our economies exceeding the safe level of greenhouse gas emissions. So we need an institutional framework which limits a country's total greenhouse gas emissions to the safe level. That is, in fact, precisely what we have in the UK. The 2008 Climate Change Act requires the government to set, by law, a set of 'carbon budgets' (the total permitted amount of UK emissions) for the next fifteen years, on a declining trajectory to 'net zero' by 2050. It must do this on the advice of an independent Climate Change Committee, which must take scientific, economic, social and international context factors into consideration. It must then publish plans and policies which can realistically be expected to limit emissions to the carbon budgets. If it does not do so, it can be taken to court and told by the judges to have another go—which is precisely what has happened, twice in the last three years. The Climate Change Act is an institution in the sense I have defined it—a set of rules that structure economic interaction. It requires government to act in a way which limits and reduces the UK's emissions over time, and this then shapes government policies and business expectations. It represents an institutionist approach.

Another aspect of our problematic economic condition is the UK's low rate of business investment. This is a primary cause of our low productivity relative to other G7 countries, of our poor record of commercialising innovations, our inadequate infrastructure and our wide geographical disparities. The neoliberal policy solution to low business investment, using neoclassical economic reasoning, is to give investment tax breaks. It takes the existing financial institutions and assumes that, since they are profit maximising, they must simply not be able to make enough profit from investment in the UK. So, they need financial incentives: reductions in corporation tax; super-deduction capital allowances for investment expenditure; freeports; enterprise and investment zones in deprived regions. But the record of investment incentives is very poor. There is actually no causal relationship between corporation tax and investment levels.[49] The OBR expects the recently introduced 'full expensing' of investment expenditure to be very expensive, but with rather little impact.[50] Freeports and enterprise zones are generally found to have moved low-skilled businesses from one locality to another, but few have had a significant impact on regional regeneration.[51]

The institutionist approach would be rather different. It would ask whether we have the right institutions for investment. Is the model of the shareholder-owned business, where the shareholders are financial institutions mainly seeking a short-term return, the best one? Are profit-oriented multinational banks the most appropriate backers of businesses which want to invest?

[49]G. Dibb, 'Cutting corporation tax is not a magic bullet for increasing investment', IPPR blog, 20 September 2022; https://www.ippr.org/blog/cutting-corporation-tax-not-magic-bullet-for-increasing-investment

[50]Office for Budget Responsibility, *Economic and Fiscal Outlook—November 2023*, London, 2023, ch. 3; https://obr.uk/efo/economic-and-fiscal-outlook-november-2023/#chapter-3

[51]P. Swinney, *In the Zone? Have Enterprise Zones Delivered the Jobs they Promised?*, Centre for Cities, 2019; https://www.centreforcities.org/publication/in-the-zone-have-enterprise-zones-delivered-the-jobs-they-promised/

International comparisons can help us here. We know that corporate governance structures which give primacy to long-term shareholders and include workers on investment boards (workers on average last longer in firms than shareholders) tend to lead to higher rates of investment. And we know that state investment banks, such as the German KfW, have much better records of investing in infrastructure, housing and business development in deprived regions than the land and property-focussed private banks of the UK.[52]

We also know why this is. KfW is a different kind of institution from a commercial bank. It must by law invest in socially useful activities. It has specific mandates to invest in green infrastructure and in deprived regions of Germany. So it is not distracted by the possibility of higher returns in Californian tech start-ups or London real estate. It's not allowed to do these things, so it has developed specific expertise in those parts of the German economy which otherwise would not get sufficient investment. It is operationally independent and must make a commercial return, but it is not profit maximising and its priorities are set by the German government in response to social and economic need.

Corporate governance reform and state investment banks are not panaceas for the UK's low rate of business investment. But they would almost certainly do better than our current investment institutions. And the point here is that this is a more effective way of thinking about economic policy making. Where the neoliberal approach, resting on its neoclassical foundations, asks: how can we make this market work better—or if we haven't got a market, how can we create one?—the institutionist approach asks: are these the right institutions for the outcomes we are seeking? Could we reform the institutional arrangements, or create new institutions, which would be more likely—because of the values and motivations they embody—to achieve our policy objectives?

A market, of course, is a kind of institution. Or rather, it is several different kinds of institution, because markets can be structured in different ways. Markets and institutions are not opposites: market solutions are a subset of institutional solutions. And, sometimes, they are the right one. Markets, suitably regulated and shaped, are often a very good way of achieving what society wants. But they are only one way and are appropriate only in some contexts. The institutionist approach is not to reject markets. It is to reject them as the *only* kind of institutional arrangement available.

There is not space here to detail further examples of institutionist approaches to economic policy. But it is not difficult to suggest some.[53] If we want to reduce wage inequalities and improve working conditions, we need to change the institutional structure of the labour market, for example by encouraging wider trade union membership and collective bargaining. If we want to reduce wealth inequalities, we need to change the institutional structure of capital and property ownership, for example, by giving all citizens shares in the stock market and making housing a right not an asset class. Scandinavian experience suggests that the best way to reduce the gender pay gap is to change the institutions of motherhood and childcare to make it much easier for women to go back to work after having children.[54] The impact of social media would be radically improved if the digital platforms were turned into consumer cooperatives and regulated utilities, and users were required to post under their real names and identities.[55] A diverse news media and public broadcasting ecosystem would be best

[52]M. Mazzucato and L. Macfarlane, 'State investment banks and patient finance: an international comparison', UCL Institute for Innovation and Public Purpose, working paper, 2018; https://www.ucl.ac.uk/bartlett/public-purpose/sites/bartlett_public_purpose/files/state-investment-banks-and-patient-finance-an-international-comparison_policy-report_mariana-mazzucato_laurie-macfarlane.pdf

[53]Many of the following policy proposals were made in the report of the IPPR Commission on Economic Justice, *Prosperity and Justice*, 2018.

[54]D. Grimshaw and J. Rubery, *The Motherhood Pay Gap: A Review of the Issues, Theory and International Evidence*, ILO Working Paper, no. 1, 2015; https://eige.europa.eu/resources/wcms_371804.pdf

[55]M. Lawrence and L. Laybourn, *The Digital Commonwealth: From Private Enclosure to Collective Benefit*, IPPR, 2018; https://www.ippr.org/research/publications/the-digital-commonwealth

achieved by leaving the BBC and Channel 4 as publicly owned institutions.[56]

Conclusion

I want to conclude with a few remarks on institutions and politics in relation to the UK. My own policy objectives are rather left-wing and green. I want to reduce inequalities and leave the world in a liveable state for my children. So I want institutions which will make these outcomes more likely. But institutionism in itself is not intrinsically progressive. If your primary policy objective is individual liberty and you don't value equality or posterity, you will design different institutions: more market-oriented ones, as neoliberals have indeed done.

Once upon a time, conservatives were very concerned about institutions. They wanted to defend traditional institutional forms: the monarchy, the church, marriage and the nuclear family, the family business, the parish, the BBC. They thought that institutions embodied identity and embedded social order. Institutions made us who we were and held society together. But then they discovered neoliberalism and went off in another direction altogether.[57]

In previous eras of crisis, worldviews have changed across the political spectrum. It has been realised that to address the crisis, we need to think in a different way and bring in different approaches in policy. After the Great Depression and the Second World War, everyone became a Keynesian and a supporter of full employment and the welfare state: socialists, liberals and Tories alike. After the economic crises of the 1970s, almost everyone became a kind of neoliberal. Those on the left didn't admit it, but in truth, many accepted much of the Thatcherite settlement and the primacy of the market, and largely tried to ameliorate its most inegalitarian effects.

Today, a new government in the UK is imminent. It will confront in the polycrisis amongst the most daunting array of policy challenges that any government has faced in the postwar period. It, and we, may come in these circumstances to acknowledge that it is not just a new set of economic policies which is needed, but a whole new theoretical foundation for them. That environmental sustainability, a reduction in inequalities, wellbeing and resilience, need to be elevated to become the paramount goals of public policy. And that to address them, we must ask, not: how can we make a better market here? But: how can we build better institutions?

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Michael Jacobs is Professor of Political Economy at the University of Sheffield.

[56] R. Harvey, et al., 'Editorial—breaking the news: the future of public service broadcasting in the UK', Progressive Review, IPPR, June 2022; https://www.ippr.org/juncture-item/editorial-breaking-the-news

[57] K. O'Hara, *Conservatism*, London, Reaktion Books, 2011.