History can guide, yet there are new limits of the possible

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This is most certainly a time for honest thinking. Too much at is stake to do otherwise. An unfinished and not necessarily propitious tectonic change is still in train. Though recent UK economic policy was never as ultra-liberal as some pretend - neither the public expenditure nor tax revenue ratios in the UK economy are hugely different today from what they were in 1979 - these are clearly now new times. Under pressure of events the limits of the possible have been redefined - or at least reopened.

In the recent past Brown has veered uncertainly between pandering to the regulatory left and paying court to the deregulatory right. Now, however, he appears to believe events have presented him with the space to promote a third way in the form of a controlling but flexible governmental stake in what remains fundamentally a free-market economy. This is good, if hardly new thinking, though it is undeniably bold in the circumstances. But he is gambling £500bn and Labour's 21st century credibility on a hope and a hunch.

This well-read prime minister must know we have been somewhere quite like this before. The capitalist world, wrote John Maynard Keynes at the height of the economic crisis of August 1931, faced a choice. That choice was between "finding some way to increase the money values of assets towards their former figure" and "seeing widespread insolvencies and defaults and the collapse of a large part of the financial structure". That remains a good statement of the choice facing us again today. Yet now, just as Keynes argued, we may again be overly concerned with trying to preserve the system's gains rather than cutting its losses and allowing parts of the financial structure to collapse.

Keep several provisos in mind when considering how Keynes might reflect on the events of 2008. One is that the crisis of 1929-31 was extremely different from the one the world is grappling with today. The problem in 1931 was a massive stock market crash followed later by an international currency crisis that left national economies deflated, companies insolvent and governments literally bankrupt. Today, the deep crisis is still largely confined to finance and banking, though it is certain to spread. Though there has been a fall in shares, this has certainly not been reflected in a widespread corporate collapse or a general lowering of prices of the sort that fuelled the Great Depression.

Yet Keynes's words in 1931 still ring true. "Banks and bankers are by nature blind," he wrote. "The present signs suggest that the bankers of the world are bent on suicide. At every stage they have been unwilling to adopt a sufficiently drastic remedy. And by now matters have been allowed to go so far that it has become extraordinarily difficult to find any way out." RBS take note.

A second point is that, in times that would tax a Cromwell or a Churchill, the politicians are doing their best. It is not their failing that they are not always sure how to act. What David Marquand writes about the crisis of 1931 - when another intellectually gifted Labour prime minister from north-east Scotland battled to hold the national economy together - could also almost have been written today: "With hindsight it is tempting to picture the politics of these years as a manichaean struggle between the forces of light, which wished to break with the economic orthodoxy of the day, and the forces of darkness, which wished to cling to it. The truth is more complex ... Orthodoxy and unorthodoxy overlapped, not only in the middle of the spectrum, but at both ends ... The old distinctions between left and right grew so blurred as to be almost meaningless, but no new direction took their place. Politicians of all parties found themselves in unknown territory, groping for the way ahead."

A third thing to remember is that we have actually learned in some ways from 1929-31. The great lesson of the 1920s was that it was necessary for governments to step in earlier than they did to prevent the eventual firestorm of over-inflated prices and assets. That lesson has not been applied in the current crisis; on the contrary, the fault has been repeated. On the other hand, the great lesson of the 1930s, especially from America - that government alone has the wealth and power to stem the wave of fear-based selling - has been remembered, perhaps in the nick of time.

Then again, while the crisis of 1929-31 was certainly international, the responses to it took exclusively national forms, with cataclysmic results for Europe. There are signs, 77 years on, that some politicians, Brown prominent among them, really grasp the need for coordinated responses (not least because of the institutions that Keynes had a role in creating). Most governments, however, are proposing only national solutions. In Europe this poses the question of whether the EU is any longer adequate to its task. Depending on the course of events, October 2008 may go down as a month of pivotal failure. The EU could be on the verge of becoming the League of Nations of our time, an international body rendered irrelevant by its inability to deal with the greatest challenge it faced - but one which, if once destroyed, would absolutely have to be reinvented.

Unencumbered by the need to be re-elected, Keynes believed that governments should not pointlessly support all failing businesses but should seek to manage a recovering economy on a different basis. British politicians of 1931 would not take that risk. Partly as a result, social democracy never took root here, to our enduring loss. The danger now is that Brown's well-intentioned attempt to manage the current crisis will preserve rather than reshape the inequalities of today.

We should not, even so, be too downhearted. After the events of the past month, nobody now believes in unregulated markets or will do so again for a generation. The world may not have been transformed as we might like. But at least we have regained our freedom of choice.
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