

## As the new year dawns, Graeme Maxton looks at how we can change our economies for the better

Graeme Maxton

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The world remains on a rocky economic path, with weak rates of growth spoiling the Christmas and new year festivities like a grumpy guest at the dinner table.

Unfortunately, getting him to leave will not be easy. Although we might all hope that the gloom of the past few years will soon be gone, there are good reasons to think the mood is only going to get darker. The euro seems to be falling apart. Growth in America remains patchy. Manufacturing output on the mainland is stuttering.

The reason, of course, is that there is still too much debt. Too many people in the US and Europe have borrowed too much. Their houses are still dropping in value, and their credit is gone. Many Western banks remain in deep trouble, too, and not just in Europe. Every month, another crop of American banks fails. Across the world, financial institutions are laden with assets they don't want and can't sell. Worse, almost all of them need to raise capital in the next few years, and few will find it easy. They face a squeeze. With the bailouts of the past few years, Western governments are hopelessly over-borrowed now, too.

The fact is, 30 years of overindulgence is going to take some time to get over. If the past is a guide, the hangover will be a long one: the shortest bear market of the 20th century lasted 17 years.

The situation is also being made worse by woolly-headed economists prescribing the wrong medicine. All their talk of boosting consumption and printing money, in an effort to reflate Western economies, is the last thing we need. It will only add to the debts. Consumers have to save, not spend, banks need to bring their balance sheets back into balance, and governments need to raise taxes. If they don't, they will all go bust.

Globally, as most of us know deep down, the growth is not coming back. The situation may be better in China and much of the rest of Asia. But for the world as a whole, the debt-for-growth-driven economic model of the past 30 years has hit the buffers.

So what, then, should we wish for as a new year begins?

One option is greater pain. When CEOs take over businesses on the brink of collapse, they put them through six months of terrible hardship. They do this because it is better to suffer financial awfulness for a short time than suffer years of struggle. It improves the business' chance of survival. It is like having an operation. A few hours under the knife, followed by several weeks of recuperation, is preferable to lying in bed for months, slowly dying.

In that spirit, what we need in 2012 is:

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## Higher interest rates

For the past four years, the world economy has been like a cartoon character who has run off a cliff. His legs are still moving but there is nothing underneath to support him. In the real world, his plummet to earth has been delayed by ultra-low interest rates. They have encouraged more speculation, let governments print money with ease and delayed the financial restructuring that's needed. We can't run through clouds forever. We should jack up interest rates, support struggling currencies in the process and swallow a bitter spoonful of reality.

## Increased energy prices

We have been under-pricing energy supplies for years. We have not accounted for the environmental effects and have ignored the costs that will be incurred by our grandchildren. We have been using the stuff on the cheap and letting the planet and future generations pay the price. This goes against the laws of classical economics. To fix this, we need to tax energy and resource use heavily. If Durban and Kyoto can't stop us heating the planet, taxation will.

## More market regulation

Former US Federal Reserve chairman Alan Greenspan was wrong: markets should not be completely unregulated, left for the invisible hand to manage. Even Adam Smith said that. They should be controlled when necessary to make sure that bubbles don't grow, to stop companies exercising too much power and to meet the needs of society. Impossible? Not at all. This is the economic philosophy in Germany and many other parts of Europe, where the average living standard is higher than in America or Asia. So, it is possible to live without bubbles. It is possible to keep the gap between rich and poor narrow. It is possible to put society first and still let the market be mostly free. Politicians and regulators in America, Britain and many other places need to go back to economics school.

## Lower consumption

Blasphemy! But would it be such a bad thing? Consumers in the US and Europe have spent too much. They have achieved this not through rising incomes, but rising debt. Now they need to start saving again. Of course, companies will suffer and stock valuations will fall. But which is more desirable? Ever-higher corporate earnings or Western citizens living sustainably?

## Changed attitudes

Finally, we need to change the way we think. We need to focus on what is important - and that is not economic growth. Growth is yesterday's story. For the past three decades, growth has been seen as a purpose. But growth is no way to measure human progress. There are much better ways - the pursuit of knowledge, the betterment of society and discovering the new, for example. For 30 years, we have been chasing the wrong goal, and all it has brought us is a big bubble and lots of nasty consequences.

These steps will be hard, of course. They will make the pain much worse, certainly for a while. But at least there is the prospect of something better at the end: societies that are based on more than shopping, that use resources more responsibly and that narrow the gap between the rich and poor. Who knows, we might even create a world where economists and politicians are motivated by principles again, not just greed.

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But perhaps that is too much to hope for.

**Graeme Maxton is the author of *The End of Progress: How Modern Economics Has Failed Us*, published by Wiley. The book was nominated for the *Financial Times*' Best Business Book of the Year for 2011**

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