

# THE END OF PROGRESS



How Modern Economics  
Has Failed Us

GRAEME MAXTON

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Has Failed Us*

Graeme P. Maxton



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*Aufklärung ist der Ausgang des Menschen aus seiner  
selbstverschuldeten Unmündigkeit.*

*Enlightenment is how humanity can escape its self-inflicted  
immaturity.*

*Immanuel Kant*

*For my dear Bernice (aka Mitzi), who was the inspiration for  
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**Graeme Maxton**

**Singapore, 2011**

# ***Chapter 1***

## ***IT'S ABOUT YOU—YOU ARE RESPONSIBLE TOO***

*No society can be flourishing and happy, of which the far greater part of the members are poor and miserable.*

*Adam Smith*

We should all feel a sense of embarrassment. Humanity has finally evolved to a point where our species is moving backwards. We are destroying more than we build. Every year the world economy grows by about \$1.5 trillion (or a thousand billion). But, every year, we devastate the planet to the tune of \$4.5 trillion.<sup>1</sup> We have officially moved into reverse, laying waste to more than we create.

Even so, most of us have grown sanguine about such statistics.

We all know that humankind has some problems. But then, there are bound to be difficult consequences for the planet when there are seven billion people in the world. So many of us ignore those and comfort ourselves instead by focusing on the counter-balancing evidence of our progress.

We have certainly achieved much in recent decades. More people enjoy more freedom and opportunity today than at any time in history. Life expectancies and standards of nutrition are higher in most parts of the world than ever before. There is more openness for trade between peoples. We have benefited from some of the fastest, most sustained economic growth for generations. More people are educated to a higher level than in the past, and millions have been lifted out of absolute poverty. Women's rights have

dramatically improved in many parts of the world and are now far removed from where they once were. Human rights are stronger too, with slavery mostly abolished, and the right to say, do and act as you will, greatly improved in almost all countries during the last thirty years.

The environmental damage we are causing is worrying, of course, especially when it is changing the climate. But what else can we expect? Transforming the planet is a consequence of our development. Pollution, deforestation and blighted landscapes from resource extraction are some of the negative effects of humankind's progress.

Moreover, a great deal of the destruction we have wrought is likely to be short-lived. Look at Europe. Much of the continent was once covered by forests. Yet their destruction hundreds of years ago had little effect on the world. More recently, coal-fired homes and factories in the United Kingdom (UK) created an air so toxic that it shortened the lives of millions. But we learned how to solve that problem and the air quality is now better. Or look at the United States (US). Some of its rivers were once dead, completely without life, because of industrial effluent. But they recovered. And, while humankind may be killing off thousands of species, we don't seem to be suffering any ill effects. We did not need the dodo. Why are tigers any different?

As for resource extraction, what else can we do? We need raw materials for growth. We cannot progress without digging metals and fossil fuels out of the earth. To stop would be to deny most people on the planet the chance to get rich, the chance to live in healthy modern societies. Reducing the pace with which we dig for coal or mine for oil would condemn billions to poverty for longer. Besides, by the time the oil has gone we will have developed a replacement, a hydrogen- or solar-based society, which is entirely pollution free. Invention is the nature of humankind.

Similarly, we know that there are food and water shortages in many parts of the world. More than one billion people live without enough to eat. But we can surely solve this problem too. Let's not get carried away by the ideas of the Reverend Malthus, and his gloomy predictions of global famines because of insufficient food. He was wrong 200 years ago and he is wrong today. We can genetically engineer better crops, improve yields and desalinate the seas.

Yes, we are destroying more than we create. It is a consequence of our existence. We will find an answer. Just as we always have, won't we?

Unfortunately, planetary destruction is not humankind's only big challenge.

We have huge financial worries. Because of the economic crisis in the US and Europe in 2007, many of the world's largest economies are bust, laden with debts so large they cannot be repaid. Despite trillions of dollars of emergency support, the global economy remains dangerously unstable, with a bumpy path ahead.

Socially, there are signs of trouble brewing. Financial inequality is rising. The gap between rich and poor is wider today in most of the world than for decades. In the US it is wider than it was in the 1920s. Billions of people around the world are becoming fatter and less healthy. In much of the developed world, standards of education are falling.

Fundamental democratic ideas are also being corrupted. Many of our politicians seem to be mostly motivated by profit and the thrill of being in power. Few voice a desire to bring us a better life and give us hope for the future; few encourage us to raise our sights. There is little moral or social ideology behind their chat-show rhetoric and newscast sound-bites. As a result, millions of voters throughout the West have become bored and apathetic, uninterested in the systems that make our world tick, caring

little about the principles at stake. We have even returned to an age where we fight wars about religion, just as we did hundreds of years ago.

More worrying still, the pillars of liberty are under assault too. With so much snooping by governments of many countries in the name of security, we are steadily undermining long-preserved notions of freedom.

Most troubling of all, few real solutions are being proposed to these problems. There is airy hope, a belief, that many of these difficulties are simply necessary for now; that it will be all right in the end; that humankind's innovativeness will somehow come to the rescue. We will find a replacement for the world's oil when it is gone. We will somehow pay back all the debts. We will invent new ways to feed the world. We will restore hard-won legal rights when the war on terror is over.

There is, however, little substance behind these thoughts. We lack a clear plan or timetable to address the multitude of issues we face. Instead of focusing on material progress, we think instead about material gains.

Most critically, we are ignoring one vital element: many of these troubles are closely interlinked; they have the same cause. The resource shortages, the financial troubles, the political and social problems are all the result of changes we have made to the way we think about our world. And almost all of these changes have happened in the last thirty years. We have abandoned many long-cherished ideas, almost without noticing.

The environmental destruction, debts and food shortages are the price.

To understand what is happening and why, we need to go back more than 200 years to the time of the Enlightenment. We need to return to the theories of Adam Smith, the father of modern economics and one of that age's greatest champions. His ideas about the free market and the

“invisible hand” lie at the heart of most Western societies, as well as many others. They are at the core of our economic world. They are also at the center of almost all of our problems.

During the last thirty years, we have taken many of Smith’s principles and trashed them. We have invented, instead, a new and distorted set of ideas with which to run our world: these are the source of many of our difficulties.

Since the late 1970s, wily politicians and wooly-headed academics have persuaded us to forget many of the ideas that lie at the foundations of Smith’s theories. We have been encouraged instead to cling to the labels he used, without really understanding their meaning. We have warped his ideas, as well as other enlightenment principles—including those of democracy, social responsibility and justice—to suit our own ends. We use the same words as enlightenment thinkers, but our understanding of what these words mean has changed. Like mutated genes, we have found meanings far removed from the original intent.

Smith’s principles were about more than economics; they were about more than the free market and the invisible hand. In many ways his thoughts and opinions embodied the whole of the Enlightenment age.

The Enlightenment was a time of dramatic intellectual, social and political progress. It took place in the eighteenth and early nineteenth centuries, mainly in Europe and America. Influenced by the American and French Revolutions, it encouraged people to think that they could challenge convention and question authority. As one of the foremost thinkers of the time, Immanuel Kant, put it, the Enlightenment was “daring to know.”

The Enlightenment brought us modern science. It brought us reasoning. After the centuries when the Western world had been dominated by the church, the monarchy and superstition, it encouraged and stimulated discussion about

the meaning of personal freedom and democracy. Notions about republicanism led to the Declaration of Independence in America. Enlightenment ideas were the source of later concepts concerning liberalism, sexual equality, meritocracy and the right to privacy. The Enlightenment was a seed bed, planted with new ideas that grew to create a giant forest of thoughts, sustaining us for generations.

The Enlightenment was about more than ideas though. It was about transforming values, with the opportunities for improvement open to everyone. It led to reforms in education and to the establishment of libraries where people could access books: magazines, journals and public lectures encouraged debate. In France, a thirty-five-volume encyclopedia was published with the aim of changing the way people thought. With more than 70,000 articles written by some of the foremost thinkers of the time, the books were an attempt to refresh the minds of citizens about their purpose, their world and their lives. Their authors aimed to destroy superstition through reason and give everyone access to scientific knowledge and modern ideas.

It is hard to overstate the importance of the shift in thinking that the Enlightenment brought. It is the foundation of almost all modern Western political and intellectual culture.

It was within this world that Smith developed his ideas. The foundations for his theories lay not in economics but in moral philosophy. In all his thinking there were principles of justice, tolerance and fairness that needed to be upheld.

During the last three decades we have banished many of these principles to the fringes, or trampled them underfoot. We have abandoned many of Smith's core beliefs. We have demoted notions of justice and fairness, promoting instead simplified ideas of individuality and unrestrained market freedom.

Such changes are behind the financial crisis in the US and Europe in 2007 and are the reason many of our societies are increasingly divided. Modern economic thinking has led us to under-value our world, accelerating the pace of planetary destruction. We mine lands to fuel factories, to power cars and illuminate homes. But we price the world's resources at the cost of their extraction plus a share for some profit, and no more. We ignore the costs that will be incurred by future generations when the resources are gone, or the environmental damage we cause by digging them up and using them. We use the world's raw materials on the cheap, leaving others to pay much of the cost. We think primarily about short-term profit and less about long-term social gain. This does not reflect the ideas of Smith. It does not follow his principles of economics.

Such wrong-headedness has also allowed other Enlightenment principles to fade.

Instead of raising the sights and ambitions of our peoples, as the French encyclopedia tried to do, we have allowed a cult of celebrity, a hunger for pointless brands, and a belief that information is knowledge to constrain our thinking. By ignoring Smith's ideas about social fairness, we have dismissed widening income inequalities as if they do not matter. Yet they are unsustainable and dangerous, the stuff of revolution.

Unless we take a different path, we will have to wave goodbye to social order but will be able to welcome instead an age of lesser plenty, of fewer rights and greater conflict.

Unless we cease squandering our most precious resources, many poor countries will never be able to industrialize. They will be plundered of the means to develop by China and the West: their oil reserves sucked dry, their forests gone and their coal seams scraped clean. No amount of innovativeness or human ingenuity can replace many of the world's resources when they are gone. Optimistic modern-

day economists need to have a chat with their colleagues who study the hard sciences if they are in any doubt. There are laws in the world of physics and chemistry, and unlike those of economics, they do not change. We cannot simply manufacture new supplies of copper, zinc or oil when the existing ones have gone.

Modern economic thinking has given us false goals, demanding growth for its own sake, encouraging a mania for consumption that requires the planet to be laid waste, exploited for our convenience.

In return, we were persuaded that progress would come along for the ride. We have experienced fast economic growth, for sure. But we have also created a world that is unstable. In many places, for the first time in centuries, we face falling life expectancies. We risk battles about food, water and oil as resources decline. We face strife over political ideologies and the rise of nationalism.

We were persuaded that there were no limits to growth. We thought we did not have to care about the consequences of our actions. We believed that the responsibility to borrow money within our limits, or the obligation to use the world's resources considerately was for others.

As we are about to learn, that was wrong.

## **Endnote**

[1.](#) The Economics of Ecosystems and Biodiversity (TEEB), "Mainstreaming the Economics of Nature": a synthesis of the approach, conclusions and recommendations of TEEB, October 20, 2010. US Census Bureau.

## ***Part 1***

# ***Our Belief in the Free Market Failed Us***

## ***Chapter 2***

# ***TOO MUCH CHOICE, TOO LITTLE RESTRAINT***

*Economics is extremely useful as a form of employment for economists.*

*John Kenneth Galbraith, economist*

## **Fetch the Tool Box**

A major cause of our problems is modern economic thinking.

The pillars of the Western economic system were mostly established in the eighteenth century. They are based on the work of many economists and philosophers at the time, the best known of whom was Adam Smith. The ideas contained in his famous book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, are still at the heart of much economic theory today.

In practice, however, many modern economic theories have lost touch with Smith's most cherished principles. Modern-day economists talk blithely about Smith and his ideas as if their subject adheres strongly to his theories. But it does not, and in several important ways.

Smith is best known for the notion of the invisible hand, although this was not his idea originally and it was first mentioned in his previous book, *The Theory of Moral Sentiments*.

Today, the invisible hand is a popular metaphor for free markets and a *laissez-faire* economic philosophy: trade should be largely unrestricted and markets should be lightly

regulated. But the way we understand these ideas today is not the way Smith intended them.

Smith was first a professor of logic and then of moral philosophy and his principles of economics were derived from his work in these subjects. They rested heavily on ideas of efficiency, balance and social justice. Although Smith strongly advocated free competition and open trade, as well as a minimum level of government interference, he also saw fairness as vital to all economic activities.

For there to be a social balance, for example, Smith believed that the rich should be taxed more than the poor.<sup>2</sup> Although he saw politics as wholly separate from economics, he also argued that sometimes governments needed to take steps to ensure no one exercised too much power in the market.

The “wealth” mentioned in the title of *The Wealth of Nations* was not monetary wealth. His book is not about how countries can get rich. It is about how they can improve the well-being of their ordinary citizens. He believed economics was about how society could achieve prosperity and progress. It was also about achieving fairness and justice.

Although he talked about individuals acting in their own “self interest,” it was not understood then as it is today. The actual term he used was “rational self interest,” and it was not about acting selfishly, it was about acting responsibly, with a sense of duty to others. Smith believed that there is a powerful sense within all of us to help our fellow men and women, not to hurt or exploit them:

How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it.<sup>3</sup>

*Adam Smith*

Each of us should act freely, Smith said, guided by the invisible hand and in the interests of social harmony.

Smith's enlightened underlying ideas about social responsibility remained vital elements of Western economic thought for many years. While some of his principles were gradually diluted and others sometimes ignored, such as those on the need to regulate monopolies, the basic moral pillars remained unchanged during almost all of the nineteenth century.

In the years following World War I, however, there was a widespread belief in the need for radical social and political change. There was a desperate need for new investment too, to encourage recovery and, it was hoped, create a better world. New discoveries seemed to offer the tantalizing possibility of an entirely different kind of society, a new paradigm, where war and poverty could be banished forever. Investors, spurred by rising stock markets, believed in an upward and self-sustaining spiral of progress and rising wealth. But the unleashed flurry of greed which followed also led to a vast speculative bubble and the Great Crash of 1929.

In the fall out, politicians recognized that markets left to their own devices can often get things wrong. So, over the following years, politicians began to take a much larger role in defining economic policies. Governments around the world believed that they needed to carefully regulate the banks and stock market companies, which they saw as being largely responsible for the "crash."

With the growing power of trade unions and the influence of new political ideas, some countries even nationalized many of their primary industries—coal, electricity generation, gas supply, media, steel, telecoms and water. The politicians and economists of the time believed that these businesses would benefit from state control. The coal and power generation industries needed heavy investment

and provided products or services for all citizens. Under state control, went the thinking, no individual could extract unfair profits from a country's natural resources. Other industries were regarded as strategic, like telecoms or state media businesses. These needed close supervision to make sure they acted in society's best interests.

Economists of the time believed that the invisible hand had caused the 1929 bubble, at least partly. They concluded that it needed to be guided, that markets should be regulated by governments.

By the late 1970s, however, many of the drawbacks of state control had become obvious. There were frequent strikes in many countries, with workers accused of holding their governments to ransom. State-owned companies were now seen as inefficient and bureaucratic, partly because they had no competitors.

This led to a radical change in thinking, which, in some ways, took the Western world back to the ideas that had been popular during the 1920s. A new wave of economists, notably those from the Chicago School in America, began forcibly to argue for a more hands-off approach. They believed that government intervention was best kept to a minimum and that markets should be given more freedom to police themselves.

A new sort of politician appeared at the same time. In the US, Ronald Reagan was elected to the White House, while Margaret Thatcher became Prime Minister in Britain. Thatcher, in particular, inherited a country that was riven by labor problems.

Both politicians had a strong belief that the influence of the state on enterprise was inefficient and bureaucratic, that it represented a "dead hand" on the levers of growth and progress. US politicians were also keen to prove that their model of economic development was superior to that of their Cold War enemies at the time. The free market could

triumph over the Soviet system, dominated as it was by government ownership.

So emerged the Washington consensus; a group of economists, politicians and journalists who argued for less government involvement and more freedom for the market. Global institutions such as the International Monetary Fund (IMF) and the World Bank joined the chorus. And all of them provided a renewed sense of energy to US foreign policy, which encouraged other countries to adopt the American model of democracy and freedom, with liberalized, deregulated markets.

The change in thinking was also driven partly by opportunity. The banking sector was seen as being stifled in the decades following the Great Crash of 1929 and the ensuing Depression. The tight regulatory controls that had been introduced to constrain its activities had divided investment banks from retail banks. This had limited their ability to speculate, grow and offer new financial products. Modern economic thinking allowed bankers to argue that these restrictive controls should now be lifted.

Soon the mantra became: “the markets are always right, governments are always wrong.”<sup>4</sup> Gradually, the cry for free markets, free trade and individual choice was heard around the world. Politicians in the US, the UK, Australia, Ireland, as well as parts of Asia, were especially keen to hear the new call and adopted the ideas readily. Much of the European Union was less enthusiastic. It did not follow this path so unquestioningly, preferring to keep a much greater level of state involvement instead.

But the new ideas certainly seemed to work. The following thirty years saw the fastest period of world economic growth ever. More liberalized internal markets, globalization and the gradual opening up of countries like China and India brought unprecedented new opportunities. The banking sector grew especially quickly.

But the power unleashed by the largely unrestricted free-market mantra also brought more volatility. Economies and prices were more prone to bubbles, such as the information technology boom in the late 1990s and the sharp rises in food and commodity prices nearly a decade later. Speculation was not only tolerated but encouraged, allowing the prices of many items to become divorced from the real level of underlying demand. Consumer spending also rose rapidly, with much of it fueled by debt. Income inequalities widened.

Eventually, of course, the under-regulated free-market model led to a massive financial bubble. The system failed, just as it had in the 1920s. The largest debt bubble in history led to the 2007 financial crisis and the biggest bank bailout ever.

That this bubble had been created should not have come as a surprise. It should not have been a shock to anyone that a complex system, left unregulated, had got badly out of control. Politicians, government officials and economists should have known that this would happen—just as it had before. They should have seen that allowing people to borrow too much was neither sustainable nor socially responsible. They should have known that giving bankers too much freedom would lead to trouble—because it always had in the past. Legislators should have punctured the bubble before it got too big. They had a duty to society, a duty of care.

Indeed, all of us, as consumers, citizens and voters, should have seen that something was wrong. The rise in wealth and pace of growth were not natural and we knew it. But most of us chose instead the path of blindness, of personal short-term gain rather than long-term social responsibility.

# **Economics Is Not Rocket Science: It Is Not Even Science**

The West's politicians and regulators should have known that what they were being told was wrong. They should have known that economics was never intended to provide an all-encompassing, self-regulatory, model of social progress. Along with the regulators, they should have known that economics is not a science, despite being labeled that way, and despite the claims of many academics and economists who wish that it was.

This distinction is important. Modern-day economists like to talk about the laws of economics because they want all of us to see their subject as one with hard-and-fast rules. They want us to think that there are economic certainties. They want to be seen as clever, trusted experts with their mastery of complex concepts and baffling theories. For thirty years, they told Western governments to let the market allocate resources, set prices and ensure supply met demand. Smith's invisible hand would ensure that the system was self regulating, they said. Governments should interfere as little as possible.

Yet this was only a theory and for the second time in a century it failed.

Economics is not a science like physics or chemistry, where experiments and observations produce consistent results. It is not a subject where predictions can be made with much certainty. If we heat two chemicals together we know what the outcome will be. If we repeat the process we will get the same result. Economics does not work like this. If a government cuts interest rates or raises taxes, economists do not actually know what will happen. If the government does it a second time, economists cannot, even then, predict accurately what will happen based on what