

From the Desk of...

Graeme P. Maxton
Writer and Speaker on Asia and the World Economy

Issue No.52 - September 2010



© copyright The Insight Bureau Pte Ltd / Graeme Maxton

Has modern economics failed us? In the first of a series of articles that precedes his new book, *'From Enlightenment to Endarkenment'*, to be published in 2011, Graeme Maxton suggests we have been fooled by today's misguided economic theories.

Fetch the tool box: The cause and solution are the same. Many of the world's biggest troubles are not the result of pointless consumption, excessive borrowing and government bailouts. They are not caused by over-mining, plundered oceans, rising CO2 levels, greed and dumber-down. Those are just the symptoms.

The cause and solution to many of our troubles lie with the economic system we now use. This greatly determines what we value, how we think and the way we behave. It is a vital foundation of our political systems. Yet modern economics is no longer functioning properly. In the last 30 years, like some poisoned gene, it has mutated. It is in desperate need of a rethink, repair and reform.

A mutated system: The pillars of the modern Western economic system were established in the 18th century. They owe much to the work of Adam Smith and his book, *An Inquiry into the Nature and Causes of the Wealth of Nations*.

Today, the idea of 'the invisible hand' which is attributed to him and his book (wrongly on both counts) is the popular metaphor for free-markets and a *laissez-faire* economic philosophy. These hold that trade should be unrestricted and that business should be lightly regulated. But the way we understand these ideas today is not the way Adam Smith ever intended.

Since the late 1970s Adam Smith's ideas have become warped. We have adopted

instead a system which has allowed the financial services industry to wreak havoc, just as it did in the 1920s. It has encouraged us to squander the world's resources. And it has manipulated our values.

We have been gravely misled by modern economics, cheated into thinking that this adulterated form can provide a sound base for society. It cannot.

Modern economics is not rocket-science - it is not even science: Economics is not known as the 'gloomy science' for nothing. Yet it is not a science, despite being sometimes labelled that way and despite the claims of many academics who wish it was.

This distinction is important. Many of those who spout about the laws of economics like to persuade us that it is a subject with hard and fast rules. They have told us that the 'free-market' is the best approach, indeed the only approach which works. Yet economics is a subject that dreams of being a science and the 'free-market' is just an idea.

Economics textbooks contain lots of analytical tables and complex equations which baffle most of us. But this is just window-dressing. These tools are used, like much of the jargon, to give economics an air of knowable permanence. Usually, the fancy tables and charts are not derived from complex mathematics at all but from its much simpler cousin, statistics.

Economics is not like physics or chemistry, where experiments and observations produce consistent results. Economic outcomes do

not fit mathematically provable theories. It is a pseudo-science more like psychology, astrology or divination using pendulums.

Unlike a science, the observed results of actions are often different from expected. So the theories of economics often change.

Economics is not a subject where predictions can be made with any 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. But if we cut interest rates or double the tax on oil, we don't actually know what will happen. If we do it a second time, we cannot even predict accurately what will happen then based on what happened before.

Economists will tell you that this is because there are too many variables. Or they will blame 'externalities', variables which were not obvious at the time. These externalities can be critically important.

An externality of burning fossil fuels is that it creates the greenhouse gas CO2 and lots of other pollutants. These result in illness and are one of the causes of global warming. But few economists bothered to quantify their effects. So they were ignored for years. This is what Lord Stern, who headed up the UK's study on climate change, meant when he called our business-as-usual mindset 'the greatest failure of the market the world has ever seen.'

Because we believed unquestioningly in the power of the market, because we believed in modern economics, we were lured into thinking that burning fossil fuels had few consequences. It caused a bit of smog, some respiratory problems and ravaged the planet a bit. But this was seen as an acceptable cost. We ignored the wider

consequences and the price future generations will pay. This does not say much for the subject.

Adam Smith believed in a different system. He believed that we all have a responsibility to society. To him, politics was wholly separate from economics. He argued that government intervention was sometimes necessary. When he talked about people acting in their own 'self-interest' it was not understood then as it is today. It was not about acting selfishly. It was about acting responsibly, with a duty to others. The vastly unequal distribution of wealth in the world today was not the idea at all. Smith was not an advocate of the sort of unrestrained capitalism we have experienced in the last 30 years. He believed instead in efficiency and social justice. The 'wealth' mentioned in the title of *The Wealth of Nations* is not monetary wealth. It is the well-being of ordinary citizens.

The recent financial crisis was the result of twisted economics. It is behind our failure to make 'green' policies really work. Economics, at least the sort we have been practicing for the last 30 years, rewards the individual first and the community only as a hoped-for consequence, sometimes. Society has become an externality.

Economics is not a science. And modern economics has not been very good at doing what it was said to do. Its theories have failed us. For decades we have been expected to believe in modern economics, as if it is something to be depended upon. We have lived our lives by its 'rules'.

Now we need another model.

About Graeme Maxton and The Insight Bureau

Graeme Maxton is a writer and commentator on world business, Asia and the automotive industry. His book, *From Enlightenment to Endarkenment* will be published next year. The Insight Bureau represents a resource network of individuals, including Graeme Maxton, for speaking engagements and client events, as well as providing confidential, in-house briefings. Mr Maxton is an expert chairman and moderator of business dialogues at conferences and client forums around the world.

<http://www.insightbureau.com/GraemeMaxton.html>

The Insight Bureau provides speaker placements and briefings as a service that helps achieve a better understanding of the world in which we do business and ultimately enables companies to make better business decisions.

www.insightbureau.com

+65-6300-2495

engage_us@insightbureau.com

Disclaimer: The Insight Bureau Pte Ltd accepts no liability for the content of this document or for the consequences of any actions taken on the basis of the information provided. Any views or opinions presented herein are solely those of the author(s) and do not represent those of The Insight Bureau.