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# Europe's and the World's
# Magic Formula for Bankruptcy

Greece, like so many times in the history of our civilization, is not sluggishly lagging behind us, as often portrayed in the media, but on the contrary: Greece is ahead of us – they have merely bankrupted some decade or two ahead of us.

If other countries continue to grow the way they have, and change nothing about the unsustainable growth system, then they, too, will arrive at a similar fate: collapse of the economy as a result of too much debt, and debt because of why? Because of growth. It is not the lack of growth that can bankrupt us, but the excessive amount of debt sacrificed for growth's sake. It isn't the lack of growth that could bring us Europeans to our knees – it is the desire to have too much growth that does.

### Manic depressive economy

There is a wrong diagnosis. What we hear all the time is that the economy is depressed, this is not accurate. A much more accurate description would be that the economy is manic-depressed. The economy has a tendency to exaggerate its good times into manias and to exaggerate its worse time into almost suicidal depressions. The role of both fiscal and monetary policy is to go against these tendencies and to slow down GDP growth during happy times and speed it up only during bad times, i.e. not stimulate it as we have always done in most countries in Europe in the past generation or two.

In other, and extremely simplified terms, if the Greek economy worked twice as efficiently as it did, it would not have had a problem. Ok, let's buy this media simplification. But then, let's use the same prism to look on Ireland: if the Irish economy (and especially its bankers) had been half as effective as they were, if they had worked half the time, had invested half of what they had and with half the optimism, they would not have the problem. Ireland's story is a case of mania. And in fact, if you read about the description of behaviour of patients with bipolar disorder, in their manic phase, they typically (I) have overly optimistic reading of the present and especially future prospects, (II) they spend much more money than they can afford, and (III) they tend to be very creative and very efficient. I suppose there is no need to remind ourselves that exactly this behaviour well describes our (especially financial) markets prior to crisis. It is this mania, that is our problem and we should focus primarily on slowing down our manias. The problem is not too little growth, but too much of it (debt induced) prior. It is not the lack of growth that is killing Greece, but the sins of stimulating the "growth economy" of the past. If we only focus on dealing and curing our depressions, it is like treating an alcoholic by reducing the pain of hangovers only. One does not need to be an experienced drinker to know that such "treatment" will result in exactly the adverse behaviour. It is not the hangovers that are the root of the problem, it is the excessive use of alcohol. In our case the excessive growth.

### Magic formula for growth

The problem is that we have invented a magic formula for growth, "endless" growth: deficit. The problem is this is not just the case in Greece, but in fact in most advanced countries of the west including Japan. And the other problem is that it is not endless. And the third problem is, this drug (the deficit boosting of the economy) is very addictive and we need more and more. And finally, the biggest problem is that this drug seems, at first, not to have any side effects (thus making it even more addictive and dangerous), but in the long run it leads to economic "death" or paralyzation of the given economy: namely bankruptcy.

### By the hair of a dog

The often quoted consensus today is that one of the causes of the crisis was too much (debt induced) consumption. And what is our cure to the following crisis? Even more (debt induced) consumption! What is the second most quoted reason? Too low interest rates in the boom cycle. What is the devised cure? Even lower interest rates! And the third reason was a too optimistic view of the rating agencies resulting in too positive and too optimistic ratings. Now, what's the solution? Some more optimistic ratings and great complaints when rating agencies decide or threat to downgrade. This behaviour somewhat reminds me of the hangover strategy "by the hair of a dog", i.e. drink some more in the morning of what made you sick last night …

### Grow! or die

But let's get serious again. All this stimulation is done for the one reason only that growth might grow a bit faster. Without it, we hear, we will collapse and economic armagedon will follow. Is growth a result of market democracy? Or is it a conditio sine qua non of market democracy? This is the key question. Can we stand without growth or will we collapse? Do we produce growth or are we dependent on it?

### The great debate is over

One point to make here is that it seems that the almost hundred years old Keynesian debate, whether to stimulate the economy by deficits or not, is now slowly over. We have simply exhausted, or are very close to exhausting, the debt reservoir. So the debate, whether to speed up the economy by this cheap drug called deficit, will soon no longer be relevant - the drug is running out. What then should be done? We must quickly start a slow debt detox and unhook - and yes, of course, it will be painful and it will have adverse short run effects on growth. We should have done austerity in the good times when growth was strong. This would have been much less painful. And it’s even worse: because we got the economy used to quite high doses of debt in good times, the fiscal impulses are now "slack" and they do not produce the given effect. If, for example, the economy is used to 4% annual deficit, then it will perceive a decrease in deficit to 2% as contradictory, not any more as expansionary, although the economy is still running deficits. So we come to a paradox. The debt will be growing, yet the economy will not take this as a stimuli, but as contradictory fiscal policy and will react with a GDP (a Gross Debt Product) slowdown.

## Steady she goes or ready for steady (state)

To be clear, no objections were raised in this article against growth as such. It is better when the economy is better (this is a truism), but what I object to here are artificially high levels of debt induced growth, which sadly was and is the case for most of our growths in most countries.

The question is what happens if the economy does actually not grow for a long time? We should also be ready for the worst case scenario, so that we can survive prolonged periods of non-growth. In other words, we should have two modes on our ship: so far, we have only built the system around strong growth, i.e., for a quick run to the sales when the wind is blowing. We should also have a MODE 2, when the wind doesn't blow. In other words there is no point employing people to stand at the sails when the wind doesn't blow. This requires different, steady-state models, which would focus on maintaining stability rather than growth. Public policy should be able to switch between the two.

## No magic formula

There are also other "magic formulae for growth". What they have in common is that they too do not work in the long run. Devaluation does not work - devaluation does not increase the competitiveness of a given economy, it merely relatively decreases the competitiveness of its trading partners. No wonder devaluation policies are called "beggar thy neighbour" policies. And, in fact, this is one of the reasons that euro was introduced as European currency: so that countries rid themselves of the temptation to start (devaluation induced) trade wars with each other.

The same case applies to other protectionist policies such as tariffs (how happy we were to forget that word in EU), introducing legislative barriers on imports and subsidizing exports. Other "cheats" include inflation (as a way of getting rid of debts - at the creditor's expense) and, as already debated, deficit financing (stimulating the economy at future's expense). All of the above seem like easy and intuitive things to do in crisis, which we have many times used in our history. But these "easy fixes" that seem sweet in the short run turn bitter in the long run and come at a high price: devaluation can be used in a country which is in trouble and with others ready to pull it out at the expense of their own growth (this is not the case today, when most economies are in a similar position and the crisis is global). Inflation is very hard to get rid of and we have very bloody historical examples and experiences with exactly that. Deficits are addictive and lead eventually to bankruptcy of the given economy. Protectionism makes us all poorer in the long run, when other counties retaliate. There is no magic formula.

## What to do?

What we should have always done: curb the overspending of the government, make the state more efficient, undergo necessary reforms, integrate, destroy European barriers to trade, invest in education, innovation, make the environment more easy for quality businesses to flourish, make laws that are just and courts that are quick, invest in stable macroeconomic environment, non-corruptive politics and rules, etc. Simply put: supply side economics.

We have so much focused on the stimulation of demand that we have forgotten about the proper role of the government, which is to focus on supply side. Our demand cannot be stimulated on and on for much longer. There is no magic formula, no cheap fix and there is no free lunch. And this is true even in Europe in 2012.

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