

# We can't spend our way out of this one

[Economics & Deregulation](#) | [Alan Moran](#)  
*Australian Financial Review* 17th March, 2009



The present economic downturn is widely recognised as being, at the very least, the most serious since the end of World War II. It is without parallel in that never before has virtually every major bank in the world's leading economy (and in the UK) essentially become insolvent.

There is also no precedent for a 45 per cent fall in exports like that Japan experienced in January, nor of the 13 per cent annualised rate of economic decline that it recorded in the last quarter of 2008. The US had an annualised decline in gross domestic product of 6.2 per cent last quarter. Even Germany has national income falling by 2 per cent (a rate not experienced since 1945) and is forecasting 9 per cent jobless.

Australia's GDP fell at an annualised rate of only 2 per cent in the December quarter, but nobody believes this is as bad as it will get. And, while Australian house prices have not fallen as fast as those of the US and UK, they were already down 6 per cent in December.

Governments across the world failed to anticipate both the likelihood of a downturn and its seriousness. And, in most cases, they are fuelling consumer spending by tapping savings and printing money. These approaches are the opposite of what is required to restore economic health and will, at best, considerably prolong the malaise.

The post-mortems are under way. People are blaming greed, especially by bankers. But this is not new - bankers and others are no more or less greedy, foolish, or reckless than they have ever been. That said, the bonuses they paid themselves as they drove their organisations into receivership are unconscionable.

Kevin Rudd has blamed the "neo-liberals" for deregulating economies. Although we have seen trade liberalisation and important market deregulations in air travel, telecommunications and finance, there has also been a considerable increase in government oversight in other regulatory theatres such as environmental controls. And it was leftish governments in Australia, the US and France that implemented the type of economic reforms Rudd now condemns. Moreover, in the area spearheading the crisis - US banking - the regulatory restraints are greater than those of almost all other countries.

Others have blamed globalisation, although it was the opposite of this - protectionism - that is generally agreed to have intensified and prolonged the 1930s Depression.

Some consider demand deficiency as triggering the downturn but this does not seem to have been important, as the fall in consumer demand followed the banking crisis and did not lead it.

Among all the possible causes, one that stands out is the rapid credit expansion administered by the US Federal Reserve and other central banks in the aftermath of the 2001 terrorist attacks on New York and Washington. Central bankers, anxious to offset plummeting investor confidence following 9/11, vastly expanded credit, bringing interest rates down to only 1 per cent in 2003-04.

Contrary to expectations, the money supply increase did not appear to cause inflation. This was because the credit expansion went into areas where other government policies had created an artificial scarcity and that were largely outside normal inflation indices.

Chief among the venues for the expanded credit in the US was housing in states such as California, Florida and several in the north-east, where government land restraints had created a casino of upward spiralling prices. The same artificial shortage was present throughout the UK and in

Australia, where regulatory restraints in other areas such as shopping centres also had a price impact.

In the US, regulatory measures were important in also bringing about excessive lending to people who were poor risks.

It appears banks in the UK needed no such prodding to provide poorly collateralised loans.

Australian banks are preening themselves for avoiding the cataclysm but they have not faced (yet) the decline in property prices that destroyed their American and British counterparts.

The touchstone for the crisis has been banking failure triggered by government creation of excess liquidity. The liquidity injection was designed to combat the adverse effects of the 9/11 attacks on New York. Al-Qaeda can therefore claim to have succeeded in meeting many of the goals it set for its attack - but in ways nobody could have expected.

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- > [October](#)
- > [September](#)
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- > [June](#)
- > [May](#)
- > [April](#)
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- > [February](#)
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- > [November](#)
- > [October](#)
- > [September](#)
- > [August](#)
- > [July](#)
- > [June](#)

- > [May](#)
- > [April](#)
- > [March](#)
- > [February](#)
- > [January](#)

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- [2009](#)
- [2008](#)
- [2007](#)
- [2006](#)
- [2005](#)
- [2004](#)
- [2003](#)
- [2002](#)
- [2001](#)
- [2000](#)
- [1999](#)
- [1998](#)
- [1997](#)
- [1996](#)

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