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Financial recovery needs a massively different mindset

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President-elect Barack Obama has announced his intention to restart the American economy with hundreds of billions in new spending on transportation, public works and energy. Ever since John Maynard Keynes, economists have seen such fiscal stimulus as the key tool for leading economies out of recession. In 1971, Richard Nixon famously remarked, "We are all Keynesians now."

But what worked during the Great Depression may not work quite as well today.

By the time Keynes published his classic *General Theory of Employment, Interest and Money* in 1936, it was clear that government had to spend money to counter economic decline, and it was also clear where it should be spent – on big construction projects such as highways, public works, even housing. At the time, Keynes famously remarked that the economy would be better off even if all workers did was dig ditches and fill them up again.

While few economists believe the global economy will fall into a 1930s-style collapse, a similar approach to the current financial crisis may not work as well now for a simple reason: Today's economy is largely driven by the creative industries that have grown up over the past two or three decades. The overall picture now bears more resemblance to the early industrial economy of the mid-to-late-19th century – when industries such as automobiles, chemicals and electronics were just emerging – than to the relatively mature industrial economy of the 1930s.

Restarting economic growth this time around will require a new social and economic framework that is in line with the new idea-driven economy.

The trouble is: We remain trapped in the mental models of the old industrial economy. The bursting of the tech bubble in 2001 held back the emergence of the new order. Scaring investors out of technology, the Internet and emerging economic sectors, it sent capital flowing out of the creative economy and back into the safety of housing and real estate – from "clicks to bricks," so to speak. This is why attempts to prop up housing prices or to bail out Detroit are giant steps backward.

The way out of the current crisis involves creating the social and economic conditions within which the new system can evolve. While it is impossible for anyone – least of all government policy-makers – to know what this system will look like, there are several things that can help it along.

The first step must be to reduce demand for the core products and lifestyle of the old order. The industrial economy more than a century ago required a revolution in agriculture – one that improved productivity and reduced the share of agricultural labour from roughly 50 per cent of all workers in North America in 1900 to less than 5 per cent today. Cheaper food then freed up disposable income for cars and other household products.

What's needed now is to massively shrink expenditures on houses and cars to free up spending for newly emerging goods and services. Part of this rollback will naturally occur as the real-estate bubble deflates and housing prices fall. But we need to take it a step further if we truly want more demand for new kinds of economic activity.

Our reliance on single-family homeownership is a product of the past 50 years – and the experiment has outlived its usefulness. Not only is it now readily apparent that not everyone should own a home, and that the mortgage system is a big part of what got us into the current financial mess, but homeownership also ties people to locations, making it harder for them to move to where work is. Homeownership made sense when most people had one job and lived in the same city for life. But it makes less sense when people change jobs frequently and have to relocate to find new work.

Housing production remains a cottage industry that needs to be brought into the 21st century. As a sector, it holds huge potential for making environmental gains, reducing energy use and overall consumption, and introducing new technology.

Government can also encourage a shift from ownership toward flexible rental housing. Instead of bailing out homeowners who have fallen behind on their mortgage payments, tying them to houses and locations for life (and taking up 38 per cent of their income or more), why not take the houses off their hands and rent them back at a much more affordable rate? This would allow people to move more freely as their job, career and lifestyle prospects change. Government incentives spurred a massive increase in homeownership after the Second World War; it can do the same for the expansion of new, more flexible forms of rental housing today.

Both energy and transportation must become significantly cheaper before we can shift into a new era of economic growth. Every economic revolution has been premised on the rise of new and less expensive sources of energy to power growth, and a drastic reduction in the costs of moving goods, people and ideas. The car will surely remain part of our life, but we need to improve rail, subway and bus transit. We should also make a major effort to reduce widespread commuting patterns.

Imagine a future where people live in plug-and-play rental housing units – able to move quickly when they change their jobs, with many shrinking their commute to a short walk or bicycle trip and many others able to trade in their cars for accessible mass transit.

Last but not least, government investment can help to revolutionize the way we develop people. Human capital investments are the key to economic development. But many of our schools are giant creativity-squelching institutions. We need to reinvent our education system from the ground up – including a massive commitment to early-childhood development and a shift away from institutionalized schooling to individually tailored learning. This will require a level of public and private investment of a mag-
nitude larger than the widespread creation of public schools and modern research universities a century ago.

Only by catalyzing such a wholesale shift in our underlying socio-economic system – and thereby unleashing the massive innovative and productive potential of our time – can government investment restore our economy.