



# Popular Economics

*Promoting the Popular Understanding of Economics*

## **Popular Economics Weekly**

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### **Nobel Economists Benefit Public**

The 2007 Nobel Prize in the Economic Sciences was just awarded to three U.S. economists, all mathematicians, in what is part of a watershed movement to bring back science that benefits public institutions, as well as private individuals. Their research into "mechanical design theory" has made financial markets more workable for the many, rather than leave markets to the devices of the "invisible hand" of Adam Smith, our first free market economist.

In other news, what is the real cause of the credit crunch? Fed Chairman Bernanke claimed in his most recent speech it was the fault of sloppy underwriting of subprime loans: "The rate of serious delinquencies has risen notably for subprime mortgages with adjustable rates, reaching nearly 16 percent in August, roughly triple the recent low in mid-2005. Subprime mortgages originated in late 2005 and 2006 have performed especially poorly, in part because of a deterioration in underwriting standards."

Yet the Fed has raised short-term interest rates 4.25 percent over that time in chasing the phantom of inflation. This in fact has doubled mortgage payments in many cases; something that no borrower (or maybe lender) could have anticipated—whether prime or subprime loan. Therefore, the Fed should be shouldering much of the blame. It created the problem, not faulty underwriting.

The economics prize Nobel press release stated that "Whether one considers auctions, elections or the taxes we pay, our lives are governed by mechanisms which make collective decisions, while attempting to take account of individual preferences. Such mechanisms are designed to deliver the greatest social good despite the fact that individual participants may act for their own gain, rather than for the general well-being of society."

This is bringing us back to a form of Keynesian economics that sees a role for government and regulation. The latest research is moving economics away from libertarian or so-called supply-side economics, in a word, which had enshrined unregulated, free markets that tended to cause greater income inequality.

The economy should continue to grow in fourth quarter, even though residential housing investment has declined 20 percent since it topped out in Q4 of 2005. Why? That is just when commercial real estate and exports took off. Commercial building has been expanding at a 13.5 percent annual clip since then, while exports have been rising 8.5 percent annually over that time, according to Barron's.

And consumer spending has been expanding 3.1 percent annually, as well. This is because wages are growing at 4.1 percent, twice the rate of inflation, because our economy is still at full employment. The relatively low jobless rate should keep this economy on track for the rest of the year, at least.

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