

Popular Economics Weekly

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THE TYRANNY OF THE MARKETS

The 'tyranny of the markets' is a bandied-about term with multiple meanings, from consumers being at the mercy of all-powerful multinational corporations that control prices and markets (such as oil), to recently deregulated financial markets and banks that leave investors at the mercy—and risk—of so-called 'market forces'.

But there is a deeper, more subtle market tyranny discussed among economists. This is the neo-classical argument advocated by so-called 'free-marketers' who dislike any regulation. They maintain that markets should be a clearing house for all aspects of our life—the less regulation, the more efficiently markets will be able to produce products and services.

Even asset bubbles like the dot-com, stock market and recent real estate bubbles should be left to deflate on their own, without government or Federal Reserve intervention, maintain free-market advocates. Such theories have motivated the policy actions of past Federal Reserve Chairman Alan Greenspan and current actions of Chairman Ben Bernanke. Bernanke maintains that the Federal Reserve should not intervene in the current subprime debacle, for example, unless banks' solvency is endangered in some way.

The subprime mortgage market is another example of market tyranny. So-called 'market forces' took advantage of a too-lenient Federal Reserve credit policy and lax regulators to create predatory lending practices that led many homebuyers into loans they could not hope to repay.

But this 'hands-off' market policy may not last long, if economic growth continues to slow. The Conference Board's Index of Leading Economic Indicators (LEI) for March rose just 0.1 percent, weekly initial unemployment claims are running at a high 339,000 level, and various regions are reporting shrinking industrial production. This may also lead to the continued slowing of GDP growth. The initial estimate of first quarter growth is reported at the end of this month. It could be even less than the 2 percent of last quarter.

Good news this week was the March rise in housing starts, though RealtyTrac reports a 47 percent increase in foreclosure filings over last March—including auction sale notices and bank repossessions. Both wholesale (PPI) and retail (CPI) core inflation was milder, causing bonds to rally and longer-term interest rates to fall.

INFLATION—March core wholesale prices for PPI Finished Goods were unchanged and core (CPI) retail prices were up just 0.1 percent. But overall PPI and CPI annual inflation rates are running 3.2 percent and 2.5 percent, respectively, still above the Fed's comfort zone.

HOME STARTS—New construction increased almost 1 percent to 1.54 million annualized units, but is down 23 percent from last March. This surge was attributed to warmer weather in the Midwest, where starts soared 44 percent. Starts fell in the rest of the country.

INDUSTRIAL PRODUCTION—Output of the nation's factories, mines, and utilities fell 0.2 percent in March, due to warmer weather and lower utility use. Factory output rose 0.7 percent, the most since December. But it is up just 2.3 percent in the past year, the weakest growth in 18 months, according to CBS Marketwatch.

While financial markets provide a useful purpose in setting market prices, there is no evidence of their superiority in either pricing or providing services. Private healthcare can do a better job for the affluent with the means to pay for a wider range of services, for example, but not for the majority with moderate incomes. In fact, Medicare overhead for seniors costs just 3 percent of premiums paid, whereas private, 'market place', plans' overhead costs range up to 25 percent of premiums, according to many studies.

"Let the markets decide" has become such a common term that it tends to escape scrutiny, unless such a basic necessity as gas prices soar, for example. There certainly is wisdom in the markets' ability to set prices, since it ensures that resources are allocated efficiently. But markets are only as wise as the individuals who control them.

The question is how long the Federal Reserve will allow the economy to slow in the name of fighting inflation, before intervening. It really has 3 mandates: control inflation, while maximizing employment and economic growth. Historically, it has been more successful at controlling inflation in the past 2 decades, claiming that this is the best way to sustain long-term employment and economic growth. But

employment and economic growth tend to suffer when not given the same priority.

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