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FREE MARKET

Our economy is not 'fundamentally sound'

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Americans are learning the hard way that the economy is not "fundamentally sound." President Bush, Sen. John McCain and Treasury Secretary Henry Paulson all assured us that it was — and then the bottom fell out.

Too late we are learning that reliance on the free market can be very costly.

While there is an understandable urge to get back at the CEOs who profited immensely, we would be better off to lay the blame on the free market itself and move to correct the underlying problem.

Over the last eight years, the economy has gone south by several indicators.

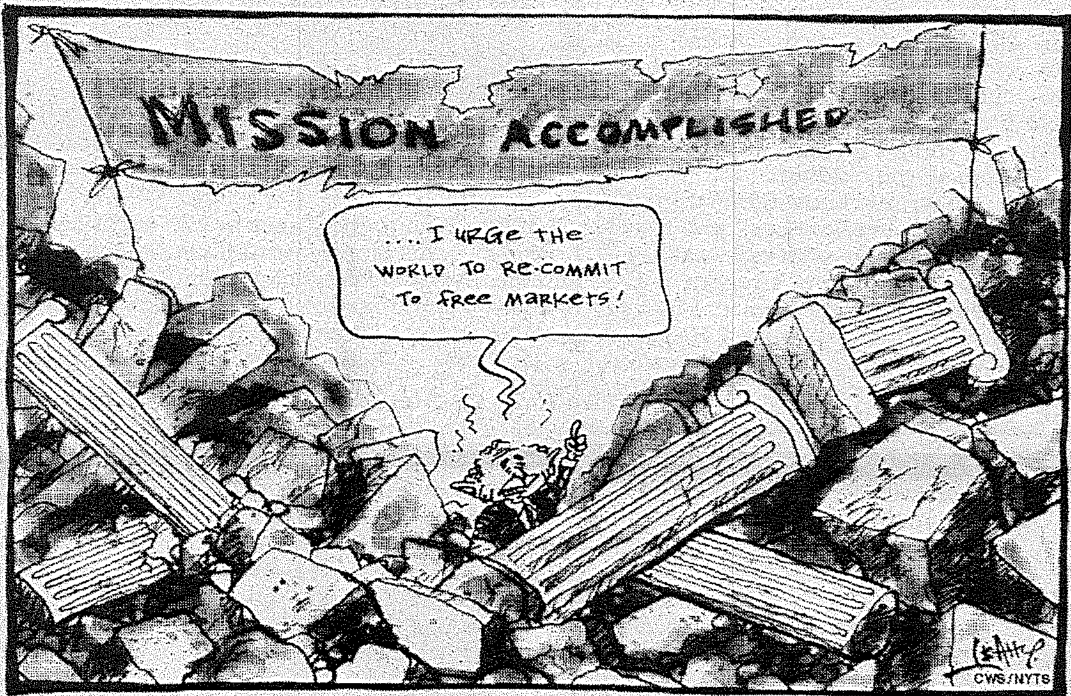
- The economy has lost 3.8 million manufacturing jobs, and about half a million jobs in the information industries.
- The trade deficit has exploded from \$380 billion in 2000 to \$700 billion in 2007.
- The federal deficit has jumped from a cumulative surplus of \$431 billion from 1998 to 2000 to a cumulative deficit of \$1.7 trillion from 2002 to 2007.
- The inflation-adjusted median income of prime working-age families (those 35 to 44) fell from \$69,939 in 2000 to \$67,849 in 2007.
- Families' combined household debt rose from \$8.5 trillion in 2006 to \$13.9 trillion by the second quarter of this year.

Free market is not self-regulating. Without government regulation, markets create bubbles, bubbles burst, people suffer and the entire economy can collapse.

Our economy is drowning in debt.

Over the last eight years, an unregulated financial sector devised many clever ways to recycle that debt. International finance partners parked their money into the American mortgage market.

The decline in interest rates helped the price of homes increase, despite the fundamental problem of falling incomes for American households. But the Bush administration and Alan Greenspan, former chairman of the Federal Reserve Board, showed little concern for the growth in debt or the bubble in housing. As housing prices went up, it appeared that homeowners were getting wealthier.



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But the market got it wrong. The plain truth is that the almost \$11 trillion in mortgage debt was built on an asset that was priced incorrectly. So as the price of homes has fallen to a more realistic level, the mortgage debt has become shaky.

We can blame the deceptive lenders and greedy traders. We can even put some blame on consumers who bought beyond their means. But deception and greed and miscalculation typify market behavior — especially when that market goes unregulated.

To blame the actors for reading their parts misses the point. The point is, we need to regulate the economy so as to change the script. As to the specific problem in the housing market, we can't solve the asset side of the balance sheet (the debts held by the financial sector) without solving the liability side of the balance sheet (the debts held by households). We must solve the debt problem, and we must include bailing out the household sector so that a better-regulated financial sector can work normally.

We can solve the balance sheet of Wall Street and Main Street. Put the mortgage-backed assets the government is going to purchase into the Social Security trust fund. Adding to the wealth of Social Security puts the money into the piggy bank of every American worker.

This would have the added advantage of allowing the government to adjust Social Security benefits upward and replace the loss in wealth Americans are feeling from dropping home prices and pension savings — a drop that is delaying retirement decisions for many, and sending others into retirement poorly prepared.

Beyond the housing crisis, though, we must recognize that the free market is not self-regulating. Without government regulation, markets create bubbles, bubbles burst, people suffer and the entire economy can collapse.

If we grasp that truth, we'll be the better for it.

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