The Complete Failure of The Economic Market Pundit

Hale Stewart, The Bonddad Blog | Aug. 23, 2012

From Ezra Klein:

> *As Joe Weisenthal details, back in September 2009, Ferguson was warning that "long-term rates have risen by 167 basis points in the space of five months," which "settled a rather public argument" Ferguson had been conducting with Paul Krugman, in which Ferguson argued the markets were turning on our debt and Krugman argued that they were not. So who was right? Well, the interest rate on 10-year Treasuries was 3.73 percent when Ferguson wrote that column. Today, they're 1.81 percent. Point, Krugman.*
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> *Having been rebuffed by the bond market, Ferguson then predicted that we were entering a period that would come to be known as "the great inflation of the 2010s". We were not. On Sunday, Bloomberg News published an article that began with the sentence, "So much for the inflation warnings."*
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> *These predictions — and others, like when Ferguson warned that "the Chinese clearly feel they have enough U.S. government bonds" — were the testable hypotheses generated by Ferguson's worldview. That worldview, in essence, was that the United States was under imminent threat from its debt, and that the result would either be a crisis as the U.S. proved unable to pay its creditors or runaway inflation as the Fed printed money in excess of what the economy could handle.*
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> *These predictions were wrong. But Ferguson hasn't updated the theory to account for their failure. Instead, he has simply applied that same theory to argue that Paul Ryan, who he first met at "a dinner in Washington where the U.S. fiscal crisis was going to be the topic of discussion," should be vice president, because his deficit-reduction plan could "end four years of economic underperformance [and] stop the terrifying accumulation of debt."*
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> *If Ferguson's theory had passed its previous tests and we had evidence that the debt is what's holding back our economy, perhaps that would be a*

> *reasonable prediction. But Ferguson's theory failed its previous tests, and there's no evidence that debt is what's holding back our economy right now. Which is one more thing Ferguson never tells you.*
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> ***And this is really a rather important point about the current crisis. There is a strain of thinking that argued, from the beginning, that Obama's policies would fail because the required borrowing would send interest rates soaring. Ferguson was a member of this club, but so was the Wall Street Journal editorial board, which warned, back in May 2009, that the bond vigilantes "appear to be returning with a vengeance now that Congress and the Federal Reserve have flooded the world with dollars to beat the recession."***
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> ***It is no surprise that most of the folks who bought into this theory were early and enthusiastic backers of Paul Ryan. After all, he bought into this theory, too, and his initial budgets included deep, quick cuts. More so than any other politician, he translated this theory into legislation. But the theory's primary predictions proved wrong. That has not, however, had any reputational impact on the people who believed those predictions, and their champion is now on the GOP's presidential ticket, but neither he nor his backers appear to have rethought any element of their critique or of their program****.*

The above was written in response to the Newsweek cover story, but it goes to something entirely deeper in the world of economics.

However much the political right may hate Krugman (and there is an almost vitriolic hatred for the man) they can't ignore one basic fact: he's been right for the last three years. Inflation has not reared its ugly head; the bond vigilantes have not come out to play in the markets and we are still mired in a slow-growth environment. Compare that track record to the likes of Art Laffer (perhaps the most appropriately named individual on the plant) and the economists who have been counseling the political right -- and who have also been consistently wrong. And not just slightly wrong, but nearly 100% wrong for the last three years regarding most of the events which have been occurring.

This goes to a deeper division in economics, which you can divide into two camps. Those that agree with Keynes and those that don't. **And it is those that agree with Keynes have been right about the current crisis.** Case in point are Paul Krugman and Brad DeLong. Also put Marc Thoma in there. Those that are from the University of Chicago School -- John Cochrane and John Taylor are good examples -- have been consistently wrong.

The reason for this is the near pathological avoidance coming from the University of Chicago folks regarding the Great Depression. There is a giant black hole in all of their analysis and it starts in 1929 and ends about 1940. As I wrote a few days ago, the most logical comparison for our current economic situation is that period. This is not rocket science; it's actually pretty simple logic at work. To make the point, read the first 10 pages of Irving Fisher's Debt Deflation Theory of the Great Depression; the parallels to the current situation are near 100% dead-on. And yet no one from the U Chi school of thought is making the comparison. I recently saw a video of John Taylor giving a speech at either the Heritage Foundation or Cato Institute, where he mentioned the current situation. He quickly dismissed the idea that we were in the middle of a debt deflation environment, yet offered no in-depth explanation as to why. And further highlighting this issue -- at least from Taylor's perspective -- is his continual comparison of this expansion to the Reagan recovery which was an entirely different fact pattern. Again, figuring out the appropriate historical comparison isn't that complicated, yet we still see people making it on a regular basis. The 10 year period when Keynes theories were implemented -- and proved successful -- are completely ignored in the hopes that, by ignoring this period -- it will simply retreat from the history books.

But most importantly, despite being universally wrong about the current environment, these people not only have a platform but are actually listened to on a regular basis, And, their opinions -- regardless of the near universal failure of those predictions and prognostications -- are still considered with the same weight as those who have been right. This is what I find utterly baffling. If you have choice between any other professionals and one has a track record of being right and the other has a track record of being wrong, you'd go with the person who was right. That's what the market should do. And yet, it is those people who argue for the absolute unfettered outcome of the market -- who, according to their own analysis should be considered failures -- that still have a platform and are still sought for counsel. That's an amazing failure of the market.