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The Biggest Bubble-Makers

No, not investors — government officials.

Amid signs that another financial bubble might be in the making — this time involving U.S. Treasury bonds priced at about 100 times their yield — it would be helpful to review what one might call bubble dynamics.

That's the subject of a new book, *Crisis Economics*, by Nouriel Roubini, the New York University economics professor who famously warned about the housing bubble that began to break in 2007. He discusses "how and why markets fail." He blames the financial meltdown on "the mantra of free markets" and "decades of free market fundamentalism." He declares that "in the future, central banks must proactively use monetary policy and credit policy to rein in and tame speculative bubbles."

One problem with this view is that the government officials who were supposedly watching out for us failed to see the housing bubble develop, and they didn't do anything about it. For example:

On April 17, 2002, Federal Reserve chairman Alan Greenspan downplayed the idea of a housing bubble.

On March 4, 2003, Greenspan stated that "any analogy to stock-market pricing behavior and bubbles is a rather large stretch."

In spring 2004, the Federal Deposit Insurance Corporation declared: "There is no U.S. housing bubble . . . it is unlikely that home prices are poised to plunge nationwide."

On Oct. 19, 2004, Greenspan expressed the sunny view that the run-up of housing prices and housing debt wasn't "overly worrisome."

In December 2004, the Federal Reserve Bank of New York reported: "The most widely cited evidence of a bubble is not persuasive . . . a bubble does not exist."

On Jan. 28, 2007, Federal Reserve chairman Ben Bernanke testified before the Senate Budget

Committee about financial trends. He didn't say a word about a possible bubble. He expected that "the budget deficit may stabilize or moderate further over the next few years."

In April 2007, the International Monetary Fund issued a report that said "the overall U.S. economy is holding up well." The IMF suggested "the continuation of strong global growth as the most likely scenario."

Greenspan, Bernanke, and others look like dummies for not seeing a bubble that's obvious to us now. But since they're smart guys, it would be reasonable to suppose that recognizing a bubble might be hard, and that government officials could have difficulty protecting us.

Government officials are imperfect human beings, so they make mistakes. After all, nobody can foresee the future. Government officials scan a constant, voluminous flow of often contradictory economic data. They aren't sure that we're in a bubble or a recession until it's far along. Nor are they sure what to do after they find out. Because officials have considerable power, their mistakes are likely to harm not just a city or state or region but the entire U.S. economy and beyond. Political power magnifies the harm done by human error.

Even if there somehow are perfect officials who always know the right thing to do, they're unlikely to be given the necessary power by the president and Congress. Incumbent politicians are more concerned about getting reelected than anything else. There's pressure for Federal Reserve officials to "play ball" by promoting easy money before an election, because if they create political problems, politicians can retaliate by restricting the Fed's power. Reining in a bubble — which means no more easy money, and consequently trouble and possible bankruptcy for firms that have become dependent on it, and therefore higher unemployment — is absolutely the last thing incumbent politicians want.

Roubini's idea of rational government intervention is a fantasy. Intervention is subject to political pressures that work overwhelmingly in favor of promoting bubbles and against reining them in. Such pressures are about as difficult to control as runaway government spending. Anyone who doubts this ought to consider how Congress passed a so-called financial-reform bill without addressing Fannie Mae and Freddie Mac — the government-sponsored enterprises that promoted the housing bubble by spending trillions on subprime mortgages. We shouldn't be surprised if it turns out we're in another bubble now.

Far from being our salvation, as Roubini suggests, politicians and government officials are the biggest bubble-makers. We need less government intervention, because it's a principal source of instability. When making financial decisions, ordinary people should assume that we're on our own, because we almost certainly are.

— Jim Powell, a senior fellow at the Cato Institute, is the author of FDR's Folly, Wilson's War, Bully Boy, *and other books. His next book is* What's Likely To Happen When Government Goes Broke.