Mortgage Market Metastasis

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There remains very little debate regarding the depth and extent of our economic downturn. Each passing week brings news of mass lay-offs, rising anxiety and fears about further economic trouble. The last year has seen more than 4 million Americans added to the unemployment statistics and over 3 million people pushed into involuntary part-time work. We are losing over half of a million jobs per month. Debate rages on regarding the wisdom, timing and content of The American Recovery and Reinvestment Act, the stimulus. There are many plans, complaints, diatribes and wisdoms swirling about. The broadest divisions are ideological and separate those who believe the state can spend us back to prosperity from those who believe that private consumers and firms are the only path back to health. Lost in the ideological shuffle has been any real inspection of how we got here and the profound change required.

Let's try to seek an answer to this out of fashion question? Real wages, the dollar earnings of Americans adjusted for what these dollars can purchase, have been stagnant or underperformed overall economic growth for most of the last 30 years. The average weekly earnings for all employed Americans have not risen significantly since 1973. Yet, we live materially much better lives. How is this possible? Over various past decades we have stayed focused on material consumption as the measure of success, happiness and well being. Various decades have seen different and increasingly intense systems for coping with rising material wants/needs and stagnant real wages. The history of these coping methods is the story of how we got here and suggests much about what needs to change. Each part of the stimulus responds to an issue created by past strategies to keep spending without support from earnings and savings.

Stagnant and falling wages pushed more family members out of the house and into the labor force for a greater number of years. This means more working high school kids, older people and married women with young children. This helped, but not enough. It has been three decades of longer hours, second jobs, small businesses for extra money and endlessly falling savings. We are a nation of tired, on edge consumers. Consumption continued. International opening up and the emergence of transnational firms and opportunities created another partial and temporary respite.

Our firms moved production off shore and we learned to find lower and lower priced goods from increasingly distant shores. Thus, half trillion dollar trade deficits and the need to sell foreign creditors on our stimulus. This is why we badly need to export more and import less moving forward. This might serve to explain the emergence, controversy and disappearance of the Buy American clause in the stimulus.

Over time the cry went out and was answered for tax relief. Taxes, particularly progressive income taxes, were cut. This helped too, but starved the state for money and led to painful and expensive service cuts. Ultimately a formula was decided upon where taxes were cut more than services as both were chiseled away. This produced our rising federal deficits and debt, alongside declining faith and function of many state agencies. This made folks see the government as wasteful and poor at service provision- often for very good reason. This is why many Americans feel the state can't save the economy now and they are fearful about the trillions- already 10 and counting- in government debt we will leave future generations. Tax cuts, more hours, more people working, cheap foreign imports and drawing down savings proved insufficient to fully compensate middle class America for falling wages. Enter speculation and debt.

The two great, addictive and ultimately destructive crutches became debt and speculation. This went hyperbolic with the internet/tech/telecom bubble of the mid and late 1990s. America faced insufficient funds and exhausted savings. There were few more hours to work, no one left to send out of the household into the labor markets and precious little tax cutting that could be done without immediately enfeebling the state. Enter the great equity market/mutual fund and housing speculative bubbles. The financial firms in the center of this process grew profits, balance sheets and importance as they enabled us to continue to buy. Folks poured their beliefs and funds - begged, borrowed and stolen - into the markets. Financial firms found, pooled, deregulated, bundled and lent.

For a few brief shining years it seemed as though new technologies, an enlightened money policy from the

Federal Reserve and speculative furry could bailout spending well ahead of earnings. This would allow developing nations to boom on exports and pay wages too low to consume domestically. In the spring of 2000 this began to go horribly wrong. The great bubble burst, leaving debts but not inflated assets. This is part of the reason recent Fed cuts have failed to rekindle the economy. This trick was tried last time and we are living the painful aftermath of that mistake.

We responded to the bursting of 1990s bubble by inflating another bigger and broader bubble of housing and housing debt. The Federal Reserve slashed interest rates to 45 year lows. Lending standards were innovated right out of existence and the great housing bonanza began. We borrowed $3.7trillion against or homes between 2003 and the end of 2007. House price appreciation and debt would do what sending everyone to work-for more hours-, buying cheap imports, burning the savings, tax cuts and equity speculation failed to do.

House price appreciation and debt would allow us to spend more than we earned. It would allow the state to borrow and spend well beyond tax receipts. It would allow families to not save, to borrow and spend. People could spend and live like their wages had not been largely stagnant since 1973. It all sort of worked until it did not. That is the story of the great bust that follows the hollow boom. That is what we are trying to stimulate our way out of with $815billion.

Yes, we need government stimulus. No, that is not nearly enough. We need to change the way people earn, save and spend. These are major changes. We need to change the way our government taxes, spends and prioritizes. These last two weeks signal how hard that will be. The stimulus we are poised to get contains all the past impulses that created the present pain. However, we need to stabilize our free fall in order to be able to rebuild. The Recovery and Reinvestment Act has many necessary elements. Policy response seems necessary and will be insufficient. We are left to hope this is a first step on a long journey.