

**Froth and Bubbles, Bubbles and Froth**  
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There are two key ideas in economics that shed a great deal of light on the times we have been experiencing. The first of these says that when too much money chases too few goods, inflation results. No, we are not returning to the bad old days of the early Eighties, although I'll say more about that later. Rather, we have experienced serial inflation in the price (if not the value) of technological industry stocks, real estate, and now commodities. We have gotten caught up in the last two and forgotten about the others. Yet each of these stems from the axiom stated above: too much money chasing too few goods.

The second economic truism is that there are only two kinds of economic policy: bad and worse. Put another way, the capitalist system in which we live is so complex that it is self-correcting and trying to change that process with monetary or fiscal policy leads to problems worse than those the actions were intended to solve. As that great American philosopher Peter Clemeza once said. "You gotta have these things once every five or ten years. It gets rid of the bad blood."

Back to the first proposition. Why is there too much money chasing too few goods? The answer lies in the way in which income distribution has changed since 2000. Virtually all the real income gains made in the American economy this century have accrued to the top 20 percent of the income distribution. For the other 80 percent real income has been stagnant or falling. To an extent this has been masked and offset by rising home equity and the willingness of the middle class to use their homes as ATMs, funding consumption unattainable on income alone. This has allowed the economy to grow (modestly) and allowed consumers to maintain their standard of living in the face of rising prices. Now, that game is over: equity has been tapped out, incomes are still stagnant and prices are rising faster. The net of all this is an economy slipping into recession.

But I digress. Those who found themselves at the top of the heap needed to put their wealth to good use and so they began chasing high investment returns. First it was tech stocks. In the late Nineties, these were trendy investments—until someone noticed that infinite price-earnings multiples could not be sustained. That bubble burst in April 2000. Then it was real estate, and owning one building was not enough. Investors would up owning two, three, four houses or more. That worked until someone noticed that prices were getting out of reach of lagging middle class incomes. That bubble burst in mid-2005.

The latest trendy pick is commodities, with oil topping \$115 a barrel, gold rising over \$1000 an ounce and rice, wheat and other grains tripling in price. This bubble is still inflating. Every one of these represents the inflation of prices beyond actual value because of the concentration of income in the hands of a

few. This concentration tendency began in the Nineties but was given a huge boost by the tax cuts of 2003, which were skewed toward the wealthy.

This brings us to the second point. Fiscal policy has altered the distribution of income significantly. In addition, it has created a nagging deficit that has weakened the dollar and pushed the prices of all imported goods (check the labels on the clothes you're wearing as you read this) up, yet another burden for Americans who did not benefit from the tax cuts. If one were to grade the fiscal policy of the Bush years, one would have to award a solid "F".

Has monetary policy been better? Right now, the Fed is attempting to keep the economy from slipping into recession. It is doing this by pumping liquidity into the economy. Eventually that excess liquidity will have to come out in the more classical form of inflation, too much money chasing too few goods. Look for the inflation rate to be up 2-3 percentage points by the end of 2009. This can be prevented only if the Fed soaks up that liquidity by increasing interest rates at the end of 2008. In other words, in attempting to solve one problem, the Fed is creating another. To paraphrase an old line, it's a tough job, but nobody really has to do it. Or to quote that Zen philosopher Gil Grissom, "Sometimes the hardest thing to do.....is nothing at all." For the makers of public policy, these should be words to live by.