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January 12, 2009: The End of Market Economics

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1/12/2009--In this month’s edition of Portfolio.com, Michael Lewis, the author of Liar’s Poker, has written an article entitled The End, which describes the deceipt, fraud and ineptitude that contributed to the subprime mortgage crisis. Lewis describes the investment approach of Steve Eisman over the last few years. Eisman could see that these loans would default, so he shorted the market. In other words, Eisman profited from noticing what everyone else must have known but found it more profitable to ignore. Lewis describes Eisman’s outrage at the selfish greed that motivated investment advisors and institutions to play games with the money of their clients without caring very much whether these investments would be a good idea for these people. Indeed, the money flow required that no one ask any probing questions, especially not the rating companies who acted in willful ignorance. None of these investment people will go to jail, apparently.At the same time I was reading this article, I was in San Diego at a law professors conference listening to Richard Epstein, Professor at the University of Chicago Law School, praising the private market and offering it as a model for African economic development. The conjunction of these two events really struck me.It occurs to me that the reason Epstein is so little shaken by the debacle of the past year—Epstein kept saying, “Don’t blame me for these policies”—is that he is very little interested in how markets actually work, and very interested instead in how markets are said to work. Epstein is committed only to ideology.It is very hard to say that the market is efficient when it crashes so often. To be a serious market proponent these days would require some really hard thinking. And some policy innovations. But Epstein is not interested in that. We really do need a new approach to economics that does not go back to socialism.