Both The Market and Government Are Irrational

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One of the great economic myths is that markets are rational. Not a day passes without this myth being disproved scores of times, but the myth persists.

For example, today (March 14) Bank of America/Merrill Lynch reported that "yesterday US markets started the day off with a strong rally after the solid retail sales report. . . . tailwinds are helping boost global equity markets today."

The "solid retail sales report" for February consists of a 1% nominal gain. That is, the increase is not deflated by the month's inflation rate, which will be released on March 16. In other words, if very much of the 1% nominal gain in retail sales is due to higher prices, the inflation adjusted gain will not be statistically significant. The "rational market" took off without waiting to find out whether the gain was real.

Moreover, as statistician John Williams has established, the official Consumer Price Index (CPI) understates inflation. If an honest measure of inflation was used, retail sales could be in negative territory.

The "rational market" loves deception as long as it provides an excuse for equities to rise. The Federal Reserve's focus on "core inflation," which does not include rising food and energy prices, allows Federal Reserve officials to maintain that the inflation rate remains below target. By pretending that there is no inflation, the Federal Reserve continues to support banks with near zero interest rates while depriving savers and retirees of interest income. With no income from savings, people are forced to consume their capital. Thus, the Federal Reserve's policy makes bankers richer and the country poorer.

Meanwhile, those whose old age security is based on pensions are confronting insecurity. Many with private pensions were harmed by the financial crisis. Those dependent on Social Security and Medicare are finding that these programs are being blamed for budget deficits caused by multi-trillion dollar wars of choice. Those expecting pensions from state and local governments are finding that governments are unable to make good on underfunded pension benefits.

State and local governments counted on a growing economy and rising consumer incomes to provide the tax base to make good on underfunded pensions. These governments did not foresee that US corporations would destroy their tax base by moving manufacturing, engineering, IT, research and design jobs overseas. The absence of growth in real incomes for the vast majority of the people and the capture of productivity gains by capital at the expense of labor have added to the budget woes of most state and local governments.

John Rauh at Northwestern University estimates that the unfunded obligations of state and local governments amounts to $4,400,000,000,000, an amount that is within the ballpark of Joseph Stiglitz and Linda Bilmes' estimate of the cost of the Iraq and Afghanistan wars.

Money that could have saved Americans' pensions instead was allocated to profits for armament corporations and to advance Israel's territorial hegemony.

When the Occupy Wall Street movement says that Washington rules for the benefit of the 1%, OWS is not far off the mark.

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