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# Yes: Blame inaction by the Fed

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Mark Weisbrot is codirector of the Center

for Economic and Policy Research in Washington

In the baseball-and-sex classic *Bull Durham*, Susan Sarandon accidentally calls out the wrong name in the heat of passion, and makes a remarkably quick recovery. She asks her partner which he would rather have, her having sex with him and saying the other guy's name, or vice versa.

In the movie, it seems to work; for the moment, at least, he doesn't seem to realize that these aren't the only two possibilities.

Former Fed Chairman Alan Greenspan appears to have gotten away with a similar trick, as the housing bubble that bloated up on his watch continues to deflate, dragging the economy toward recession.

Since the bubble was easily recognizable - and recognized - as early as 2002, he could very likely have prevented it from growing to dangerous proportions. But he has made it look as though his only choice would have been to raise interest rates and, thereby, risk taking down the entire economy much earlier.

In the numerous interviews he gave promoting his latest book of memoirs, the journalists neglected to ask him about a more logical option: simply explaining the bubble to the public and, thereby, curbing the expectations of ever-rising prices that fed the speculative frenzy.

It is also now widely recognized that the Fed abdicated its responsibility to regulate against predatory, deceptive and abusive lending in the subprime-mortgage market, although the bubble itself was still the main problem.

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Greenspan himself recently put the odds of a recession at 50 percent. And that was before the latest data showing home-price declines of 6.1 percent (in October, year over year), the biggest in more than six years. Greenspan's prognosis was also made before this Christmas holiday shopping season came in as what looks like the worst in five years.

But he was overly optimistic even with the data at hand. It is difficult to imagine that a collapse of asset prices of the magnitude expected - probably on the order of \$8 trillion - would not cause a recession.

Most of the six-year recovery from the last recession, which ended in November 2001, was fueled by trillions of dollars of borrowing that consumers were able to take against their rising home values. That source of credit is now drying up as home prices fall, and the decline has only begun.

It would take an additional 28 percent reduction in real home prices just to bring them back to long-term-trend levels. Consumer spending is about 70 percent of the economy, and it is mainly debt-fueled consumption that has kept our economy afloat since the housing bubble began to burst last year.

Over the last six months, exports have also expanded considerably - due to the fall in the value of the dollar, which makes U.S. products more competitive in world markets. But exports are only about 12 percent of our economy, so even fast-growing exports cannot compensate for a serious decline in consumer spending.

The international credit crunch, brought on by the collapse of securities backed by subprime mortgages, has added another source of drag and uncertainty to the economy. It could worsen as house prices decline, and losses in assets tied to the rest of the mortgage market - including prime mortgages - will add to the mess.

A glut of homes on the market, the prospect of millions of foreclosures, declines in residential construction, a weak labor market, and rising food and energy prices also weigh upon the economy. Since this will be the second recession since 2001 that was caused by the bursting of an obvious speculative-asset bubble - the previous recession was induced by a stock bubble collapse - the question of what the Fed should do about such bubbles should be the subject of congressional hearings.

And we need something better than *Bull Durham* answers.

Visit the Center for Economic and Policy Research at [www.cepr.net](http://www.cepr.net), and e-mail Mark Weisbrot at [weisbrot@cepr.net](mailto:weisbrot@cepr.net).

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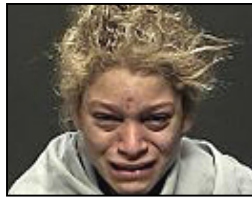
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