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The Myth of Market "Bubbles"

By Richard M. Salsman

That popular manias are an underlying source of boom-and-bust "market failures" is a notion that has tended to resurface whenever market events have diverged markedly from the expectations of the elites in power who have presumed special knowledge about (and strived to enforce) some "natural" or "sustainable" limits of the phenomena in question. In the pages that follow, Richard Salsman, who is Senior Vice President at H.C. Wainwright & Co. Economics, Inc., in Boston, aggressively challenges the view that even unprecedented run-ups in the market valuations of particular assets—so-called market "bubbles"—necessarily are driven by the investing public's ignorance or emotionalism. He suggests rather that one can find good reasons for, say, the stock prices that, after their collapse, were called bubbles. He also observes that it has been not the deluded public, but Government interference in market processes, that has been a principal source of the perceived problems.

Such a view in no way implies that the financial markets do not go down as well as up. But even severe bear markets or crashes may not be market failures in the sense implied by today's "bubble-ists," in Mr. Salsman's words. Rather, as discussed in the boxes that accompany the text below, the circumstances that may have contributed to the current high U.S. common stock valuations seem to conform neither to a dictionary definition of the term "mania" nor to the views of one of the original, and most often-cited, of the "bubble-ists." – Ed.

This year's continued surge in the U.S. stock market has renewed fears that the rise is an unsustainable "bubble." Dire warnings of an impending "pop" proliferate. In late 1996 Federal Reserve chief Alan Greenspan said stocks were driven by "irrational exuberance," that the U.S. risked a Japanese-style crash. Later he said analysts were assuming unrealistically robust earnings growth "into the hereafter."

Many economists and Wall Street strategists echo these sentiments. U.S. stocks have risen 70% since Mr. Greenspan's 1996 remarks. If the market was "irrationally exuberant" back then, Mr. Greenspan must think it's *positively psychotic* today. Mr. Greenspan, long described as a free-market economist, once told Congress that markets are inherently unstable, while the Fed's job is to smooth them out:

> In a free market, complex society of the type we have, the dynamics of it, coupled with the fact that people get excessively exuberant on occasion and inordinately depressed on occasion, you get a cycle that gets built into the system. What we try to do [at the Fed] is to try to hit the top and the bottom, to sort of flatten it out, to the extent that we can, on both sides, and that is not an easy thing to do because it implies that one is forecasting the economy.[1]

In testimony before Congress on June 17 this year, Mr. Greenspan said the U.S. economy cannot grow more quickly than 3% per year without accelerating inflation. The current growth rate is 4%. Thus the Fed may soon raise interest rates to slow growth, even though inflation has been *decelerating* in the past three years. Does the Fed also target stock prices? A Congressman asked Mr. Greenspan whether he thought today's market was a "bubble." "It's possible," he answered, because "many analysts" believe stock prices are "excessive." Yet, he added, "to

[1] Testimony before the U.S. House of Representatives Sub-Committee on Monetary Policy, February 20, 1996.

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spot a bubble in advance requires a judgment that hundreds of thousands of investors have it all wrong."[2] He concluded that he prefers to raise rates slightly now to depress the market a bit today, to avoid depressing markets more "drastically" later.

Two related but false premises color this analysis. The first is that markets are prone to failure, to "excessive production" and improper price-setting ("over-valuation"). The second is that the government's job is to detect such failure and take swift, corrective action. Unlike most officials, Mr. Greenspan expresses some humility about whether government officials can claim to know the proper rate of production or proper pricing decisions. He concedes that investors with their own wealth at risk are in a far better position—and better motivated—to know the right answers. But he's not humble enough to remain on the sidelines and let market-makers decide such matters for themselves.

Government officials are not alone in holding such false premises. Economists and market strategists typically refer to large declines in stock prices as "corrections," as if prior valuations were mistaken.

The fact is, neither the current U.S. economic growth rate nor current stock market levels are at all "excessive." Indeed, it's doubtful that markets are ever anything *other* than fully functional and fully priced, incorporating all known and relevant factors, positive or negative, operating now or likely to operate in the future. Market activity is not based on irrational or psychologically unstable emotions nor on estimates detached from real phenomenon. Sound reasons exist for high growth rates and stock valuations. And there are legitimate reasons why—and when—such successes might terminate. Success is halted not when markets become "sane" after a bout of insanity but when insane policies are enacted.

Whatever the policy climate, markets are made by producers and savers. No one can demand, consume or invest without first having produced and saved. Production, profit-making and investing require enormous intelligence, fact-finding and foresight. People tend to spend their own wealth with care. They resist paying more than what's reasonable. Whether alone or with advisors, they consider the relevant factors affecting prices. Investors need not be—nor can they be—omniscient to be discerning. Mistakes are made, to be sure, but the mistaken lose their capital to that extent and lose their influence on markets. In short, markets are efficient. They work well—while government often works to wreck them.

History shows that Federal Reserve interest rate policy does not "smooth" business fluctuations—it *generates* them. The most sustained expansions, with high growth rates, have occurred when interest rates were most stable. The longest post-War expansions in the U.S.—1962-69, 1982-89 and 1991-present—proceeded when interest rates changed least. The lesson? Markets left to themselves bring stable and sustained runs of prosperity. Particular firms or industries rise or fall, but the overall system is not prone to collapsing on its own.

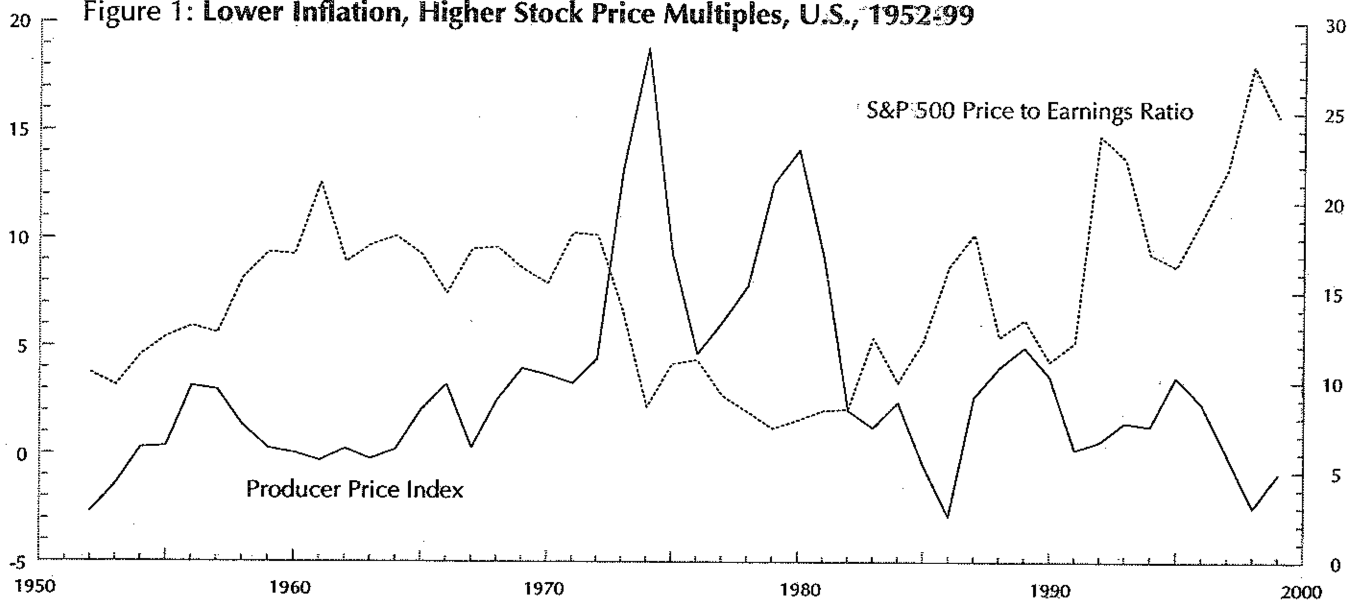
Contrary to the claims of academic economists and Fed officials, inflation is not caused by output growing "too rapidly." All else equal, a greater supply of goods mean *lower* prices. Inflation is strictly a result of government monetary policy, of the joint actions of the Fed and the Treasury—the former whenever it issues money in excess of market demand, the latter whenever it lowers the dollar's foreign exchange value. Rising interest rates are often interpreted as "tight" monetary policy aimed at fighting inflation, but in fact, they result from rising inflation expectations. Likewise, falling interest rates do not reflect a "loose" or inflationary monetary policy, but a decline in the market's inflation expectations.

> **Mania**, *n.*
> 1. *Nosology.* Mental derangement characterized by great excitement, extravagant delusions and hallucinations, and, in its acute stage, by great violence.
> 2. Great excitement or enthusiasm resembling madness...A vehement passion or desire...a 'craze', 'rage'...Also, a period of great excitement affecting a body of persons.
> *Oxford English Dictionary.*

The best gauge of any nation's inflation rate is its currency price in terms of gold. The purchasing power of gold—the only uniform and tangible money accepted globally—has been stable for centuries.[3] Hence a rising gold price reflects a currency that's losing value while a falling gold price reflects a higher-valued currency. The dollar-gold price has fallen for most of the 1990s, especially in the past two years. That's not been welcomed by gold investors, but it means the dollar and dollar-denominated securities have appreciated. A dollar that's nearly "as good as gold" brings low and stable interest rates, which are conducive to stable and rapid growth and higher stock market valuations.

[2] Cited in "Greenspan All but Announces Rate Rise," *The Wall Street Journal*, June 18, 1999, p.A2.

[3] See Roy W. Jastram, *The Golden Constant: English and American Experience, 1560-1976* (New York: John Wiley & Sons, 1977).



The "price-earnings multiple" is one valuation measure, showing how expensive or cheap prices are relative to earning power. Since WWII, the average P/E multiple in the U.S. has been about 15. Since today's multiple is 25, many observers insist that the current market is a "bubble." The market, they suggest, is *two-thirds higher* than history justifies and is, therefore, a bubble prone to bursting. If prices return to "normal" they'd have to fall by as much as 40%.[4] Indeed, if the market *were* overvalued, it would pay to sell. But if not, selling makes one forego genuine wealth gains.

All else equal, today's multiples may appear excessive. But "all else" is *not* equal. The average multiple is 15, but averages mask a lot. The inflation climate is crucial—and it varies. Figure 1 shows a distinct *inverse* relationship between inflation and P/E ratios. Multiples are higher when inflation is lower (or amidst deflation) and lower when inflation is higher. Investors who drop the inflation context risk a flawed valuation analysis. Today's high stock multiples reflect, not a "bubble" or a "new economy," but the low inflation rates last seen in the 1950s and 1960s.

The inverse relationship between inflation and stock multiples is rationally-based. First, lower inflation (and deflation) raises the *quality* of profits. Its effects are precisely the opposite of the more-widely recognized effects of high inflation. Under historical cost accounting, higher inflation creates an undervaluation of inventories and an under-depreciation of plant and equipment, both of which lead to artificially higher earnings and effective tax rates. This lowers after-tax returns. Bearish results were widespread in the inflationary 1970s, when multiples plunged to single digits. Today the opposite condition holds. Lower inflation is raising stock values, lowering effective tax rates and raising after-tax returns. A dollar earned today—when prices are stable or down—is a far more highly-valued dollar.

Lower inflation also brings lower interest rates, which, when used to assign a present value to future cash flows, raises stock prices and multiples. Low interest rates also tend to be more stable. The result—a less cyclical economy—allows a more sustained and predictable flow of future cash (dividends and capital gains) and these favorable conditions justify higher stock multiples.

Another valuation measure frequently cited by believers in "bubbles" is today's historically low dividend yield on stocks. At 1.5%, it has rarely been lower. To many observers, it's nonsensical to buy stocks of such low yield when bonds yield 6%. But again, this view drops a key context. The total return on stocks consists not only of income from dividends but also capital gains from stock sales. Consistent with low inflation, the total return on U.S. stocks in the 1990s has been high—nearly 15% per annum. But the *composition* of the total has shifted, away from income toward more capital gains. Why the shift? Tax policy. In 1986 the top marginal tax rate on income and capital gains was 28%. Since then the top rate on income was raised to 40% while the top rate on capital gains was cut to 20%. Investors faced a growing incentive to receive less return in the form of income and more in capital gains. Firms became motivated to retain more earnings (the source of capi-

[4] Indeed, Ed Yardeni of Deutsche Bank, one of Wall Street's most widely-followed economists, believes the U.S. stock market is overvalued by 30% and that the "bubble" will burst at the end of this year, triggered, he predicts, by Y2K problems.

tal gains) while buying back stock (effectively a dividend, but disguised as a capital gain).

When U.S. postwar financial history is divided into three 15-year periods, the role of inflation becomes clear. The market has done best in the last 15 years (1984-98), when the average P/E multiple was highest, at 18.3. Why so high? The era exhibits relatively low inflation, reasonably low interest rates, superior profit growth, and the most stable rate of profit growth. The period 1952-67 is second-best. Its average P/E was 15.4, due primarily to having the lowest inflation and interest rates, offset, however, by profit growth that was neither as fast nor as stable as in 1984-98. The worst period for stocks, 1968-83, exhibited an average P/E of 12.1. That era saw the highest average inflation and interest rates, the slowest profit growth and the most volatile profit pattern.

The damage done to markets by inflation undermines the popular case made for "bubbles" by monetarists. In trying to explain their repeated forecasting errors—the numerous cases in which the money supply seems to grow "excessively" with no similar rise in prices of consumer goods and services—they argue that such excess money must have "spilled over" into spending on financial assets. But money does not flow in or out of the stock market, which is a secondary market consisting of trading in shares that were already exchanged for cash at an earlier date. For every buyer of stocks putting money "in," there is an equal and opposite seller taking money "out." There is no net change in cash driving prices. Only the joint valuations of buyers and sellers matter for stock prices. And history shows that inflation only lowers stock prices and valuations.

The influence of interest rates on the stock market also undermines the case made for "bubbles" by adherents of the Austrian school of economics. They contend that "booms and busts" are due to government manipulations of interest rates and that lower rates reflect an inflationary policy of "easy money" or "false credit." The bust is inevitable, they argue, when inflation stops and interest rates rise. But inflation does not lower interest rates—it raises them. Low interest rates reflect sound money—a condition usually delivered by a free market monetary system and, more rarely, by central banks issuing currency that's nearly as good as gold. Markets do not boom due to inflation and bust due to sound money. On the contrary, they boom in the normal case of sound money and low interest rates and they bust whenever governments debase money. A busted market is not an inevitable result of prior prosperity but an inevitable result of statist interventions.

Misguided monetary policy is based on false notions of market pricing and a belief in "bubbles." History shows that stock markets have crashed after central banks or finance ministries have devalued and inflated the currency and raised interest rates. The U.S. market rose 22% per annum, on average, in the five years before crashing 27% in October 1987. Multiples rose from 8 to 20 in those years based on a sustained disinflation and profit growth of about 17% per annum. The October crash was preceded not by sudden irrationality on the part of investors, but by a disastrous monetary policy. Beginning with the 1985 Plaza Accord, the U.S. Treasury depreciated the foreign exchange value of the dollar by 47%—12% alone in the year before the crash. Meanwhile, in that year the Fed raised interest rates by 1.5 percentage points. Stocks did not crash in 1987 because they were previously inflated; they did so when inflation returned.

For decades the 27% stock market crash in the fall of 1929 has been seen as a "bubble" that burst. But corporate profits grew a healthy 14% per annum in the 1920s—20% in 1929. Stock prices rose on a sturdy base. Inflation and interest rates were low. Capital gravitated to the U.S. from a stagnant Europe. Stock multiples reached 25 in 1929, like today's. But again, the Fed denounced prosperity as "speculative" and raised interest rates by 2.5 percentage points in the year before the crash—1 percentage point in just the month prior to it. The assault on wealth was based on the false belief that prosperity is immoral and unsustainable.

Monetary policy is not the only threat to market gains. Taxation, regulation and protectionism have also proved fatal. Taxes, controls and tariffs were raised considerably in the 1930s. A similar array of assaults also sabotaged U.S. "junk bond" prices in 1989-90. Not only did the Fed raise interest rates, but market-makers in junk bonds were unfairly penalized and bankrupted. The holding of junk bonds by financial institutions was declared illegal by Congress. Still, analysts referred to prior junk bond prices as a "bubble" that somehow had to burst. Not so. The blatant, statist assaults on junk bonds, and the subsequent revival of that market once the crushing burdens were lifted, invalidates that interpretation.

U.S. officials are hardly alone in distrusting and sabotaging prosperity. In recent decades previously-labeled "miracle" economies in Asian have suffered similar attacks. From 1985 to 1989 a strengthening yen had brought Japan low inflation, low interest rates, good growth, rapidly rising profits and a stock market that rose 60%. The healthy gains were derided by the Bank of Japan as a speculative "bubble" and it raised rates by 2.5 percentage points in the few months before stock prices plunged 50%. That mar-

ket has yet to fully recover. Southeast Asian central banks enacted similar policies in 1997-98: they devalued their currencies, inflated and raised interest rates, slashing stock prices by more than half. The crashes were not attributed to statist policies but to markets, to "crony capitalism," unregulated lending and bubbles.

Sky-rocketing gold and silver prices in the late 1970s were also deemed a "bubble." But those increases were rationally-based, reflecting yet another devaluation: the U.S. government's 1971 default on the gold exchange standard and the inflation that ensued. The peak in gold and silver prices in early 1980 and their subsequent plunge reflected not a "pop" but a return to some semblance of monetary sanity.

Many writers delight in recalling lurid tales of "bubbles" from centuries past, such as the "Tulipmania" in Holland in 1636, the Mississippi Bubble in Paris in 1719-20 and the South Sea Bubble in London, also in 1719-20.[5] But if by "bubble" is meant irrational hysteria unwarranted by facts, not even these distant episodes were bubbles. For instance, the high prices paid, briefly, for a few Dutch tulip bulbs reflected the fact that they were newly-devised strains to be propagated and sold in the millions. After their propagation supplies of the new

[5] These stories were first popularized in an 1841 book by Charles Mackay titled *Extraordinary Popular Delusions and the Madness of Crowds*. The book was reissued in 1932 with a glowing forward by Wall Street financier Bernard Baruch and remains in print today.

The Original Bubblist

In reading the history of nations, we find that, like individuals, they have their whims and their peculiarities; their seasons of excitement and recklessness, when they care not what they do. We find that whole communities suddenly fix their minds upon one object, and go mad in its pursuit; that millions of people become simultaneously impressed with one delusion, and run after it, till their attention is caught by some new folly more captivating than the first. We see one nation suddenly seized, from its highest to its lowest members, with a fierce desire of military glory; another as suddenly becoming crazed upon a religious scruple; and neither of them recovering its senses until it has shed rivers of blood and sowed a harvest of groans and tears, to be reaped by its posterity. At an early age in the annals of Europe its population lost their wits about the sepulchre of Jesus, and crowded in frenzied multitudes to the Holy Land; another age went mad for fear of the devil, and offered up hundreds of thousands of victims to the delusion of witchcraft. At another time, the many became crazed on the subject of the philosopher's stone, and committed follies till then unheard of in the pursuit. It was once thought a venial offence, in very many countries of Europe, to destroy an enemy by slow poison. Persons who would have revolted at the idea of stabbing a man to the heart, drugged his potage without scruple. Ladies of gentle birth and manners caught the contagion of murder, until poisoning, under their auspices, became quite fashionable. Some delusions, though notorious to all the world, have subsisted for ages, flourishing as widely among civilised and polished nations as among the early barbarians with whom they originated,—that of duelling, for instance, and the belief in omens and divination of the future, which seem to defy the progress of knowledge to eradicate them entirely from the popular mind. Money, again, has often been a cause of the delusion of multitudes. Sober nations have all at once become desperate gamblers, and risked almost their existence upon the turn of a piece of paper. To trace the history of the most prominent of these delusions is the object of the present pages. Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one...

Popular delusions began so early, spread so widely, and have lasted so long, that instead of two or three volumes, fifty would scarcely suffice to detail their history. The present may be considered more of a miscellany of delusions than a history—a chapter only in the great and awful book of human folly which yet remains to be written, and which Porson once jestingly said he would write in five hundred volumes! Interspersed are sketches of some lighter matters,—amusing instances of the imitativeness and wrongheadedness of the people rather than examples of folly and delusion.

—from the Preface of *Extraordinary Popular Delusions and the Madness of Crowds*, 1852 edition, by Charles Mackay.

bulbs increased and their prices fell. The rise and fall were factually-based. Likewise, the Mississippi and South Sea "bubbles" had a factual basis. In both cases state-licensed trading firms obtained special favors and subsidies that initially attracted investors eager for "easy" monopoly gains. Profits were recorded at first, but as with most state-sponsored enterprises, the lack of sound commercial prospects ultimately brought losses.[6] Again, the stocks of the favored firms rose and fell for good reason, which is not to suggest that state favoritism is rational. Neither is inflation, punitive taxation or regulation "rational"—but investors do assess their impact quite rationally.

The case for a "bubble" in Internet stocks seems justified, to some, because many of the new firms have yet to record profits. But stock prices set today reflect profit rates expected in the future, not profits from the past or present. And in any new, fast-growing industry—like automobiles at the start of this century—vast start-up costs necessarily preclude current profitability. Investors wisely incorporate this fact of business in estimating and pricing future profits. Since the returns of start-up firms are less-certain and projected farther into the future than those of established firms, their stock valuations will fluctuate more and will be more sensitive to fluctuating interest rates. But the rational basis for valuation remains. Even in the absence of current profits investors can assess the sales growth, gross profit margins (before development costs) and management talent of start-ups.

Like the Tooth Fairy, a belief in "bubbles" has a long tradition—and just as little empirical verification. What about the economic theory advanced in favor of bubbles? None exists. Few economists can even provide a comprehensible definition of a "bubble," let alone a theory of how they originate, become sustained or burst. An entry for "bubbles" appears in the leading reference book for economic concepts and theories.[7] But the entry offers only fuzzy

[6] For an examination of the "bubble" tales of yore which treats the empirical record dispassionately and casts strong doubt upon their very existence, see Eugene N. White (ed), *Crashes and Panics: Lessons from History* (Homewood, Ill: Business One Irwin, 1990).

[7] "Bubbles," Charles Kindleberger, in *The New Palgrave: A Dictionary of Economics* (1987, Volume One, pp. 281-2).

In Today's World, Who's Nuts?

For many years, we have observed that in a financial world absent sound money and credit, there is no such thing as a "safe investment." Today, all the world's official "money" consists of fiat currency. All of the world's governments to some degree regulate credit for political purposes. All of the world's governments manipulate contract law and, in the Western democracies, increasingly curb property rights via administrative fiat. In Third World countries, even these procedural niceties are foregone—and privileges granted at the whim of the regime of the day. Except where statist excesses have yielded to kleptocratic anarchy (and so rendered the tax authorities impotent), most of the world's governments now collect more tax tribute from their subjects than ever before.

Without exception, no government in history has honored its obligations over the long term. Rather, the chronicle of sovereign abuse of its financial powers is unrivalled in the "private sector." From monetary inflating, capital restraints and defaults to outright confiscation of assets and negation of their contractual obligations, governments have wielded vast powers for financial ill that even the most corrupt financial entrepreneurs must envy.

The pertinent question would seem: given such a record, is it not long-term common sense to take one's chances with investments in the private sector that over time always have provided (sometimes infinitely) greater returns than those provided by "safe" government promises—even if those investments sometimes suffer marked reversals? And is it not even more so given that those same unreliable governments may from time to time (as in the current situation) offer strong incentives for deploying assets over an extended period in a particular way—say, in ways that returns on investment will be taxed least?

Although today's stock markets are not necessarily volatile by historical standards, they could plunge at any time. But the experience of recent years so far has shown that—undoubtedly for a variety of reasons—most of the "little guys" in the market are there for the long haul. That a significant portion of today's funds flowing into the market represents scheduled investing according to an IRA, 401k, or other sheltered retirement plan is the antithesis of the stock market "mania" attributed to market bubbles. Given their dismal record, it is governments the world over whose financial behavior would appear most deluded and prone to "mania"—indeed, from a common sense perspective, genuinely nutty.

claims and obscure citations before concluding that "at the time of this writing, the theoretical literature has yet to converge on an agreed definition of bubbles, and on whether they are possible." According to MIT's Paul Samuelson, whose textbook, *Economics*, has influenced millions of students since 1948, today's U.S. market is an "incipient bubble," implying some scientific theory of "bubbles." But, he adds, "economists have no theory of how long a bubble will last." That's unavoidable, of course, if they have no theory of bubbles *to begin with*. Samuelson, who dismisses such fundamental facts as earnings, inflation, interest rates or economic growth rates, insists that "any prosperity in a speculative market is lent by the Fates and may have a string on it and may be taken away."[8] Legions of Samuelson students—at investment firms, financial media and the Fed—believe as much—which is why bubble-ists invoke emotional or mystical notions to sustain their belief.

Samuelson's textbook popularized the views of John Maynard Keynes, this century's most influential economist. Keynes insisted that investors rarely focus on facts or use reason.[9] They are ruled by "whim or sentiment or chance" and suffer spontaneous and irrational mood swings due to "animal spirits." They rely on others' subjective opinions, hence the "greater fool" theory of stock pricing. "If the animal spirits are dimmed," Keynes wrote, "and the spontaneous optimism falters...enterprise will fade and die—though fears of loss may have a basis no more reasonable than hopes of profit had before." Markets are "arbitrary" and valuations, "established as the outcome of the mass psychology of a large number of ignorant individuals" are "liable to change violently as a result of a sudden fluctuation of opinion." Keynes opposed liquid securities markets *per se*. "Of all the maxims of orthodox finance," he wrote, "none is more anti-social than the fetish of liquidity." He denounced securities markets because they separated owners and managers. This "adds greatly to the instability of the system," he claimed. Such markets should be abolished: "The spectacle of modern investment markets has sometimes moved me toward the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only....The only radical cure for the crises of confidence...would be to allow the individual no choice between consuming his income" and investing it. His "solution" was to have the state regulate investment or else become the sole investor.

This view of markets as driven by an animalistic "herd mentality" or by "fools" of varying degrees is a mere superficial cover for ignorance about how markets actually work. In the 1930s capital effectively went on strike, due to an onslaught of anti-market state interventions. Statist economists have been unwilling to admit this and thus they blame the victims instead of the perpetrators for such onslaughts. Such precepts survive today in "behavioral finance" studies. Behaviorist psychology equates human nature and conduct with that of mindless rats. Behavioral finance extends similar premises to markets.

It is rarely mentioned, but true nonetheless, that if an investor could draw upon some sound theory of "bubbles" based on facts he could make a fortune. Knowing how "bubbles" form, what sustains them and how they "pop," he could easily *short* the market and make a windfall, by borrowing stocks and selling them at today's high prices, committing to return them at much lower prices. He could become rich *instantly*, for when stocks drop 50% they drop quickly, unlike the slow, steady ascents of a like percentage. So why don't bubble-ists put their money where their theory is? Because they have no confidence in their theory. Why? Because *they have no theory*—at least none based on facts and logic.

Evidence for market "bubbles" is scant, if not wholly non-existent. Markets do crash and seem to "pop" on occasion. But the reason they crash is that government officials and the economists who advise them tend to presume "market failure" and in aiming to "fix" markets, only break them. Most "market failure" economists derided the pro-market, supply-side theories advanced by President Reagan's advisors as "voodoo economics." But the "market failure" economists and officials who take their advice are the real practitioners of "voodoo." In misidentifying the actual workings of the market, they treat it like a voodoo doll, feeling justified in repeatedly sticking it with pins to elicit the preferred results. But the market is no doll—it's a living, breathing system that responds badly to the pin-pricking policies of currency devaluation, inflation, interest rate hikes, tax and tariff burdens and regulation.

Few claims in economics or finance are at once so widely and casually deployed—and yet so poorly documented—as are "bubbles." That's why bubble-talk usually degenerates into vague formulations, sensationalist stories and apocalyptic warnings. The only "air" one finds in bubble discourse seems to emanate, not from market activity, but from the air pockets in logic and rhetorical hot air of bubble-ists.

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[8] Quoted in *The Wall Street Journal*, March 30, 1999, p. C15.
[9] John Maynard Keyens, The *General Theory of Employment, Interest and Money* (Harcourt Brace: 1936), pp. 150-163.

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