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Oil, Housing and Health Care

By William Short

There is a little dark secret that is sitting in the background behind the falling dollar and its inflationary consequences.

When the dollar falls against other currencies, it literally costs more dollars to purchase goods from other countries. That means that if you are looking to buy a BMW, for example, it will cost more dollars if the dollar falls against the euro and it will cost less if the dollar rises. The same is true of all foreign goods, including oil.

Why is the dollar falling? A very big reason for this is the housing credit crunch that we are currently going through. The Federal Reserve's response to this is an effort to prevent a 'financial meltdown' by lowering interest rates and increasing the amount of dollars in the system.

The problem with this approach is twofold. First, the Fed's manipulation of interest rates is the source of flawed market signals in the first place. Lowering them further will only result in additional loans to those who could not afford them under normal circumstances, and therefore potentially more defaults. On top of that, more dollars always equals higher inflation.

A huge part of the credit crisis in this country is because of the incentives created by exactly such tinkering with the market. The individuals that were issuing the loans had very little incentive, if any, to ensure that the borrowers were actually credit worthy. Instead, they had the incentive to 'churn and burn' as many loans as possible. The buyers of these loans were eager to get as many loans as possible because a large pooled loan market existed. Once the markets stopped buying these 'sub-prime' loans and the originator of the loans started closing shop, however, a situation developed where a lot of credit was issued on assets that were not retaining their value on the open market. A credit crisis, in other words.

As is too often the case, the government's response to a crisis created by market intervention is more intervention. Instead of letting the markets run the Fed has stepped in and lowered rates in order to 'soften the blow' of the imploding housing market it fostered. If the market's attempts to rectify previous errors is prevented from following its course, then the problem will only grow worse. In the case of the Fed's response to the housing crisis, the supposed "solution" will further hamper growth and productivity across the market.

Health care is another example of where the government's efforts to give us something for nothing will only backfire. As in the housing market, if the incentives in the health care industry are not aligned toward what market signals indicate, the results will be catastrophic. In the case of universal coverage, for instance, the perverse side effect will likely be that while coverage may exist for all, it will be at the expense of both the quality of and access to care. Just as the market could not support individuals that made \$80,000 a year purchasing a million dollar home, the market will not be able to support free health care for all.

In a free society choices need to be directed by the choices made by the individual and with those choices consequences must be allowed to run their course. The role of government should be to protect the integrity of the markets while never deciding the outcome.

The housing crunch should serve as a sobering reminder of what we may yet see in the health care sector should plans for universal coverage move forward. The American Dream may be everyone owning their own home, but the American nightmare could easily be foreclosures and long lines for needed care.

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