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Efficient Market Solution to the Economic Crisis

Hugh Carter Donahue, Ph.D. investigates a way out of the current financial climate

Two innovative information solutions are now in hand to reconstruct efficient markets: 1. a data repository, enabling disclosure and reporting to aggregate and clarify financial instruments, loans, mortgages, lines of credit, insurance, reinsurance and securitized risks and structured products, and 2. a transaction platform providing economic and strategic incentives rewarding disclosure.

Their consequential and transformative clarity will enable institutions, investors and citizens to recreate efficient markets. No matter how many times a risk, like a mortgage for example, has been sold and resold in secondary markets, the data repository and transaction platform enable efficient risk transfers which will support economic recovery.

Extensive broadband networks, robust, real-time data processing, falling storage costs, Internet ubiquity reaching to portable hand held devices and the potential efficiencies and cost savings of secure lockers in Internet clouds, constitute the information keys enabling institutions, investors and citizens to access and use the data repository and transaction platform.

The insurance industry is ahead of Wall Street, employing the data repository and transaction platform to stimulate efficient markets. This fall, building on innovations pioneered by intellectual property firm Marketcore, property agents and brokers will use a web based exchange enabling agents to submit applications and to evaluate availability, price and coverage of competing insurance products. The system will cut administrative costs for agents and enable brokers to reach multiple carriers with single data submissions. Insurance carriers will find it easier and cheaper to differentiate products. Customers will net cost savings thanks to more competitive comparisons. These are all attributes of efficient markets.

Systemic data repository and transaction platform adoption is crucial to prosperity. The 2008 Asset Bubble implosion, a $55 trillion "unrestrained book making paradise" in the words of one analyst, still hobbles. One in four hundred homes is in foreclosure according to RealtyTrac. Other experts caution of as many as 25 million home foreclosures by 2011. At the point in time when the U.S. concludes Iraq combat, Iraq tallies $5-12B/month; Afghanistan $5.5B/month, approximately $960,000,000,000 to more than $1,000,000,000,000 with goodly portions awarded to preferred vendors as no bid contracts. Boomers are switching to bonds from mutual funds at an historically high rate, $33B so far this year, placing wealth in debt instruments rather than stocks. Bush tax cuts have backfired. The wealthiest one percent of the population, those with incomes over $340,000/year received 40% of the Bush tax cut benefits. These wealthy Americans are not investing or, to the extent that they are, their investments are not stimulating aggregate demand. The US economy's gasping for investment and employment.

Unfortunately, presidential and central bank initiatives are not yet nor seem robust enough to stimulate aggregate demand and spur national income. President Barack Obama's stimulus is accomplishing all it was designed to do but is now pilloried for not spring boarding the economy to prosperity and is getting another iteration. The Federal Reserve Bank has kept short term interest rates close to zero for two years and it may buy additional government debt. The Fed has already purchased and holds $1 trillion plus home mortgages. Economist Alan Blinder recommends that the Fed cut interest rates on bank reserves to free up $1 trillion for investment.

For all the promise of corrective regulation, Financial Reform Act loopholes diluting Volcker Plan stipulations still enable large banks to behave pretty much as they did during the Asset Bubble, say by executing client oriented trades pretty much as proprietary bets, among other ambits, and intermediary disclosure responsibilities remain maddeningly vague.

Given the powers of the financial services and military industrial sectors, a legitimate question arises as to what institutions, investors and citizens can reasonably do to reclaim their rightful places in the American economy. Innovations like the data repository and transaction platform remain the time tried solution.

Observing the transforming impacts of railroads and telegraphy on commerce and society in the 1840s, Ralph Waldo Emerson wrote "invention breeds invention. No sooner is the electric telegraph devised than gutta-percha, the very material it requires, is found. The aeronaut is provided with gun-cotton, the very fuel he wants for his balloon. When commerce is vastly enlarged, California and Australia expose the gold it needs. When Europe is over-populated, America and Australia crave to be peopled; and so throughout, every chance is timed, as if Nature, who made the lock, knew where to find the key."

Too many people and too much wealth are being held hostage to remedial solutions, which still insulate a self-interested handful, who prosper by perpetuating inefficient markets premised on information asymmetry. Efficient markets, enabled by innovative information keys like the data repository and transaction platform providing granular, real time monitoring, data analysis and risk metrics, constitute the most viable pathways to stimulate sustainable investment, reanimate aggregate demand and reinvigorate national income.

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All parties will have access to the same information in the data repository and transaction platform solution in near real time. Who do you think will be early adopters?	As usual, those responsible for their own money and those taking care of assets under their management and rewarded for their net results. In other words, players who are mostly interested in cutting out an inefficient or an expensive intermediary.	The biggest roadblock is that bankers essentially make money by exploiting tiny inefficiencies in markets due to asymmetric access to information, so it will not be easy to convince them to put transactional data into a global repository.	The adoption process would clearly depend on the cost factor. Most likely it will end up being prohibitively expensive and thereby used by the biggest players who will yet again gain some serious advantage.
Is there too much profit in the existing system to allow a more robust and more efficient system to be implemented with available communications technologies?	Nobody wishes to be arbitraged by the new market dynamics out of their traditionally protected sources of revenue. But technological progress, supported by the opportunistic providers, is seemingly unstoppable.	In a purely efficient market everyone has access to all information at all times, so in theory every player in the market should end up doing no better than tracking the average returns in each market segment.	We are all striving to become faster and better but some market participants or industry heavy-weights will certainly try to slow down any new system unless they are primary beneficiaries. It's a dog-eat-dog world and there are no free lunches.
Why is real time lending standard and loan performance information so useful in clarifying systemic risk?	It allows one to take a good picture of the economic environment and to guide one's risk management and one's micro investment decisions by the macro real time awareness.	Central banks need real time information on loans as well as derived assets that banks are carrying in order to monitor correlations and thereby keep track of the systemic risk.	Real time information on any subject is useful and allows investors to reduce risk exposure. RT information also makes the decision-making process more efficient.
Why is rewarding disclosure with an incentive for strategic or market information so necessary at this point in time?	The industry is driven by selling and trust is often a missing ingredient in our daily activities. Knowledge gives a chance to defend, it re-introduces fairness and drives the democratization of the market.	If the database shows systemic risk rising beyond the acceptable level, central bankers can call in the bankers and thus take corrective measures.	Transparency is the word on many investors' lips. Too many billions were lost to fraudulent schemes so the market needs disclosure but the best reward is investors confidence, no additional incentive needed.