

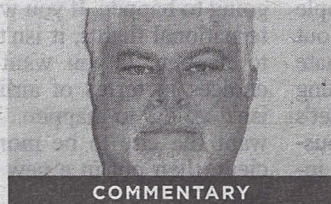
COMMENTARY | Uncertainty, artificial rates take a toll

WHY THE U.S. ECONOMY IS STUCK IN NEUTRAL

Money is a medium of exchange that is also a storehouse of economic value. Fiat money is money declared to have value by government fiat (edict). Its value changes primarily because of governmental manipulation of the money supply and, with it, interest rates.

In an arms-length economic transaction, all parties should feel they have improved their economic position through the exchange. Money provides a medium to make economic exchanges simpler, faster and more precise than bartering. There is one huge caveat, how-

CALLOM B. JONES



COMMENTARY

ever: If all participants in an exchange do not know the real value of the money at the time of the exchange, one or more participants may not achieve the improvement in their economic condition that they thought.

Friedrich Hayek won the Nobel

Prize in economics by fleshing out the Austrian theory of the trade (business) cycle. The trade cycle is a repeating cycle whereby a capitalistic economy undergoes a period of expansion (boom) that eventually changes to a period of contraction (bust, depression, recession).

When a government or a central bank artificially drops the interest rates it controls below the natural rates of interest, the math involved in making business decisions is distorted, causing some uneconomic projects to be undertaken. Eventually such projects must

fail, since they only appear economic.

The economy expands because both economic and some uneconomic projects are undertaken, expanding the use of capital and, usually, jobs. Eventually, some of the capital deployed and the jobs generated are lost as uneconomic projects fail. The longer the market rates of interest are below the natural rates of interest, the more uneconomic projects are undertaken.

Eventually, the economy reaches a "tipping point," where the failure rate of uneconomic projects is no longer mitigated by money supply or interest rate manipulation. This is the contraction phase, also known as depression, recession (a word the government invented after World War II) and bust.

The contraction phase is actually where an economy gets healthy. Like having a cold, you get sicker until you begin manifesting symptoms. Those symptoms are your body's immune

and defense mechanisms curing you. The recession is the phase under which the disease is cured.

Hayek's theory discusses the distortion of the economy because of an artificially low cost of money. What about the capital lost from losses incurred by participants (especially producers) from mispricing products and services because of a decline in the value of the currency involved in the transactions?

Making a profit is difficult enough in a fair and relatively unchanging economy. Imagine complicating pricing and profitability calculations with an unnoticed change in currency value and with a market rate of interest that is dramatically below the natural rate of interest. Do you think it might be daunting to try to calculate a competitive price that allows your business to make enough profits to survive, let alone

SEE RATES | C11

RATES: Artificially low interest isn't helping

FROM C10

thrive or expand, creating jobs? What about introducing unquantifiable costs from legal and regulatory changes? Health care? Taxes? New regulatory costs?

Is it surprising in such an unfriendly environment that people and companies will hoard cash, spend less and not hire or start new projects? Isn't it responsible to "stand pat" until you can see a path to survival, let alone profitability? The government's steps to encourage business expansion are far outweighed by the additional difficulties and uncertainties they've made businesses deal with currently.

When governments screw up, they collect more taxes to make up the loss and businesses go under. Remember that as you listen to politicians criticize our businesses, not realizing their policies are part of the problem, not the solution.

Callom B. Jones V holds personal financial specialist certification and owns Trend Capital Management LLC, a registered investment adviser in Overland Park. A longer version of this article appears as the October newsletter at www.trendcapitalmgmt.com.