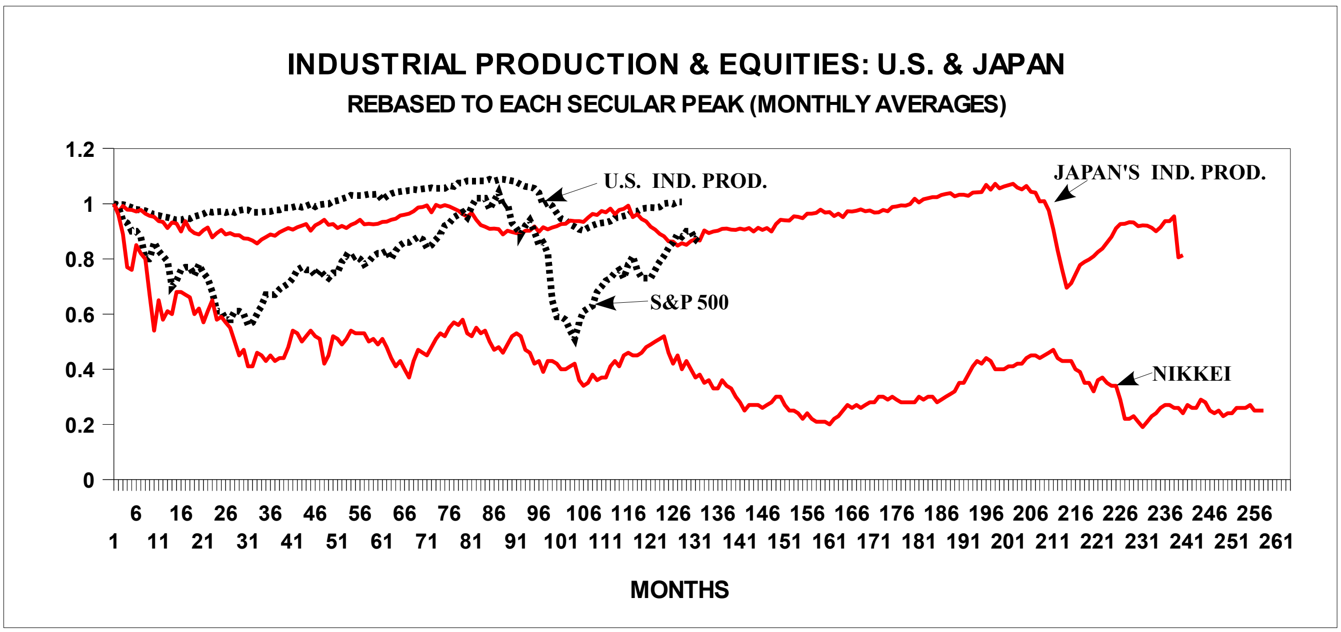
BUSINESS CYCLE DEVELOPMENTS

Politically connected groups have avoided going to the Schumpeterian woodshed. Such public policy-errors enables weak industries and sectors, explains the slow U.S. economic growth and socializes these errors.

Joseph Schumpeter, the Austrian-American economist, believed "creative destruction" is progress, but politically influential industries, their creditors and unions lobbied for bailouts, which prevented prices from falling and clearing out the mal-investment and bloated wages. Likewise, in 1990, Japan tucked its overpriced real estate in their banks (read bailout) and they've seen 20 years of no growth.

In contrast to these enabling policies, in the early 1990's, the Resolution Trust Company erected an auction block in the southwest and let market prices prevail to liquidate the 1980's oil speculation in Texas banks, which were not politically wired! The southwest boomed after the write-off. The recent sub-prime speculation was big and not geographically contained like the southwest and the losers lobbied, so the U.S. is on the same "tuck-it-away" footpath as Japan - see below. So, we're now faced with slow, yo-yoing growth like Japan and the U.S. equity markets are mirroring this fluctuating, as the Nikkei does – see below.



Assets that were marked up, due to lax credit standards, need to be marked down to current conforming financial criteria. Diverting more resources to failing sectors, like foreclosure containment programs, only postpones and deepens the problems. Propping up the redundant auto capacity sends market miscues about the Fed's 'output gap' because, in reality, there's too much excess capacity generating poor returns on investment, which is seen in the sideways trend of output or production. Why should corporations add to production when inventory turns are slower due to spending retrenchment, deleveraging, increased savings and realistic credit standards. Lower prices for these marginal assets and lower wages are the only quick resolution, but politically connected groups have delayed a prompt solution. This has dragged-out the asset liquidation, the need for a corresponding downward wage adjustment and ultimately socialized the mal-investment.

By avoiding the painful bank debt restructuring and by the Fed managing yields lower to reinvigorate the banks, leaves savers without sufficient yields and the population facing rising import prices (falling dollar), which spreads the problem around, or socializes it. Schumpeter was right.

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