y demand specialized skills from their Czech employees," she summarized, adding hat "they greatly speed-up technology ransfer to the Czech Republic and bring modern know-how."

Rudyšarová referred to research conducted by the **Economist Intelligence Unit**. "One of the latest such research tudies [by the unit] anticipates that the Czech Republic will stay atop the Visegrad Four countries with an average foreign diect investment (FDI) worth $528 per apita until 2011," she said.

From 1993 to 2007, CzechInvest mediated around Kč 50.58 billion worth of inestments from the U.S. In 2007, it mediated 22 projects worth around Kč 7.15 billion. This compares with 20 projects worth pproximately Kč 4.22 billion in 2005.

"Estimating the outcomes of the current conomic situation in U.S. is quite a complicated task," Rudyšarová added. "If the conomy is to slow down, the impact on the Czech Republic would be the same as in any ther developed country in the world." Still, he noted that the Czech Republic is in a much more consistent position to retain its tatus as an ideal place for investment. "The act is that the Czech Republic is a stable ountry both economically and politically nd could thus offer a secure harbor for inestors." ■

Analysis

What is **wrong** with the U.S. economy?

As bubbles develop and burst—and greedy speculators make money at the expense of taxpayers—American homes, the Internet and tulips remain as real as ever.

BY MILAN ZELENÝ

Former U.S. President Ronald Reagan, when facing the collapsing stock markets, insisted that "there is nothing wrong with the economy." Today's "crisis" is the crisis of the financial sector only. There are, in fact, two economies: The real economy of products and services, based on market transactions of goods and payments for goods, and the virtual, or symbolic, economy of money and financial instruments, which is based on betting on future price movements and gambling with one's own or with other people's money.

The "second economy" is not necessarily based on real flows of goods and services; its main product is money. It produces money directly, mainly through speculation, betting and gambling, without the interference of real products or services. Clearly, there is always something wrong with this second economy.

In order to understand both the economy and economics, one should not confuse the two economies. The difference can be explained as this:

When you make money through goods and services, you leave a footprint in the economy: a useful product or a valuable service—some real utility can be consumed; new knowledge is acquired and lodged in the organizational memory of the economy. We can say that money has been earned.

When you make money through betting on, say, higher interest rates or exchange rates in the future, there is no lasting or visible footprint in the economy—no goods, no services, no knowledge. Money simply moves from one pocket to another with no real trace left. The money is simply being made, as if by magic.

There is, therefore, a large difference between earning and making money. There is nothing wrong with earning money, but the money making is periodically problematic. When I steal or win your money (transfer it from your pocket to my pocket), there is no positive benefit left in the economy. When I earn your money by selling y real goods or services, there is a positive a cumulation of utility and knowledge. So f so good.

Real and virtual economies: the disconnect

The two economies, although fundamenta different and relatively autonomous, do i fluence one another. New products and ser ices generate new capital flows; real eco omy drives the financial economy. New nancial flows allow and stimulate ne production and services, and so it goes. T trouble starts when the second economy symbols does not interact with the first eco omy of real goods and tries to make mo ey through speculation, betting and irr tional risk taking.

Because of the rapid globalization of ca ital markets, lightning-speed communic tion networks, Internet and computer-a tomated financial instruments, it is now i creasingly possible to make money witho earning it. The speed is available, the or thing one needs is a lot of money to pl with. And boy, do they play.

The eternally adolescent generatio nurtured on gaming and gambling, blis fully uninformed and unaware of re things, is perfectly suited for this new ca no in the sky. Huge amounts of money a being made by investing even larg amounts of money for a few minutes hours and running it several times arou world in one day. No real goods or serv es will or can change hands within su short fractions of time.

The symbolic virtual economy has ther fore become significantly autonomou freed from the real economy. One c speculate in oil, pork bellies, mortgages gold without ever being interested in su products, without affecting their mov ments or transfers. For global speculato the real nature of such commodities or pro ucts is mostly irrelevant.

So, lowering the interest rates will si ply drive down the dollar, increase inflati and make more money available for speculation. Similarly, U.S. President George W. Bush's policy of giving cash to people—$300 (Kč 4,882/ €190.8) to $1,200 rebates per household in June 2008—will not help the economy but will end up in low-interest accounts or high-interest credit-card debt repayment, with no real effect on the real economy.

Other people's money

How can one make money on mere fractions of percent changes in prices over short periods of time? One needs a lot of money—that is, other people's money.

A businessman or entrepreneur works with his own money or with his own debt. Banks, investment houses, hedge funds and similar institutions are specifically designed to work with other people's money. In the global communication environment even a single trader can make or lose billions overnight—given that he has enough other people's money at his disposal.

How does he get enough other people's money? Easy. When the interest rates are high, people will deposit their savings in banks. When the interest rates are low, investment bankers will borrow that money cheaply and start "investing"—not into the real economy but into speculation and betting within the symbolic economy. Take the prices of oil: although there is enough supply and the demand has been actually falling, huge amounts of money are being bet on the rising prices. The **New York Mercantile Exchange** (NYMEX) has installed 24-hour trading of crude oil. In other words, it has created new vehicles for betting on the price of oil. One can purchase huge amounts of oil (actually just short-term titles for oil) without ever wanting it, seeing it or making it move. As the price increases, one sells the next day, pockets the profits, and bets on the next round of price increases. Huge profits are being made, while the oil tankers never leave the harbor. In such an economy even real commodities become just betting chips.

Government interference

The problem is that more and more speculative money is moving in, more and more greed is driving the cycles and less and less knowledge and understanding of the real economy is involved. I have been teaching Wall Street MBAs in New York City for 40 years: their knowledge of the real economy is getting close to zero. They do learn how to make money on price differentials—but most have never earned a dime on innovating real products or services. Little knowledge and understanding is guiding their judgment, their investments are poor, their risks exuberant. They create investment bubbles and crises, pocket their profits and let the bubbles burst. It is other people's money, after all.

The best way to create a bubble is by making a lot of money available cheaply; in other words, by driving down the cost of borrowing, the interest rates. Cheap money is pouring into the economy very fast, bad money is chasing bad projects, real economy cannot respond with quality products and services and business models are getting fast and flimsy. Ultimately, the speculative bubble bursts. Huge amounts of money have been made, but always somebody else must pay for it, somebody else must lose that money. It goes from one pocket into another with no real products in between.

ČTK

Alan Greenspan *created many bubbles.*

It's the "other people"—the unwise buyers and innocent taxpayers, the pawns in the game of casino in the sky—who pay for this irrational exuberance of playing with other people's money. The government bails out financial institutions in order to avoid investors' panic and runs on the deposits. In the case of banks, it has to do so because of the deposit insurance; in the case of investment houses it has to do so, too, albeit indirectly, because of the need to shore up confidence and stabilize the financial economy. Either way, it is the taxpayers who ultimately pay for all those bad judgments, foolish decisions and unencumbered greed. Yet, there is nothing wrong with the (real) economy. Ronald Reagan was right.

Two economics: micro and macro

Take the recent collapse of the Wall Street giant investment house **Bear, Stearns & Co.** Completely foolish and incompetent decision making led to the fall of its stock price from $178 to mere $2 per share, later updated to $10 a share. You can only imagine what kind of capital wealth has been lost. But calm down, you could not buy Bear Stearns for $2 a share; it had to be done very fast, on March 16, a Sunday night, before the Chinese stock exchanges opened. The government stepped in, reduced the cost of borrowing and provided money and approved the deal for **JPMorgan Chase** to purchase Bear Stearns overnight. The markets have calmed down and resumed their usual speculative investing—and the taxpayers paid their hard-earned money for the whole deal. But no need to worry, **Lehman Brothers Holdings** and the **Goldman Sachs Group** are still waiting in the wings, as are all the other investment houses packed to the roof with highly educated economic geniuses.

That brings us to the so-called science of economics. There are two basic branches of economics: macro and micro.

Microeconomics (also the "price theory" or "theory of the firm") is concerned with the production of wealth through products and services at the firm level. It is the study of judgment and public choice, decision making, product supply and demand, price formation, productivity, competitiveness, organization, public economics, institutional economics, political sciences and so on.

Macroeconomics has evolved as a study of the aggregates at the national economy level. It deals with the governmental intervention, fine-tuning and redistribution of wealth created by others (mostly the business sector) because the government does not create any wealth by itself. Macroeconomics is the study of money, debt and interest rates as well as national economy aggregates and statistics.

So, microeconomists talk about production, innovation, decision making, firm supply and demand, etc., while macroeconomists talk about central banks, taxation, interest rates, amounts of money in circulation, exchange rates, employment and governmental policies. Under ideal conditions, the two meet and complement one another, harnessing their synergy toward national well-being as well as wealth creation and redistribution.

Under not-so-ideal conditions, the government and macroeconomics dominate and interfere with the creation of wealth through taxing it, squandering it on political projects, fiddling endlessly with the interest rates, bailing out failed banks and financial institutions and so on. A government is the least competent institution for creating wealth, yet it is the most potent institution for advancing its political goals through intervention and interference with wealth production.

This dominance of macro- over microeconomics is especially noticeable in post-communist economies. Communism was all about aggregates and governmental interference. It controlled everything, from prices and taxes to production schedules and business strategies. This why most currently active economists have been educated as macroeconomists and only very few as microeconomists. In the U.S., the balance is better and there are many effective microeconomists and many Nobel Prize winners. ➤

Mr. Bubble and his legacy

The undisputed "Mr. Bubble" was a Federal Reserve Board chairman, the pure macroeconomist and monetarist Alan Greenspan. He virtually single-handedly, through his monetary policies, created more bubbles than in the song "I'm Forever Blowing Bubbles." His dominance over the economy was undisputed over many decades. Among his crowning so-called achievements one can list the stock market crash of 1987, the savings and loan crisis, the collapse of long term capital management, the tech bubble of 2000, the feared Y2K disaster and the credit bubble and real estate crisis of 2007.

Greenspan's mess provides damning evidence about the Fed chief's public naiveté concerning shifts in the market and economy. Even more disturbing is the fact that Greenspan not only made costly mistakes, but made the same ones over and over again. He never learned from his own mistakes, was never able to recognize or admit to those mistakes, and was quite incapable of learning from the mistakes of others. Instead, he constantly rewrote his own history to justify them.

This fate is typical for macroeconomists: they like to hitch themselves to dogmas, like Keynesianism, monetarism or "free" markets—and never let go. They do not comprehend that economy is not a fixed and predictable machine where you just fiddle a bit with the inputs and get reliable outputs. No, the economy is not a machine; it is a human system, a living organism, continually adapting, adjusting and compensating within its environment.

To use a simple metaphor: the economy is like a dog—you kick it once and it licks your feet and stares at you with devotion. You kick it second time, and it runs into the corner, howling. You kick it the third time and it tears your throat out. As my mentor, economist Oskar Morgenstern, used to say, "You throw a monkey wrench in a machine, and it stops. You throw a monkey wrench in an economy—and it engulfs it." It absorbs it, adapts to it, as a living organism. Studying biology and psychology would be more useful to economists than studying physics, mechanics and descriptive geometry.

Ben Shalom Bernanke, Greenspan's replacement, is pitied in the U.S. as he has quite a task to equal Greenspan's legacy. He has inherited the last bubble, but does not know any better than to fiddle with the interest rates, which have already been lowered six times since the summer of 2007. Down and down they go, submersing the dollar even further, to its very bottom. On the other side, Secretary of the Treasury Henry M. Paulson keeps chanting that a strong dollar is the U.S. policy, without even blinking. Bernanke was the director of the Monetary Economics Program of the National Bureau of Economic Research and the editor of the quaterly *American Economic Review*. He is among the 50 best economists in the world according to the collaborative economics effort IDEAS/RePEc. "Go figure," as we say in the U.S.

There will always be bubbles

Concerning the bubbles, I should perhaps mention what I keep telling my students, continually. There was the famous tulip mania bubble of 1637. The price of tulips was driven up by speculators who did not even like tulips, just their growing prices and fast profits—then the bubble burst and they lost money. But the tulips remained, more beautiful and more abundant than ever. Tulips bring joy and good business to all until this day. There was nothing wrong with the economy.

Then there was the Internet bubble of 2000. Many greedy investors surpassed their knowledge and capabilities and lost their money when the bubble burst. But there was nothing wrong with the Internet or e-business; only the ignorant investors failed. The Internet has grown ever stronger and has become a dominant global force, a new space for doing business and earning money. There was nothing wrong with the economy.

And now there is this mortgage and real estate bubble. Houses were selling like hot cakes; mortgages were cheap; the geniuses of Wall Street, in their eternal greed, extended mortgages to those who have little or no income to rely on ... and the bubble burst. Many fools, investors and consumers have lost money and their houses. But the houses are as solid and reliable as ever before, and the building lots are beautiful, abundant and cheap. There is nothing wrong with the economy.

This old wisdom was known to our ancestors long before all the CMOs (collateralized mortgage obligation), CDOs (collateralized debt obligation), CDSs (collateralized default swap), SIVs (structured investment vehicles) and all that razzle-dazzle of the new field of financial engineering. All these creative technical wonders of eternal adolescents are without real understanding of finance, personal responsibility or long-term impacts on the economy. Even more so, their bosses on Wall Street understood these instruments and vehicles even less, and allowed the cheap money to chase fewer and fewer good deals, financing ever more mediocre fusions and acquisitions that were bound to fail as credit markets dried up.

This was known to our ancestors and can be seen when the virtual and real economies of 1875 are compared. Nothing has changed since those days and nothing ever will. Only a few are capable of learning from the mistakes of others; all the rest can only learn from their own mistakes, over and over again, generation after generation.

Fools will remain fools, monetarists will stay monetarists, macroeconomists will continue to fiddle with the interest rates, forever blowing bubbles and bursting them with adolescent cries of joyful exuberance and more adult tears of despair. The only thing we can all remain sure of is that there will always be tulips, and the Internet, and beautiful houses available in abundance—because there is noting wrong with the economy.

The speculative bubble is as much an error in decision-making and judgment as confusion of the inverse, hindsight bias, or the gambler's fallacy. In fact, hindsight, probability and gambling are integral parts of the speculative bubble. What makes the bubble more complicated, however, is the fact that it is a social phenomenon. Masses of investor-gamblers move in the same direction, follow and copy each other with zest because masses and crowds have no mind of their own, no knowledge and no intelligence. One fool who believes an asset is tremendously undervalued will not cause a bubble, but rather a temporary uptick in prices. It is the group, the crowd, that gives birth to a speculative bubble. The postwar generation of eternal adolescents has no other choice than to follow each other, because they had no time to study economics, but know a lot about simple gambling and gaming.

Improving their judgment and decision-making is very difficult. It requires the individual to break away from the crowd and think logically about history, value and probability. It requires abandoning dogmas and useless mantras about free markets and making money without earning it. That will never happen and the fluctuations of the second economy will grow more and more violent while the movements of the real economy—or the so-called "long-term fundamentals"—will grow gentler and more reliable for those who want to create new products and services to earn their money, for those who control their greed, and use sound judgment, rational decision-making and common sense in managing their affairs.

There is nothing wrong with the economy ... unless government economists keep driving down the interest rates, bury the dollar, ignite inflation, accelerate growth in energy prices, blow speculative bubbles, spur unemployment, bail out bankrupt banks and investment houses—and all but strangle the real economy of goods and services and bury free-market capitalism. ■

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