

A “SUCCESSFUL” PROGRAM?

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In June’s article titled “Consider the Incentive” I commented on the fact that investors need to think about the incentive of any source before believing their comments and recommendations. After all, everyone has an incentive. This month I want to follow up on that topic by reviewing one of many programs our government has espoused as a smashing success – “cash for clunkers.”

The program was designed to encourage owners of older vehicles with lower fuel efficiencies to trade them in for a new, more environmentally friendly one. The spin from the government was that this would benefit both the economy and environment. But was it really as successful as they would lead you to believe? Let’s consider the following points. Of course, these are my personal opinions.

This program encouraged consumers to steal from the future to consume today. Isn’t that what got us to where we are today? Every time this happens the government runs the risk of pushing any real recovery further down the road because while it may look like things are improving would anyone have made these purchases if the government had not been subsidizing them? In my opinion, not likely. So what happens when the money stops flowing?

The program ran the risk of overpaying for vehicles. The program provided cash rebates of between \$3,500 and \$4,500 towards the purchase of new vehicles for an old vehicle. But what if the old vehicle would only get \$2,000 in trade-in value under normal circumstances?

The program was funded with debt. The government is running the largest deficits in history. In attempting to “stimulate” the economy by spending money it doesn’t have, the real result is a long-term increase in debt service to us, the taxpayers. The more money borrowed the higher the annual interest payments in dollar terms. That means taxes may have to be raised if economic activity does not return to “normal” levels in a sustained manner. Higher taxes could stifle growth.

Finally, the program allowed for gaming by select people. Consider the following example that was shared with me the other week. A gentleman went to a dealership and traded in an old vehicle that qualified for the \$4,500 rebate (and the vehicle was not worth \$4,500). He purchased a new vehicle and paid \$10,000 cash for the difference. In conversation with the salesperson he shared that he intended to resell the vehicle and keep any difference. So if the vehicle retailed for \$14,500 and he paid \$10,000 cash, he could sell the vehicle back to the market for any amount over \$10,000 and make a profit. But here’s the best part – the dealership said they would buy it back from him for \$12,000 – on another day. This gives the new buyer up to a 20% profit, partly funded with taxpayer dollars. The dealership gets paid on the original sale and can then *resell* the vehicle to someone else for more than \$12,000 as a used automobile to profit a second time.

When investors read about the “success” of these programs it is my opinion they should take it with a grain of salt. There have always been unintended consequences that result from Government involvement with the free markets throughout history, and the current programs will most likely provide no exception. I understand the next program on deck is “cash for appliances.” I believe it too will probably be a “success.”

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