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# BANKNOTES

NELSON NASH MONTHLY NEWSLETTER

## Interest-Only Loans

By L. Carlos Lara

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The *World Population Clock*<sup>1</sup> is currently registering 7.6 billion people on the planet. Among those 7.6 billion people, *Forbes*<sup>2</sup> has identified only 2,208 individuals who are billionaires from 72 different countries. Based on this information our chances of ever becoming a billionaire are pretty slim — somewhere around 0.00002%.

What's more, the United States ranks third in the world, next to China and India, as the most populated country on earth and in 2018 registered 540 billionaires on its own home turf, again according to *Forbes*. One point of relevant curiosity is that our President, Donald Trump, is listed as number 69 on that list and is probably one of the most closely watched billionaires in the world. But then again, all billionaires are always under scrutiny. Their big incomes, wealth, and lifestyles are tremendously alluring to most of us.

Also relevant to this article is this perspective. According to the Tax Policy Center “roughly 80 percent (*of revenue for the federal government*) comes from the individual income tax and the payroll taxes that fund the social insurance programs. Another 9 percent comes from the corporate income tax, and the rest is from a mix of sources.”<sup>3</sup> All total the government took in \$3.3 trillion in taxes in 2016, with data such as this always running a few years behind.

Although big incomes don't always correlate to wealth in terms of balance sheet assets, the Internal Revenue Service's *Statistics of Income*<sup>4</sup> report, like the *Forbes 400 List*, is also always of special interest. In their latest issue that was just released to the public, the IRS has once again disclosed the incomes and tax shares of the 0.001%.

This elite group of individuals had always been left undisclosed from these public records until 2015. I remember when they first came out with this report based on 2012 data. They were fascinating to study.

I did a presentation on this IRS report in a St. Louis seminar in November 2015 that was captured on film and later placed on YouTube here: <https://www.youtube.com/watch?v=XPU1WcL8WMA>

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It's a stimulating thinking exercise that provides a perspective about big incomes and who has them.

This year's (2018) report based on 2015 data was equally intriguing. The top 0.001%, which represented only 1,412 tax returns from the entire 141.2 million returns filed that year, had an *Adjusted Gross Income (AGI)* of at least \$59,380,503. In other words, this is the minimum amount of money you would have to have made to be classified with this group. Their *average* Adjusted Gross Income was \$152,016,289. This gives you a good picture of why these people are indeed unique.

One other point of interest is this. With this much money these particular individuals paid a total of \$51.3 million in income taxes or 3.53% of the \$1.45 trillion in individual income taxes collected that year. Even more impressive was their average tax rate, which was only 23.9 %. Compare that to what your tax rate is and you will agree that the 0.001% actually do seem to receive a lot more tax breaks than the rest of us and these statistics from the IRS's bulletin underscore that fact.

On the other hand, the much publicized "*One Percenters, (1%),*" these are the individuals who are often portrayed as the rich and powerful, actually paid 39.3 % of all income taxes collected that year. Notably there are 1.4 million individuals in that category and the numbers do add up to make that difference. Yet their *minimum* Adjusted Gross Income was, by comparison to the 0.001% group, a mere \$480,930.

By studying this report carefully we can easily see why the top 4% of high-income earners, which includes the 3%, 2%, 1%, 0.01% and the 0.001% pay 56.4%, or more than half of the country's individual income taxes. It's well worth accessing a copy of this 12-page report and studying it. You can access a copy from the references section at the end of this article. It does a great job of spotlighting where money is concentrated in the U.S.

### **Is this why Warren Buffett says he pays less income tax than his secretary?**

We've all heard the story where Buffett has confessed that he pays less income tax than many of his own employees, even his own secretary. But how does he actually accomplish this? Some believe that it is the workings of the "carried interest tax loophole," which allows managers of certain private equity funds to treat the bulk of their earnings as long-term capital gains.<sup>5</sup> But most analysts that study the financial moves of the wealthy assume that, not just Buffett, but most wealthy individuals borrow against their assets to support their lifestyles rather than pay themselves income. "How so," we ask?

Well, let's think about it. Do we doubt for a moment that a billionaire like Buffett could walk into his bank and ask for an *interest-only* loan (with some of his wealth serving as collateral) to pay for his annual personal expenditures of, let's say, one million dollars (\$1,000,000) a year? I don't think so. Not only would the bank rush to give it to him, they would probably only charge him 1% interest or less because Buffett most likely has an enormous amount of money on deposit in their coffers. Let's not forget that banks make money from deposits. But bottom-line the simple reason for this low rate is because it's virtually *zero-risk* for the bank. After all, Buffett has the assets to cover the loan if things should go wrong.

This is why Buffett could walk in to the same bank the following year and request an additional million dollars. There is no question that the bank would give it to him. This would be the case even if Buffett hadn't even paid the principal or interest on the first loan! In fact, is there any doubt on the part of any of us that he could not repeat that same process each year for the next 10 years, if he lives that long? And, why wouldn't he repeat this scenario, after all, that money would come into Buffett's possession income tax free because it's in the form of loans.

After ten years with \$10 million in loans plus all that accumulated interest still due, is the bank worried? The answer is no. He has the assets to easily pay it

all off when ever. If he should die in the process his estate's Executor will write a check for it. He's good for it and that's what we all recognize as *leverage*.

These incredibly flexible loan terms and low interest rates are always available to the ultra rich, but the average Joe—even if he has a steady job, always pays his bills on time, and has an excellent credit score—cannot do this sort of thing.

There are other reasons why the bank would be so accommodating. For example, if it will lead to more business between Mr. Buffet and the bank it will naturally result in enormous term flexibility and an attractive rate. In effect the ratio between the amounts of money on deposit compared to the amount being borrowed actually drives the lending rate. But Buffett, Gates, Bezos and wealthy individuals like this can walk into any bank and practically demand this sort of profitable negotiation because it works for both parties.

### **Why not just spend your own money?**

The reason Buffett wouldn't just spend his own money is because his money is already somewhere else working hard earning much more interest and dividends than the cost of borrowing. It's more profitable to place your investments up for collateral on loans than to tap into those investments.

In addition to this, the analysts say that the wealthy work very diligently at minimizing their tax liability, which is one of the primary reasons they are wealthy. Besides market volatility and inflation, taxes greatly erode wealth, and individuals like Buffett know this. This is why the wealthy, through their high-priced tax advisors, are constantly seeking out tax-advantaged strategies to minimize the tax bite and this maneuver that we have been discussing is certainly one of them.

### **IBC allows you and me to live like the Warren Buffets of the world.**

Fortunately there is a strategy very similar to Buffet's idea that is available to the average household and closely held business. It's called *The Infinite Banking Concept (IBC)*, and if you have never heard of it it's

mostly because it's still one of the best-kept secrets around. Discovered and created by R. Nelson Nash, the entire idea is explained in detail in his book, *Becoming Your Own Banker* written in 2000.

Since Nash is also a student of Austrian economics like Bob and me, we came along later and wrote *How Privatized Banking Really Works* in 2010 because we saw that IBC provided a solution, not only for the individual, but also for the general economy at large. This year (2018) Nelson Nash, David Stearns, Bob and I have teamed up and just released a new book entitled, *The Case for IBC*, which provides even more "how to steps" for getting IBC started in your life. You can obtain a copy at [www.thecaseforibc.com](http://www.thecaseforibc.com) But if you want a complete immersion in IBC you should attend one of our live IBC Seminars for the general public put on by the Nelson Nash Institute and presented by Bob and myself. You can learn more about the IBC Seminar at <https://ibcseminar.com>.

One thing for sure, IBC works best with those that keep a close watch over their incomes and expenditures using their tracking methods as a way to gauge their financial performance. These are individuals that as a rule understand *cash flow* and how to best optimize it in order to save and invest their money. If you already understand the fundamentals of *cash flow management*, then you will certainly understand IBC and be able to see beyond the banking and life insurance terminology associated with it.

For those that are already familiar with IBC and are actually practicing IBC then you have recognized already how IBC literally mimics what Buffett and other wealthy people do. In fact, all of the principles discussed in *An IBC Tax Strategy*, an article that appeared as a three-part series last year in the *LMR* in a real way resembles the Buffett strategy. Besides the tax benefits found within the IBC strategy I specifically mean the following:

1. **Accesses and Control Over Your Money.** If you have cash value in your policy (alternate bank) then you have contractual right to loans whenever you

need them.

**2. Flexibility of Repayment Terms.** Although an outstanding policy loans roll over at interest, you can pay them back on your own schedule, or even not at all if you wish.

**3. Uninterrupted Compounding Of Your Money.** Whatever amount you borrow—that same amount continues to earn money in the form of interest, dividends and equity in your policy for as long as you live and as long as your policy remains in force.

So yes, relatively speaking, IBC allows average people like you and me to live like the Warren Buffett's of the world.

### Conclusion

What this article has attempted to demonstrate is that the multi-millionaires and billionaires of the world are, because of their immense wealth, separated into a class unto themselves. In a way, because of their wealth, they have managed to separate themselves from the everyday fray the average individual has to contend with. In effect, the immensely wealthy have managed to secede from the monetary regime that is imposed on everyone else.

Fortunately there is a way out for us too. We too can secede from our current monetary regime one household and one business at a time. It's called IBC.

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## Why Fractional Reserve Banking Poses a Threat to Market Stability

by Robert P. Murphy

On April 16, 2018 I participated in a debate with George Selgin, hosted by Gene Epstein's Soho Forum. I was arguing in the affirmative for the resolution: "Fractional reserve banking poses a threat to the stability of market economies." The full video is available here (and note that some of my remarks allude to the opening comedy from Dave Smith before the debate). Rather than summarize the live debate, in the present post I'll lay out the position I took and how it was influenced by my study of Joe Salerno's writings on the topic—in particular Chapter 5 of this collection.

### Instability, not Fraud

In order to focus the debate on the issue of economic instability, I purposely avoided all talk of "fraud." Although Block and Davidson (2011) for example think that the ethics of fractional reserve banking (FRB) were key in evaluating the merits of the practice, I thought most people have already made their minds up on this score.

In contrast, even many self-described Austrians do not realize that Ludwig von Mises himself, in his mature writing in *Human Action* (but also throughout his career, as Salerno documents in the chapter I linked above), quite explicitly declares:

The notion of "normal" credit expansion is absurd. Issuance of additional fiduciary media, no matter what its quantity may be, always sets in motion those changes in the price structure the description of which is the task of the theory of the trade cycle. Of course, if the additional amount issued is not large, neither are the inevitable effects of the expansion. [Mises 1949, fn 17, p. 439]

Thus we see that for Mises, what we now call the "Austrian theory of the business cycle" (and which he originally developed as the "circulation credit theory of the trade cycle") was *not* a theory of how central banks cause unsustainable booms. Rather,

it was a theory of how *commercial banks* cause unsustainable booms through the issuance of fiduciary media, i.e. claims to money that are not backed by the banks' holdings of actual money in the vaults.

### Money Substitutes

This is the critical issue, and there is nothing mysterious about it. In his 1912 book *The Theory of Money and Credit*—which Guido Hülsmann says would have been better translated as *The Theory of Money and Fiduciary Media*, see pp. 32-34 here—Mises develops the notion of a “money substitute.” This is a claim on (base) money that is immediately payable at par, and about which the community has no doubts. The significant fact about money substitutes is that they perform the same services as money, and as such can be held in people's cash balances as if they were money proper. (Here are links to free versions of Mises' classic work, and here is my Study Guide for it.)

For example, back when gold coins were the underlying base money, if someone held a paper note issued by a reputable bank promising the bearer one gold ounce upon demand, then that note was “as good as gold” economically because most people would accept it at par. Any individual holding that paper note could obtain goods and services in the market just as easily as he could with an actual gold coin.

Likewise, in our day if you have a debit card issued by Citibank that effectively tells merchants, “This person has \$400 in his checking account with us,” then that is “as good as dollars” in most stores. When you buy groceries by swiping your debit card, you aren't handing over actual money in the form of green pieces of currency, instead you are handing over claims on dollars that are issued by your bank.

Now within the class of money substitutes, Mises made a further distinction. Those money substitutes fully backed by money in the bank vault were called “money certificates.” They were simply claim tickets that took the place of the original base money. There was no economic impact of a person

depositing his money with a banker, and carrying money certificates instead, except for the increased convenience (which is why the individual would do it).

On the other hand, those money substitutes that were issued *above and beyond* the reserves of money held by the bank were called “fiduciary media.” The issuance of fiduciary media *would* have an economic impact, because it effectively increased the total quantity of money held in cash balances by the community. Beyond this monetary inflation, the specific problem with newly issued fiduciary media is that it entered the economy *through the loan market*, meaning that the first prices it distorted were interest rates.

This is a crucial point so I'll state it in slightly different words: Richard Cantillon famously explained that when new money enters the economy, it does *not* simply raise all prices instantly by the same percentage. On the contrary, “Cantillon effects” refer to the redistribution of wealth as new money cascades out into the economy, passing from sector to sector. For example, if a medieval king debased his currency and created new coins (with a lower gold content), then spent them on obtaining horses, the first prices to rise would be those of horses. Then the horse breeders would spend their new coins on (say) fine restaurants and silk clothes, raising prices in those areas. Then the waiters at the restaurant might receive bigger tips, and so on around the economy.

In this context, Mises pointed out that commercial banks engaged in fractional reserve banking effectively create money “in the broader sense” (i.e. including not just base money but also money substitutes) and that this money enters the economy through the issuance of new loans. Therefore, unlike (say) new gold flowing into the economy through the spending of mine owners which would be spread across multiple sectors, new money being created through fractional reserve banking is focused entirely on the loan market. Therefore it pushes down interest rates to artificially low levels; they are the first prices to be bombarded with the “credit

expansion.”

And as Mises' quotation from above indicates, he thought this phenomenon occurred with *any* issuance of fiduciary media. This makes sense, once one understands the nature of fiduciary media. Contrary to the claims of Selgin (which I can't elaborate here), even in scenarios where the public wants to hold more banknotes, the creation of new money (in the broader sense) entering via the loan market will still cause the interest rate to deviate from its proper level.

### But Wasn't Mises a Free Banker?

My above writings may confuse some readers, who could understandably have thought that Mises was clearly in the camp of the “free bankers” like Selgin and Larry White. After all, Mises explicitly says in *Human Action* that only the policy of free banking can contain the boom-bust cycle.

The confusion here is due to a difference in opinion about *what would happen* under a regime of “free banking,” wherein the government gives no special privileges to the commercial banks. Today's writers in the free banking tradition (such as Selgin and White) think that in equilibrium, the profit motive will lead commercial banks to adopt a reserve ratio that could be quite low. So long as this ratio reflected the desires of the public to hold “inside money” and the frequency with which bank-issued deposits were redeemed for base money, Selgin and White believe that fractional reserve banking is quite healthy for the community.

In complete contrast, Mises advocated free banking because he thought it would *restrain* the issuance of fiduciary media. For those readers who have never entertained such a view, I urge you to read Salerno's Chapter 5 here. Once you realize there is a distinction between “favors free banking” and “thinks fractional reserve banking promotes stability,” all of Mises' writings on this topic become crystal clear. Mises only seems to vacillate when the reader assumes that anybody in favor of free banking must necessarily endorse low reserve ratios.

### Conclusion

In the grand scheme, the actual positions of myself versus Selgin are quite close. We both want to remove politics entirely from money and banking, which obviously means getting rid of the Fed but it also means (so long as we have State courts) no legislation restricting fractional reserve banking.

However, where we differ is in our predictions and evaluations of the *results* of such a “free banking” policy. Like Mises, I predict that absent government privileges—such as allowing the Scottish banks to renege on their contractual obligations for more than two decades (!)—banks would be kept on a very tight leash. In contrast, Selgin had no problem (as he admitted during the debate Q&A) with banks having reserve ratios as low as 3%.

In closing, let me offer an analogy. I think that government ownership of roads causes far too many traffic accidents. Under a regime of “free roading,” the number of traffic accidents would plummet, but it wouldn't hit literally zero simply because the cost of wringing out the last few accidents would be higher than the benefits.

At the same time, Selgin surely thinks that government subsidies currently lead to too much corn being planted in the U.S., and that a regime of “free agriculture” would lead to a lower equilibrium amount of corn. Yet Selgin wouldn't view the new, lower amount of corn as a necessary evil; he would think it was a boon to consumer welfare.

Thus, even though my views on traffic accidents and Selgin's view on corn are superficially similar—in that we both think a move to the free market would reduce the amount of each—there is a sense in which my views on traffic accidents are far different from Selgin's views on corn production.

This contrast is analogous to our views on the same issue, namely fractional reserve banking. Selgin and I both favor a free market in banking, and we both agree that FDIC and the Fed's “lender of last resort” policy subsidizes credit expansion. Yet I would view any remaining fiduciary media

in a genuinely free banking system as a regrettable evil (that caused an attenuated boom-bust if large enough), whereas Selgin would view it as a healthy boon to consumer welfare.

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## Work in the Private-Law Society

By Michael S. Rozeff

A private-law society has no government safety net. In 2011, the Congressional Research Service found that the federal government had 83 welfare programs that were costing over \$1 trillion. Welfare is the largest component of government spending. One trillion dollars is like 50 million people x \$20,000 each. Welfare programs actually service 52.2 million people. That's a lot of people, a lot of money, a lot of government theft, a lot of welfare dependency and a lot of incentive to stay out of work.

In a private-law society in America, these 50-odd million people have to find other means to live and eat. The main means is work. Work gains respect and value in the private-law society as compared with the welfare state. The work ethic makes a comeback. The broader meaning of equality, which is a value that's used to justify wealth redistribution, takes a licking in the private-law society. There is equality before the law, but other meanings are shorn away.

The second or third largest welfare program is food stamps, now known in bureaucratic language as "Supplemental Nutrition Assistance Program (SNAP)". This "aid" program aids recipients while robbing taxpayers and others. At its peak in 2013,

the number of individuals on food stamps was 47.6 million.

In a private-law society, government does not exist, so that the number of people on food stamps falls to zero (0). Voluntary giving will aid some of these people; the criteria for acceptance will be stiffer than a government program. Many former recipients will be induced to find work. Employers will be induced to create work for people previously out of work, who may be employable at low wage rates.

The disappearance of food stamps will have powerful incentive effects as people realize the government is not there to bail them out. People who are not on food stamps but who may fall upon hard times on occasion will be induced to work harder and smarter. They will be induced to learn skills that are saleable. They will be induced to save, not spend all they earn, so as to have the means to ride out a period of unemployment. Since all unemployment is avoidable by lowering one's price for labor, people will be induced to avoid unions that hold out for above-market wages. Entrepreneurs will be induced to devise insurance that protects at least partially against unemployment. Those who may be inclined to use drugs or alcohol to excess will be induced to restrain their proclivities, because if they cannot work they may not survive. The end of food stamps will induce families to pull together. It will raise the authority within families of those who are the breadwinners. Work itself will become more valued as an essential element of society, as the rule "No work, no eat" becomes known and effective.

All of the above incentives run in reverse when food stamps are a welfare program.

When I searched on "welfare and left-libertarians", I found all sorts of arguments that claimed compatibility of the welfare state and libertarianism. The private-law society and its concomitant elimination of the welfare state are incompatible with all such versions of left-libertarianism. There is no way to sugarcoat this pill. If left-libertarians think that the welfare state is a good idea, they have my blessing to form their own "church" of welfare,

to extract tithes forcibly from their members, and to redistribute them in any ways they like. But this activity should be at their own cost and risk, and not be imposed upon anyone who rejects such a church.

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## 7 Lessons Business Owners Can Learn from Austrian Economics

Fernando Monteiro D'Andrea

Apart from dealing with government intervention, understanding markets is probably the most challenging task of any business owner or entrepreneur. It was for good reason that Ludwig von Mises insisted that economists and institutions that teach economics go out of their way to share economics theory with business owners and the general public. Economics, as Mises wrote: "deals with society's fundamental problems; it concerns everyone and belongs to all." This applies, not least of all, to the daily problems of owning, starting, or running a business.

And Mises wasn't alone. The Austrian School has long concerned itself with being accessible, and not positioning itself as a school of esoteric knowledge for a few scholars. So what can business owners learn from the basic insights of the Austrian economists? There are at least seven lessons that can be quite helpful for those seeking to grow and sustain business ventures:

**One: People Act:** Let us get to the basics. Praxeology, as described by Ludwig von Mises, states that people act and they do it looking to increase their satisfaction. Business owners (businessmen, entrepreneurs, and managers — I am using all the terms interchangeably here, but in theory, they are not the same) have specific goals. Usually they are looking for profits, or what is

sometimes called "better financial performance." Meanwhile, their clients are usually looking to pay as little as possible for the best possible products they plan to consume. Every action can be considered self-interested and, in business relations, since actions are unconstrained (i.e. people act freely, without being forced to), business owners have to provide the best possible goods or services at reasonable prices. If they do not, someone else will. Moreover, people's goals and wishes are subjective — so two different people can value the same product in very different ways. These intrinsic differences lead to differentiation in offered prices, in products and lead to the creation of different brands for similar.

**Two: People and Things Are Different.** Business men know that every client is unique and that their tastes and wants change on a daily basis. Austrian-school economics explains that every human action is based on the different kinds of knowledge under possession of the actor. Knowledge changes over time, those changes will lead to modifications in the characteristics of demand. Consumer demand dynamism will ask for constant adaptation from suppliers in the production process which will lead to constant innovation, entrepreneurs and business men will guide that change. On the one hand there is the diversity of desires and wills and the dynamism of demand, and on other hand there is the demand for intermediate goods derived from final product's demand. Demand in every industry will always be heterogeneous and dynamic. Business owners cannot sit on their current advantages. The myth of the rich businessman that can afford to sit around and do nothing is exactly that: a myth.

**Three: The Market Is Dynamic.** When entrepreneurs act they are doing so to try to solve their own problems by solving their client's problems. F.A. Hayek and Israel Kirzner saw the market process as tending towards equilibrium. Lachmann<sup>1</sup>, on the other hand, said that market actions could be coordinating, discoordinating, equilibrating, or disequilibrating, and that in the really important cases the disequilibrating tendencies

prevail. Put more simply: the market is constantly changing, and entrepreneurs will need to constantly adapt. When a new and innovation product reaches the market — as frequently happens — it changes the whole competitive landscape.

**Four: Nobody Has Full Knowledge** Neither companies nor clients know everything and this limited access to knowledge directly influences business decisions. Mises stresses that it is impossible to possess all knowledge at the same time. Hayek says that knowledge is spread in society, knowledge acquisition is thus costly and imperfect, as any successful business man knows: “the more you know, the more you know that you don’t know much.”

**Five: Resources Matter.** Firms can be understood as groups of resources, including human resources and their knowledge. Resources are always heterogeneous and imperfectly mobile. For instance, it is impossible for a restaurant owner to use the resources that he has at hand to create a new business consulting company, a shoe factory, or a construction business at the same time or with the exact same materials. In economics we call this "capital heterogeneity." Resources (that economists usually call ‘capital’) cannot be immediately transferred between two different lines of production or even two different stages of the same production. You could try to do that, but the effectiveness of the resources will be diminished. Further: entrepreneurs, are responsible for combining and recombining resources continuously because of the new attributes, technologies and new consumer demands. Firms with a competitive advantage in one segment of the market could see this advantage disappear elsewhere. When combined: tangible and intangible, heterogeneous and immobile resources and heterogeneous demand, bring a number of different possibilities to firm organization. Those business owners who combine these resources in a way that most pleases consumers will be the most successful.

**Six: Managers Analyze and Act.** What about the role of managers? Manager are agents that have the company’s decisions in their hands. Managers

act based on their knowledge and incentives, self-interestedly. Decisions will be implemented through actions and results will be observed after the passage of time. Managers need to act via recognizing, understanding, creating, selecting, implementing and modifying the various strategies that firms put in place. In short, managers or business owners need to constantly innovate. When analyzing market needs and acting upon them, these agents are acting to adjust to constantly-changing realities of the marketplace.

**Seven: Competition Is About Generating Advantage.** Competition is based on the ongoing search for resources capable of generating competitive advantage. Learning happens when people within firms gain a better understanding of market signals — especially financial signals — that convey information about the company’s competitive position. Bad results indicate competition in a segment in which the firm has no competitive advantage. Firms that hold competitive advantages will have to defend their position by innovating continuously because competitors will act to try to overcome other firm’s competitive advantage through the modification of their own set of resources. Changes won’t lead to an optimum stage, but to growing diversification.

At the core of all of this is the need to better serve customers. Since the preferences and desires of all consumers are constantly changing, business owners and managers who constantly strive to discover and understand both what consumers want, and how resources can be used to deliver the products people demand. This is not an easy task, and it's why a better understand of economics, as Mises knew, is something that can benefit everyone.

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## **Saving — not Spending — Is the Engine of Economic Growth**

Frank Shostak

Most economists concur with the view that what keeps the economy going is consumption expenditure. Furthermore, it is generally held that spending, rather than individual saving, is the essential condition for production and prosperity.

Savings is seen to be detrimental to economic activity as it weakens the potential demand for goods and services.

In this framework of thinking, economic activity is depicted as a circular flow of money. Spending by one individual becomes part of the earnings of another individual, and spending by another individual becomes part of the first individual's earnings.

If however, people become less confident about the future it is held they will cut back on their outlays and hoard more money. Therefore, once an individual spends less, this worsens the situation of some other individual, who in turn also cuts his spending.

A vicious circle emerges — the decline in people's confidence causes them to spend less and to hoard more money. This lowers economic activity further, thereby causing people to hoard more etc. The cure for this, it is argued, is for the central bank to pump money.

By putting more cash in people's hands, consumer confidence will increase, people will then spend more and the circular flow of money will reassert itself.

All this sounds very appealing and various surveys of business activity show that during a recession businesses emphasize the lack of consumer demand as the major factor behind their poor performances.

Notwithstanding this, can demand by itself generate economic growth? Furthermore, nothing is said here about goods and services — are we to take them

for granted? Are they always around and all that is required is to have demand for them?

It would appear that what impedes economic prosperity is the scarcity of demand. However, is it possible for the general demand for goods and services to be scarce?

### **Scarcity of Means Thwarts Demand**

Most people want as many things as one could think of. However, what thwarts their demand is the availability of means.

Hence, there can never be a problem with demand as such, but with the means to accommodate demand. In the real world, one has to become a producer before one can demand goods and services. It is necessary to produce some useful goods that can be exchanged for other goods.

For instance, when a baker produces bread, he doesn't produce everything for his own consumption. Most of the bread he produces is exchanged for the goods and services of other producers, implying that through the production of bread the baker exercises his demand for other goods.

His demand is fully covered (i.e. funded by the bread that he has produced).

Demand cannot stand by itself and be independent, it is limited by prior production — it is the production of bread that permits the baker to procure various goods and services. Bread is the baker's means of payment.

What limits the production growth of goods is the introduction of better tools and machinery (i.e. capital goods), which raises workers productivity. Tools and machinery, are not readily available, they must be made.

In order to make them, people must allocate consumer goods that will sustain those individuals engaged in the production of tools and machinery. The allocation of consumer goods is what savings is all about.

Note that savings become possible once some individuals have agreed to transfer some of their

present goods to individuals that are engaged in the production of tools and machinery. Obviously, they do not transfer these goods for free, but in return for a greater quantity of goods in the future. Since saving enables the production of capital goods, obviously saving is at the heart of the economic growth that raises people's living standards.

### **Money and Saving - What Is the Relationship?**

The introduction of money into our discussion will not alter the essence of what saving is all about. Money fulfils the role of the medium of exchange. It enables the produce of one producer to be exchanged for the produce of another producer.

Observe that while money serves as the medium of exchange, it does not produce goods and services, it only enables goods and services to be exchanged.

Also, in the money economy the ultimate payment is with real goods and services for other real goods and services.

A baker exchanges his bread for money and then employs the obtained money to buy other goods and services, implying that he pays with his bread for other goods and services. Money only facilitates this payment.

Another important role of money is to facilitate the channeling of savings. In the world of barter, perishable goods are difficult to save for long periods. These difficulties are resolved by the money economy.

When a baker sells his bread for \$1 to a shoemaker, he has in fact supplied the shoemaker with his saved i.e. unconsumed, bread.

The supplied bread is going to sustain the shoemaker and allow him to continue making shoes. Note that money received by the baker is fully supported by his saved bread.

Being the medium of exchange, money enables the baker to secure goods sometime in the future, whenever he requires them.

Through money, people channel real savings, which permit economic activity to take place. The exchange

of real saving for money of one individual supports the production of another individual, who in turn by exchanging his real saving for money, supports a third individual.

Likewise, when a company issues stocks or bonds, the money received for these financial instruments enables the company to obtain real savings which in turn will enable it to pursue its planned objectives.

In this way, money enables real savings to permeate across the economy and lift the pace of production of goods and services. Note that we do not save money as such but employ money to facilitate real savings.

When an individual hoards money, he does not save money but rather exercises his demand for money. Exercising demand for money can never be bad news as popular thinking has us believe.

Contrary to popular thinking then, saving does not weaken aggregate spending; on the contrary, it reinforces it. Note however, while savings are an important factor in fueling economic growth, for them to become effective they must be properly employed.

### **Money Printing and Economic Growth**

When money is printed (i.e. created "out of thin air") by the central bank it sets in motion an exchange of nothing for money and then money for something (i.e. an exchange of nothing for something).

An exchange of nothing for something amounts to consumption that is not supported by production. Since every activity has to be funded, it follows that an increase in consumption that is not supported by production must divert funding from wealth generating activities.

This in turn diminishes the flow of real savings to the producers of wealth, which weakens the flow of production i.e. sets in motion an economic recession.

For instance, when money "out of thin air" gives rise to consumption that is not supported by a preceding production, it lowers the amount of real savings that supports the production of goods and services of the first wealth producer.

This in turn undermines his production of goods, thereby weakening his effective demand for the goods of another wealth producer.

The other producer is in turn forced to curtail his production of goods thereby weakening his effective demand for the goods of a third wealth producer. In this way money "out of thin air", which destroys savings sets up the dynamics of the consequent shrinkage of the production flow.

Observe that what has weakened the demand for goods is not the sudden capricious behaviour of consumers, but the monetary injections of the central bank that has weakened effective demand.

Every dollar created "out of thin air" amounts to a corresponding dissaving by that amount. It must be emphasized that as long as the pool of real savings is expanding the central bank and government officials can give the impression that loose monetary and fiscal policies drive the economy, this illusion is shattered once the pool becomes stagnant or declining.

*Frank Shostak's consulting firm, Applied Austrian School Economics, provides in-depth assessments of financial markets and global economies.*

## Want to Be Valuable? Study History. Here's Why

**In a globalizing economy, the study of history is more relevant than ever.**

by Maarten van Doorn

Albert Einstein is supposed to have said:

"Never memorize what you can look up in a book."

In Einstein's days, books were unequaled as a source of information. We, on the other hand, live in an age where nearly everything can be accessed through the magic vehicle of the internet.

Following Einstein's logic, then, *nothing* is worth memorizing anymore, because *everything* can be looked up.

But, of course, that is probably not what old Albert

was getting at. Most likely, the advice he wanted to dispense was that you should not waste your time by committing unimportant details to memory. Rather, your focus should be on understanding the bigger picture—on how things relate to each other.

This reminds me of Elon Musk's approach to learning. He recommends viewing knowledge as a tree:

"Make sure you understand the fundamental principles, the trunk and big branches, before you get into the leaves/details or there is nothing for them to hang on to."

To "learn" we need to do more than merely feeding ourselves new information. Expanding our intelligence requires *connecting* new materials to what we already knew. That, in turn, requires something to connect *to*. There's no adding branches without a solid trunk.

The very possibility of genuine insight requires a memorized base. Without it, data you consume will not be added to your tree of knowledge. Rather, they will float in the air for a couple of weeks or so, before being taken away by the wind.

Knowledge, gone. Time wasted.

To learn *how to live*, we need to (among other things) discover patterns between behavior and consequences. Likewise, if we acquire knowledge of this sort it needs to be connected to what we already knew in order to be a lasting addition to our tree of knowledge.

The problem is that we only accumulate such knowledge very slowly: the occasions on which we truly learn something about why our behavior had the results it had are rare. Hence, building a solid trunk of practical knowledge is a lengthy process.

To speed this up, we should study history.

### Just Names and Dates?

You might be skeptical about the life-improving value of knowing when the second world war ended or about the point of being cognizant of the date on which the French Revolution took place.

These are legitimate doubts.

First, unless you're a historian, and apart from having a generally accurate mental model of the history of mankind, remembering dates is not very likely to aid you in attaining your goals. Secondly, dates can be very easily looked up.

Hence, you should refrain from allocating large fractions of your memory to storing historical data.

That, however, does not mean that the study of history is useless. By contrast, it can be extremely useful.

As it happens, it involves a lot more than memorizing dates.

### **Give Me Your Experience**

Almost 2,500 years ago, the Chinese philosopher Mengzhi (372 BC–289 BC)—a follower of the famous sage Confucius—had some useful insights about how we can learn from history.

When done right, studying history yields two kinds of advantages, he argued.

One, studying historical examples from different times and places allows us to identify the likely effects of different types of conduct. How did those heroes accomplish all these great things, and how can I become like that?

What *precisely* is it that Nelson Mandela did that makes us admire him and how can we emulate his conduct?

Two, stories from history offer possible directions for our lives; they provide us with scripts and encourage us to try these out.

These people are not dead yet, but without the examples of Tim Urban (the philosopher behind WaitButWhy) and Alain de Botton (the philosopher behind The School of Life) the script of the academically trained philosopher who writes blogs like these would not have occurred to me as a possible way of living.

Like that of most ancient Eastern philosophers, Mengzhi's prose is rather vague. Let's embrace the

interpretive freedom that grants us—isn't it lovely how philosophy isn't a science?—and take him to say that reading history is not a detached intellectual activity but can be done with an eye to optimizing ourselves. After all, the benefits Mengzhi identifies are clearly relevant outside of the classroom.

When done properly, the study of history is about self-improvement.

### **Another Kind of Knowledge**

History is not just about which battle took place on what day. On top of *what* happened, it also seeks to understand *why* these events unfolded as they did. On top of collecting historical data, it involves *explaining* the past.

To do so, it investigates *why certain deeds had the consequences that they had*. And this—the study of the results of different decisions in different contexts—places the study of history in the very center of our daily lives. For, if there is one thing we all have reasons to be interested in, it is why our acts give rise to the sequence of follow-up reactions that they cause.

Understanding the motivations and upshot of human behavior is no easy task. Consider this example:

Why did Julius Caesar decide to cross the Rubicon with a part of his army in 49 BCE? Why did that have the consequences it did?

To answer such questions, we need to think about how larger contexts impinge on the impact of behavior.

Doing so will improve our understanding of why things happen as they do, without having to undergo the events ourselves. We gain practical knowledge, "for free."

Studying history, then, helps in acquiring a solid trunk for our knowledge-tree of *life*.

### **What Is Education?**

"Public schools were not only created in the interests of industrialism—they were created in the image of industrialism."—Ken Robinson

Now, the final step of the argument for the value of studying history.

Please consider this question: what, in our civilization, does an educational degree stand for? What, supposedly, is *indicated* by possessing such a qualification? What skills or abilities does one gain by successfully going through the compulsory schools? (If you think the answer is "intelligence" put on your philosophers-hat and ask the follow-up question: what does *that* supposedly signify?)

In his TED-talk-went-viral, Ken Robinson points out that our educational system was designed to serve the needs of an industrializing world. It teaches kids to do the job they're supposed to do in the way it's supposed to be done according to the script of the big factory that is society. Schools groom us to be a properly-functioning cog.

The problem is that the contemporary economy is no longer industrializing but *globalizing*. There are plenty of countries where people are willing to be obedient and work harder for less money than us. We cannot out-obedience the competition.

Training cogs has become a sucker's game. (As Nassim Taleb would say.)

The way we educate our children is broken.

### **What Education Should Be**

(It turns out the final step of the argument is two-phased step.)

Look at the bright side: that means that there are plenty of opportunities for improvement.

Let's think about that together.

Please consider this question: in today's world, what abilities *should* one gain by successfully going through the mandatory schools?

According to Seth Godin, we should teach our kids two things: how to lead and how to solve interesting problems. If we cannot out-obedience the competition, we should out-lead and out-solve them.

How do we learn how to do that?

To start building our knowledge-tree for these

abilities, we normally would need real-life experience. However, if we study history like Mengzi told us to, history will give us some of that experience for free.

Examining why this action done in that socio-cultural context had the effects it had improves our understanding of how the world works and contributes to our *practical* knowledge—*understanding* behavior makes us better leaders and better problem-solvers.

Therefore, in a globalizing economy, the study of history is more relevant than ever.

Some questions to start you off:

How did Caesar get his army to join him in his illegal act? How did Caesar fix the malfunctionings he diagnosed in the Roman political system?

What would you have done?

*Reprinted from Medium.*

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This article was originally published on FEE.org. Read the original article.

## **Continuing to Ponder Income Tax and Social Security**

by R. Nelson Nash

Let's begin this pondering session with a definition of the term *statism*.

*Statism is the principle or policy of concentrating extensive economic, political, and related controls in the state at the cost of individual liberty. A statist is one whose fundamental belief system is fully grounded in the concept of statism.*

A statist can't conceive of life without the U.S. Postal Service (which is older than the U.S.) — how could we ever do without the USPS — who would build roads without the state — who would protect

our lives and property without the state — who would educate (they wouldn't dare admit that the correct term is really *indoctrinate*) our children — how could we possibly survive without the idea of Social Security, etc., ad infinitum.

Lest there be any doubt in your mind, *I am not a statist*. Sixty-one years ago, I was introduced to the Austrian school of economic thought through the *Foundation for Economic Education (FEE)*. Leonard E. Read taught me that *governments* don't do all those things mentioned above — *people perform these functions*.

People acting freely with one another under contract with one another *can* — *and do* — perform all the necessary functions in life. *It is only this form of action that keeps us alive*. Unfortunately, our broadcast media and government education (excuse me, I meant *indoctrination*) centers don't spend much time making us aware of this fact. That's because they are statist.

Statists believe that there must be a monopoly coercive force that performs these necessary functions in order for us to exist. In essence they are saying, "People can't do these things without being forced to do so through government action."

How did people survive before all these government actions came into being? The U.S. Postal service began in 1775, one year before the thirteen independent English Colonies seceded from the mother country.

Income Tax, as we know it today, began only 104 years ago. (Good grief! I'm 87 years old — so that's just 17 years before I was born). Social Security law was passed in 1935 and became effective in 1937. (I was 6 years old then). These are just a few examples within a plethora of statist intrusions in our lives that have occurred since the beginning of the 20th century.

So, is all this government intrusion into our lives a recent phenomenon? No, to the contrary, it has been there for at least six thousand years according to Paul Rosenberg in his two-page essay entitled *Fish*

*Are the Last to Notice the Water* (Google it). It may surprise you to face the fact that most everyone you know — including you (probably) — *is a statist*. Human beings are born with that proclivity. We can only make progress through *overcoming* this tendency. It should be at the highest level in our priorities.

Remember, *the Infinite Banking Concept* is all about how you think! *Thinking like a statist is the primary obstacle that you must overcome in order to become your own banker*.

Where is the origin of recent belief in statism? On our website, [www.infinitebanking.org](http://www.infinitebanking.org) there is a RESOURCES tab. Click it on and find RECOMMENDED READING. Click that on and go to the HISTORY section. There are 138 books listed there. Read them all and you can easily conclude that this current statist mindset in the USA stems from the influence of Alexander Hamilton in 1789 and the creation of The Constitution. Our children are taught that there was a natural progression from our Declaration of Independence to our Constitution. Nothing could be further from the truth! The difference between those two documents is "wider than the Grand Canyon in Arizona!"

The primary reason for our separation from the mother country was something, probably best classified, as mercantilism — a sort of collusion between government and big business. We started out fairly well grounded in the beliefs of Thomas Jefferson and Thomas Payne — authors of the Declaration of Independence — the antithesis of statism. But we became "Hamiltonians" just 13 years later. The net result is that we now have "mercantilism on steroids."

In an attempt to put a measuring stick to what happened, suppose that British mercantilism punished Colonial citizens by a "factor of one." Under the influence of Hamilton's ideas, we are now punished by a "factor of four." People of my father's generation would say, "We jumped out of the frying pan into the fire."

Statism in recent history seems to get going in a big

way around 1890 with Bismarck in Germany and his idea of social security. The object was “to get those old folks out of the work force to make room for jobs for the young folks because there are only so many jobs for everyone!” He set retirement age for German males at age 70. Life expectancy for them was a little over age 50!

In 1916 — half way through WWI — Bismarck is dead, and the retirement age was reduced to age 65. That's where Franklin D. Roosevelt got USA Social Security retirement age set at 65 in 1937. Life expectancy for USA males at that time was around 61. Now it is 78+ — yet we are using age 67 as normal full retirement age. There is no way this statist idea can be sustainable. Painful change will take place in some way or another. *Reality will replace fantasy.*

I cite all the above just to notice the fact that we live in a hostile financial/economic environment. How can you survive in it? Very well, thank you — but you must first purge yourself of statist thinking. This has to be done on an individual level. You may be one who does very little statist thinking — but that is the same thing as a woman being “a little bit pregnant.”

Through the years I have emphasized how necessary it is to properly classify things we encounter throughout our lives. Governments have an endless number of bureaucratic entities that control our lives. That is their statist mission in life — but they are all examples of *statists beliefs* that are manifested by government (force) action.

So, here's an example of how one can cope in this hostile financial environment. April 17 was the due date of U.S. Individual Income Tax Return (Form 1040). During last year my wife and I had to pay \$30,000.00 in Income Tax (to a government bureau). That was “real money” — a token of goods and services that we had performed for others by freely contracting with them.

On the same Form 1040 it is listed that we had income from Social Security (a government bureau) of \$40,283.00. That was “fiat money.”

I asked my CPA recently. “Has anyone ever made a check payable to Social Security?” No, all such payments are made to *The U.S. Treasury. The money is spent on whatever the government wants to spend it on.* After paying current recipients of Social Security (like my wife and me) — anything left over is put into worthless IOUs — essentially saying “we will collect this money from future generations — and filed in a cave in West Virginia. Welcome to the USA young folks — this is your inheritance of *statist thinking.*”

We paid \$30,000.00 (“real money”) a government bureau and we received \$40,283.00 (fiat money) from another government bureau. So I have question for you — did we really pay any income tax? It looks to me like we paid income taxes with fiat money from Social Security.

How did we manage to get this amount of fiat money from Social Security? Simple — we just didn't file for Social Security until I was age 71. It was like capitalizing a business. Ruminating on that action for a while.

There is more pondering and ruminating to come so we must pace ourselves — this one can keep you busy until the next example.

### Nelson's Favorite Quotes

*“The State is an inherently illegitimate institution of organized aggression, of organized and regularized crime against the persons and properties of its subjects... a profoundly antisocial institution which lives parasitically off of the productive activities of private citizens.”*

*“Since the State necessarily lives by the compulsory confiscation of private capital, and since its expansion necessarily involves ever-greater incursions on private individuals and private enterprise, we must assert that the state is profoundly and inherently anti-capitalist.”* — Murray Rothbard

**Welcome IBC Practitioners****<https://www.infinitebanking.org/finder/>**

The following financial professionals joined or renewed their membership to our *Authorized Infinite Banking Concepts Practitioners* team this month:

- [Mary Jo Irmen - Bismarck, North Dakota](#)
- [Jim Oliver - Bonita Springs, Florida](#)
- [Vivien Adao - Burbank, California](#)
- [Isis Palicio - Coral Gables, Florida](#)
- [Chad Brosius - Yulee, Florida](#)
- [Justin Hales - Grand Rapids, Michigan](#)
- [Vernon McCarty - Calgary, Alberta](#)

*You can view the entire practitioner listing on our website using the Practitioner Finder.*

*IBC Practitioner's* have completed the *IBC Practitioner's Program* and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions. The *IBC Practitioner* has a broad base of knowledge to ensure a minimal level of competency in all of the areas a financial professional needs, in order to adequately discuss IBC with his or her clients.