



BANKNOTES

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Why are they called “Recessions or Depressions?”

"Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one." --- Charles Mackay from his book, *Extraordinary Popular Delusions and the Madness of Crowds*.

In the economic world today we hear the words, “recession” and/or “depression” used regularly to describe a downturn in economic activity. There have been booms and busts in the economy throughout all history. Graphs are presented that illustrate the highs and lows over a period of time.

In the health field, Merriam Webster defines depression as “a serious medical condition in which a person feels very sad, hopeless, and unimportant and often is unable to live in a normal way.” This means that something needs to be done to remedy this condition! This really is serious business!

Another example comes to mind. In the movie about the Apollo 13 voyage to the moon, “Houston, we have a problem” became a legendary phrase. Their problem definitely was a deviation from normal! They had to change to “plan B.”

Do the words recession and/or depression have different meanings in the economic and health fields? Is the low in a business cycle inferring that this phenomenon is a deviation from normal?

Rarely do we hear about the cause of the business cycles. Instead, the general attitude that we hear and read about seems to lead one to conclude that booms are the normal economic condition and the busts are aberrations that call for government action

to remedy the situation.

I submit that this is backward thinking. The cause of the booms is the action of central banks. They increase the money supply sharply and people think they have more wealth when the truth is that they do not. I submit that this activity is the real aberration, and therefore, should be avoided. They only have dollars that are worth less than before. The “no-thinks” claim that they have “stimulated the economy.” It is all a lie! They have only deferred the inevitable correction which the money manipulators call a recession or a depression.

Words have meaning. The phenomenon that “the authorities” call depressions should be correctly classified as a return to reality because the increase in money supply did nothing more than create an illusion which always leads to a downturn in economic activity. This is deception in its purest form! Many writers have made the case that “the correction is equal and opposite to the build-up.”

Our central bank, The Federal Reserve, was created and put into law in late 1913. The dollar at this time is only worth two cents in comparison with the dollar in 1913. This means that it will take 50 of today’s dollars to do what one dollar would back then. Does this mean that we are wealthier today than in 1913? I don’t think so! Money is simply the medium of exchange that we use. As Murray Rothbard taught many years ago, in the economy, any amount of money will do.

I was a Second Lieutenant in the U.S. Air Force in 1952. The monthly base pay was \$213.75. Housing allowance was \$75.00. Food allowance was \$41.00. Do you realize that we all got along very well with

that monthly pay?

Where did all this current thinking come from? Who are these people who influence the thoughts of people? Maybe a better question is -- why do people listen to this chicanery? Joseph Goebbels, Reich Minister of Propaganda in Nazi Germany from 1933 to 1945 provides a probable answer when he said, "If you tell a lie big enough and keep repeating it, people will eventually come to believe it." He also said, "Think of the press as a great keyboard on which the government can play."

Government has become the means of manipulating our lives through control. Their primary weapon has been government schools. But, the real puppet masters in this entire scenario are the bankers! Puppet masters are out of sight – but they are pulling the strings. In the last one hundred years they have totally captured the minds of people. Money and banking are the lifeblood of an economy. Our medium of exchange, money, must be warehoused somewhere for ultimate use in our lives. It needs to be warehoused in a location that cannot inflate the money supply. The place that best qualifies for this activity is a contract with a dividend-paying mutual life insurance company. There are thousands of people who have learned this truth through the teachings of the NELSON NASH INSTITUTE utilizing The Infinite Banking Concept.

It's all about how you think-- or is it, how you don't think?

VISION

by Leonard E. Read

Note- Frequent readers of BANKNOTES are aware of my relationship with Leonard E. Read and my admiration for his works during his lifetime. In the following issues I will be sharing his book, VISION, one chapter per month. It was written in 1978. What a privilege it was for me to know this great man! -- R. Nelson Nash

Chapter One

VISION

Where there is no vision, the people perish

-- Proverbs 29:18

Vision is the blessing of foresight, but it has no chance of realization without its companion blessing, *insight*. In the absence of these twin attainments – each within our reach – the people perish, that is, they vegetate rather than germinate, stagnate instead of growing in awareness, perception, consciousness. Vision, therefore – the power of penetrating to reality by mental acuteness – must be developed if our role in human destiny is to be fulfilled.

This commentary is founded, first, on the most remarkable instance of foresight known to me and, second, on an equally remarkable instance of insight. Here is the foresight – by Lord Tennyson (1809 – 1892), that prescient English poet, and poet laureate during the last 42 years of his life:

For I dipt into the future, far as
human eye could see,
Saw the *Vision* of the world and all
the wonders that would be;
Saw the heavens fill with commerce,
argosies of magic sails,
Pilots of the purple twilight, dropping
down with costly bales.

Saw the heavens fill with commerce, argosies of magic sails – Tennyson's imagination caught a glimpse of our modern aircraft, the magic sails being metal wings. *Locksley Hall* – from which the above lines are quoted – appeared in 1842 when flying machines were but a dream. Leonardo da Vinci was another of the rare dreamers; he drew sketches of an airplane four centuries before Tennyson's time.

Pilots of the purple twilight, dropping down with costly bales – Air flight, even at night, dropping down with bales – ranging all the way from bags of fresh spinach, air mail, billions of tons of heavy freight to millions of individuals – day-in-and-day-out!

Saw the Vision of the world and all the wonders that would be – Assuredly, Tennyson did not see all the wonders that would be but what he foresaw startles the imagination. Can his remarkable foresight be explained? It seems unlikely, unless by another blest

with a comparable vision. Who among us in today's world can see that far into the future with such accuracy and clarity? Who can see the miracles that will grace Americans in the year 2042? A confession: I cannot see what's in store for us next year!

There is at least one reason why Tennyson's foresight was keener than yours, mine or anyone else's. There have been so many millions of miracles since his day – each the genesis of countless others – that scarcely anyone, however gifted, can see today the wonders in the offing.

To foresee a carriage developing from the wheelbarrow with which one is familiar is one thing. It is more difficult to foresee in the wheelbarrow the miracle of that first plane designed and flown by the Wright brothers. More difficult still – even having seen that first plane – is to envision in it the miracle of the 747 jet. Every bit of knowledge gained opens countless new paths into the infinite unknown – each step forward and upward introducing numerous variables and complexities as well as opportunities.

Analogous to the above, consider the politico-economic situation prior to Tennyson's time. Mercantilism – no less authoritarian than serfdom or feudalism – had hobbled the people. Under that baneful restraint there were relatively few miracles, and minor ones compared with those that followed. The potential creativity of countless Englishmen was inhibited. Creativity lay more or less dormant – deadened!

However, about 150 years ago the thoughts and ideas of that great thinker, Adam Smith, were beginning to bear fruit through such spokesmen as John Bright and Richard Cobden. These men understood and clearly explained not only the fallacies of mercantilism but the truth of that absolute principle: *freedom in transactions*. Tennyson was observing the birth of an enlightenment and foresaw some of its fantastic results.

Doubtless, he reflected on the territory that is now the U.S.A. when the Pilgrims landed at Plymouth Rock. To describe it as underdeveloped would be an understatement. There was no development! Yet, seven generations later, numerous governments sent commissions here to find the secret of our unprecedented

prosperity. Their soils were as fertile, climates as friendly and resources as plentiful. Why were most of their citizens in poverty, many starving? What could the answer be?

Tennyson, being deeply observant and having witnessed the wonderful results when the Industrial Revolution replaced mercantilism, must have seen the answer.

- Government limited to keeping the peace and to invoking a common justice;
- The Creator rather than government as the endower of the rights to life and livelihood;
- Fewer man-concocted restraints against the release of creative energy than ever before in all history;
- Inventions, discoveries, insights, intuitive flashes – think-of-that's – by the trillions, and multiplying.

Tennyson's foresight was grounded in politico-economic knowledge.

While making no claim to any such keen foresight, I can foresee not the wonders but the disaster that lies ahead of our present decline into the planned economy and welfare state – socialism – continues. Also, I can foresee a return to the ideal society if that indispensable companion blessing of foresight – insight—becomes more generally known and obeyed.

Edmund Burke gave to posterity an appropriate introduction to the remarkable insight I wish to present. “I hope to see the surest of all reforms, perhaps the only sure reform – the ceasing to do ill.” How do we cease to do ill, to be rid of the current socialism? By coming to know – and strictly adhering to – that which is righteous. The Father of our Country, George Washington, bestowed on Americans the insight – the very root of righteousness:

If to please the people, we offer what we ourselves disapprove, how can we afterwards defend our work? *Let us raise a standard to which the wise and honest can repair.* The event is in the hands of God.¹

There is a correct way to evaluate this wisdom: not using the common tactic of looking upon the errors of others, but rather searching *ourselves*, the face in the mirror: **ME!**

Do I speak or write to gain favors, wealth, popularity or, if running for office, votes? Or to avoid disagreement or criticism? Is my thinking loaded with “yes, buts” – leaks – ways that I know not to be righteous. If so, could I afterwards defend my work? I could not!

How, then do I cease to do ill? By following as nearly as possible Washington's advice: Let us raise a standard to which the wise and honest can repair, in a word, *Exemplarity!* As Burke wrote: “Example is the school of mankind. They will learn at no other.”

In this, my task, my indebtedness is acknowledged – not only to Lord Tennyson and his foresight and to Washington and his insight, but also to Burke who was graced with both foresight and insight. Theirs was an attainment to which I aspire.

“Where there is no vision, the people perish.” Where there is vision, the people prosper materially, intellectually, morally and spiritually. My aim: to acquire Vision!

In this, my 23rd book, there is nothing original except the phrasing, which differs with each of us day by day. As Goethe wrote, “All truly wise ideas have been thought already thousands of times.”

The chapters that follow represent one man's striving for vision – foresight and insight; they set forth such findings as I have been able to garner from the wise – past and present. Another source – explained later – is the omnipresent radiation; an “immense intelligence,” as Emerson put it. The ability to intercept the beams of this Infinite Wisdom by finite man appears to gain bit by bit as the result of concentration and a prayerful desire for enlightenment. But no one among us, past or present, can claim originality; the origin of wise ideas is far over and beyond the mind of man.

Finally, why do I share these phrasings with others?

There are two reasons. First I wish others to share their thoughts with me. And, second, the more one shares his ideas with others, the more and higher grade are the ideas he receives. Giving or sharing is the precedent to reception. This is an ancient truth to be found in *Acts XX:35*. “It is more blessed to give than to receive.”

In the following chapters, I share with you. Now, it is your turn! -- LER

1 Attributed to George Washington during the Constitutional Convention.

Why Do We Celebrate Rising Home Prices?

May 23, 2015 Ryan McMaken

In recent years, home price indices have seemed to proliferate. Case-Shiller, of course, has been around for a long time, but over the past decade, additional measures have been marketed aggressively by *Trulia*, *CoreLogic*, and *Zillow*, just to name a few.

Measuring home prices has taken on an urgency beyond the real estate industry because for many, home price growth has become something of an indicator of the economy as a whole. If home prices are going up, it is assumed, “the economy” must be doing well. Indeed, we are encouraged to relax when home prices are increasing or holding steady, and we're supposed to become concerned if home prices are going down.

This is a rather odd way of looking at the price of a basic necessity. If the price of food were going upward at the rate of 7 or 8 percent each year (as has been the case with houses in many markets in recent years) would we all be patting ourselves on the back and telling ourselves how wonderful economic conditions are? Or would we be rightly concerned if incomes were not also going up at a similar rate? Would we do the same with shoes and clothing? How about with education?

With housing, though, increases in prices are to be lauded, we are told, even if they outpace wage growth.

We're Told to Want High Home Prices

But in today's economy, if home prices are outpacing wage growth, then housing is becoming less affordable. This is grudgingly admitted even by the supporters of ginning up home prices, but the affordability of housing takes a back seat to the insistence that home prices be preserved at all costs.

Behind all of this is the philosophy that even if the home-price/household-income relationship gets out of whack, most problems will nevertheless be solved if we can just get people into a house. Once someone becomes a homeowner, the theory goes, he'll be sitting on a huge asset that (almost) always goes up in price, meaning that any homeowner will increase in net worth as the equity in his home increases.

Then, the homeowner can use that equity to buy furniture, appliances, and a host of other consumer goods. With all that consumer spending, the economy takes off and we all win. Rising home prices are just a bump in the road, we are told, because if we can just get everyone into a home, the overall benefit to the economy will be immense.

Making Homes Affordable with More Cheap Debt

Not surprisingly, we find a sort of crude Keynesianism behind this philosophy. In this way of thinking, the point of homeownership is not to have shelter, but to acquire something that will encourage more consumer spending. In other words, the purpose of homeownership is to increase aggregate demand. The fact that you can live in the house is just a fringe benefit. This macro-obsession is part of the reason why the government has pushed homeownership so aggressively in recent decades.

The fly in the ointment, of course, is if home prices keep going up faster than wages — *ceteris paribus* — fewer people will be able to save enough money to come up with either the full amount or even a sizable down payment on a loan.

Not to worry, the experts tell us. We'll just make it easier, with the help of inflationary fiat money, to get an enormous loan that will allow you to buy a house. Thus, rock-bottom interest rates and low down pay-

ments have been the name of the game since the late 1980s.

We started to see the end game at work during the last housing bubble when Fannie Mae introduced the 40-year mortgage in 2005, which just emphasized that when it comes to being a homeowner, the idea is not to pay off the mortgage, but to "buy" a house and just pay the monthly payment until one moves to another house and gets a new thirty- or forty-year loan.

It Pays To Be in Debt

On the surface of it, it's hard to see how this scenario is fundamentally different from just paying rent every month. If the homeowner stops paying the monthly payment, he's out on the street, and the bank keeps the house, which is very similar to the scenario in which a renter stops paying a landlord. There's (at least) one big difference here, however. It makes sense for the homeowner to get a home loan rather than rent an apartment because — if it's a fixed-rate loan — price inflation ensures the *real* monthly payment will go down every month. Residential rents, on the other hand, tend to keep up with inflation.

But why would any lending institution make these sorts of long-term loans if the payment in real terms keeps getting smaller? After all, thirty years is a long time for something to go wrong.

Lenders are willing and able to do this because the loans are subsidized and underwritten through government creations like Fannie Mae (which buys up these loans on the secondary market), through bailouts, and through a myriad of other federal programs such as FHA. Naturally, in an unhampered market, a loan of such a long term would require high interest rates to cover the risk. But, Congress and the Fed have come to the rescue with promises of bailouts and easy money, meaning cheap thirty-year loans continue to live on.

So, what we end up with is a complex system of subsidies and favoritism on the part of lenders, homeowners, government agencies, and the Fed. The price of homes keeps going up, increasing the net worth of homeowners, and banks can make long-term loans on

fairly risky terms because they know bailouts of various sorts will come if things go wrong.

But problems begin to arise when increases in home prices begin to outpace access to easy money and cheap loans. Indeed, we're now seeing that homeownership rates are going down in spite of low interest rates, and vacancy rates in rental housing are at a twenty-year low. Meanwhile, new production in housing units is at 1992 levels, offering little relief from rising prices and rents. Obviously, something isn't going according to plan.

Who Loses?

The old debt-based tricks that once kept homeownership climbing and accessible in the face of rising home prices are no longer working.

From a free market's perspective, renting a home is neither good nor bad, but American policymakers long ago decided to favor homeowners over renters. Consequently, we're faced with an economic system that pushes renters toward homeownership — price inflation and the tax code punishes renters more than owners — while simultaneously pushing home prices higher and higher.

During the last housing bubble, however, as homeownership levels climbed, few noticed or cared about this. So many renters became homeowners that rental vacancies climbed to record highs from 2004 to 2009. But in our current economy, one cannot avoid rising rents or hedge against inflation by easily leaving rental housing behind.

This time around, the cost of purchasing housing is going up by 6 to 10 percent per year, but few renters can join the ranks of the homeowners to enjoy the windfall. Instead, they just face record-high rent increases and a record-low inventory in for-sale houses.

There once was a time when rising home prices and rising homeownership rates could happen at the same time; it was possible for the government to stick to its unofficial policy of propping up home prices while also claiming to be pushing homeownership. We no longer live in such a time.

Note: [Originally published on Mises.org] The views

expressed on Mises.org are not necessarily those of the Mises Institute.

Comment by R. Nelson Nash: This reminds me of the story of the man who heard that Macy's had increased the price of men's shoes. "I had better hurry down to their store and buy a few pair!"

The Meaning of Financial Repression

JUNE 1, 2015 — Mark Thornton

We live in a world of massive monetary inflation and extremely low interest rates. Mortgage rates are near historic lows and yet it seems that people cannot get loans. Home sales are up, but with a near record percentage of sales made with cash, rather than a mortgage. The unemployment rate is nearing "full employment" and yet a record number of people do not have jobs.

We are repeatedly told that the unprecedented monetary stimulus by the Federal Reserve and other central banks is necessary to stimulate the economy, create jobs, and generate economic growth. The truth is that this scheme is designed to stealthily steal from the productive classes in order to enrich the unproductive financial class and the counterproductive political classes. It is a con game.

Financial Repression

With politicians and central bankers seemingly gone mad with their obsession for money printing and ultra low interest rates, it is nice to know that academic economists have a term (i.e., financial repression) for the policies that have created our current economic conditions.

However, it is not a new term. Its use dates back to at least 1973 when two Stanford University economists, Edward Shaw and Ronald McKinnon, used the term in separate publications. The phrase was initially meant to criticize various policies that reduced economic growth in undeveloped countries, rather than as an indictment of the world's leading modern economies.

Financial repression is a revolving set of policies where the government insidiously takes wealth from the private sector, and more specifically makes it easier for government to finance its debt. In today's environment this includes:

1. ZIRP or "zero interest rate policy" where many of the world's central banks keep their lending rates to banks at or near zero. Naturally, this makes the interest rate on government debt lower than it otherwise would be.
2. QE or "quantitative easing" is the central bank policy of buying up government debt from banks. This increased demand increases the price of government bonds and reduces the interest rates on those bonds.

These are the two major policies of financial repression currently in use. The combination of the two policies has allowed governments to borrow money, both short- and long-term bonds, at extremely low interest rates. This, in turn, has kept the government's interest payments on the national debt relatively low.

Other signs of financial repression in the United States include requiring banks to hold government bonds for their capital requirements, which the Basil III accords increased; high reserve requirements, which paying interest on excess reserves effectively accomplishes; and capital controls that restrict or tax the exportation of wealth. And then there is the "War on Cash."

All these policies also come under the rubric of "macroprudential policy" under which government bureaucrats hyper-regulate and oversee the entire financial industry. Macroprudential policy provides another aspect of financial repression: government control or outright ownership of banks and financial institutions while simultaneously providing banks with barriers to competition. It is difficult to precisely define macroprudential policy, but it would seem to mean a group of imprudent policies that only make sense if you are trying to maintain the macro mess we find ourselves in.

Negative Interest Rates?

When you combine financial repression with bail-

in provisions for banks and unstable currencies you end up with the nearly unfathomable phenomenon of negative nominal interest rates on government bonds. Several European countries have already sold two-year bonds for more than their face value, so that bond buyers are paying more than 1,000 euros for which they will only receive 1,000 euros in two years time.

Why would anyone accept that deal if you could just hold the 1,000 euros in cash? Well, there is the natural inclination to keep your money safe in a bank. So people with vast sums of money do not want to keep several million euros in cash. They would rather keep it in a bank and earn interest.

The problem with that approach is that banks are not paying interest and, more importantly, some governments have established bail-in provisions for systemically important big banks, similar to what happened during the financial crisis in Cyprus. These provisions mean that depositors in failed banks will receive "haircuts" for any uninsured deposits. A "haircut" means depositors would lose some percentage of their uninsured deposits. Alternatively, uninsured bank deposits and bonds could be exchanged for equity shares in the bank.

So, for wealthy depositors it might make sense to pay more than the face value for a government bond if they think that the governments are more trustworthy and more likely to redeem the bond compared to their bank redeeming their deposits.

An alternative reason for bondholders' willingness to pay more than the face value of a bond is unstable currencies and exchange rates. If I live in the eurozone and expect the euro to depreciate against the Swiss franc or the Norwegian kroner, then you might consider buying Swiss and Norwegian government bonds with negative nominal returns based on the expectation that you will still be better off than if you bought bonds denominated in euros.

The Effects of Bad Government

Financial repression is an outgrowth of bloated government budgets and enormous government debts. It is the worst way of dealing with government debt and

actually works against the proper ways of addressing fiscal problems which include: eliminating government programs, eliminating military bases, austerity based on cutting politicians and government employees' salaries and benefits, and deregulation and privatization to increase economic growth.

The effects of financial repression cause economic harm throughout the productive sectors of the economy including workers, savers, entrepreneurs, retirees, and pensions. It hurts the insurance industry that protects our lives, homes, health, and property. The economic beneficiaries include the big banks and Wall Street, the national government itself, and certain large corporations.

Carrying on the Traditions of Bad Government

In Siena, Italy, the fourteenth-century frescoes called *The Allegory of Good and Bad Government* are housed in the old city hall on the Piazza del Campo. Good government is based on peace, resilience, prudence, fairness, and self-control with a special emphasis on justice. Good government is depicted on the right side of the hall as thriving commerce, productive labor, and good economic conditions.

Across the room is the mirror image of bad government. It is based on cruelty, deceit, fraud, rage, division, war, greed, arrogance, and excessive pride. The effects of bad government are depicted with the city in ruins, demolished houses, and no commerce except for the making of amour and weapons. The city streets are deserted and out in the country two armies are poised for war.

On the side of good government sits an image of justice on a throne. Across the room, an image of tyranny sits on the throne. The panorama of the frescos is breathtaking and all too accurate, and financial repression is merely the latest contribution of the modern state to the concept of bad government.

Comment by R. Nelson Nash – Mark Thornton “nailed it” at the end of his second paragraph – “It is a con game!” Where have people placed their confidence? Government? To quote Charlie Brown, a character in the comic strip PEANUTS – “Good grief!!” The

track record of all governments is miserable. Ours has been getting worse for more than 150 years.

The common denominator in this downward spiral centers on money and the banking function in life. Bankers have taught citizens how to become financial slaves! It doesn't have to be that way. Just don't play their game! Even in this financial condition in which the world finds itself there are thousands who have learned how to secede from the system through the teachings of the NELSON NASH INSTITUTE.

From Bailouts to Bail-Ins: Understanding the Dodd-Frank Act

by L. Carlos Lara

On the surface, the *Dodd-Frank Wall Street Reform and Consumer Act*¹ (January 21, 2010)—the most sweeping overhaul of the financial markets since the Great Depression— was created to provide increased preventive regulation in order to strengthen the financial markets in case of another 2008-type crisis. This new law specifically involves increased capital thresholds for financial institutions mirroring the cross-border framework and requirements of the *Basel III International Reforms*² that were formulated for the banking system of the European Union by the Bank for International Settlements. (*See: The Lara-Murphy Report (LMR), May 2014 edition. “Bank Deposits Are Risky—Now More than Ever.”*)

In addition to these requirements, the law also provides for an expedient liquidation process for any insolvent financial institution, including the regulatory tools to implement the liquidation. This process referred to as “*Statutory Bail-Ins*” includes expanded powers to the Federal Reserve, the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC), whereby bank holding companies and significant non-bank holding companies can be placed in receivership under federal control with the FDIC acting as receiver under Title II of the Act.³

More importantly and because investors are an essential ingredient of capital markets, the Dodd-Frank Act is aimed specifically to increase Wall Street transparency and investor protection as a means of bolstering investor confidence to draw them back into the investing arena.

NO MORE BAILOUTS

Above all, the most affirming stance this new law makes is that “*too-big-to-fail*” financial institutions will not be bailed-out by taxpayer dollars this next time around. In and of itself this one caveat alone smacks of prudence on the part of our governing officials. After all it’s no secret that the bailouts created one the worst economic hazards for the helpless American taxpayer compared to any other financial reform to date; in no way was a financial dilemma rectified. Therefore, protecting taxpayer money became the principal priority of the new U.S. reform. What is incredibly ironic is that since this colossal law was enacted, the Federal Reserve and in fact, all world central bankers, have never been so brazen in their stimulus programs. The near-zero interest rates across all boarders continue to prod the sophisticated institutional investor, global market trader, and international investment banker to proceed with business as usual, employing high-risk investments and careless credit expansion similar to the period prior to 2008. Meanwhile the world debt bubble continues growing at an accelerated pace.

According to a recent financial report put out by McKinsey & Company (February 2015)⁴, global debt since 2007 has grown by \$57 trillion raising the ratio of global debt to GDP by 17 percentage points. They estimate that as of the second quarter of 2014, the global debt to GDP ratio stood at 286%, compared to 269% back in the fourth quarter of 2007. The main thrust of the report is that the world as a whole has *not* “deleveraged” since the financial crisis of 2008, even though we all supposedly saw just how dangerous that leverage was.

In particular, household debt worldwide has exploded with debt-to-income ratios exceeding peak levels and 74% of household debt being directly tied to mortgag-

es. The similarities, then to present circumstances are eerie. One is left to conclude that perhaps this one caveat in the new banking system rules—*no more bail-outs*—has somehow created a false sense of security that our banking and government officials have their hands firmly on the steering wheel and we have no need to worry. Yet short of sheer madness what else can explain these unprecedented numbers in light of diminishing expectations of future economic growth?

The masses of society still remain uninformed regarding the particulars of the Dodd-Frank Act even five years since its enactment. But financial experts and economists who understand the details of this law are beginning to voice their doubts as to whether all this excessive regulation is warranted, or even if it can actually be enforced without creating an even more detrimental hazard to the entire economy at the time of the new crisis. At this point the only example we have of how a *statutory bail-in* would actually work are the results of the insolvencies of the two largest commercial banks in Cyprus, which occurred in March of 2013. In the end only one bank was actually shuttered and minimal taxpayer money was required. Consequently, government and banking officials were quite satisfied with the results of the bail-in process except that the stockholders, bank depositors, and the Cyprus economy did not fare all too well. (The larger stockholders of the bank exited before knowledge of the insolvency became public.) The latest news from Cyprus reported in a Wall Street Journal article⁵ late last year is that the existing shareholders were almost completely wiped out and 21,000 bank clients who had deposits of more than 100,000 euros saw 47.5% of their unsecured savings converted to equity making them 81.4% owners of an insolvent bank. Unfortunately, the bank is now teetering on closing permanently if they can’t get a new infusion of capital to keep the doors open. But what leadership for the bank can be expected from depositors turned shareholders who really only want their money back?

WHO SHOULD MONITOR THE BANKS?

“Winding back clocks, or putting genies back in bottles, rarely can be done, but history shows that nations took a wrong turn when they abandoned *bank*

shareholder double liability for a system of governmentally administered deposit insurance.”⁶ This is the strong commentary coming from a special report put out by the C.D. Howe Institute of Canada, a non-profit nonpartisan periodic analysis on current public policy issues.⁷ According to the C.D. Howe Institute, the basic flaws in the new rules for the financial system, such as Dodd-Frank and the Basel III International Reforms, are two-fold—in *monitoring incentives and the increased role of deposit insurance*, which currently insulates depositors and shareholders from some or most of the costs of an institution’s failure. The Institute points out that “until the mid-20th Century, banking regulation in the United States, Canada, the UK and elsewhere relied mostly on monitoring by shareholders and depositors.” In essence, before deposit insurance existed depositors were expected to keep a close eye on the banks that held their savings.

SHAREHOLDER DOUBLE LIABILITY

Prior to the founding of the Federal Reserve System in 1913 senior bank managers of national banks were also the bank’s major shareholders and in the case of the bank’s failure they were personally liable for any of the net losses of the bank. The shareholders of deposit-taking institutions were not allowed to use the *limited-liability* corporate form of business even though it existed. Consequently, bankers and all shareholders of banks operated their banks with ***double***-liability exposure. The principal reason for this double liability regulation was that it was well known that bankers have the legal capacity to use for their own benefit the funds they hold on behalf of others.

What the C.D. Howe report points out is that all through the 19th century and well into the 20th century, the records show that numerous deposit-taking institutions were generally small single-branch banks that could easily enter into a banking crisis associated with prolonged drought and crop failure. The picture we get is one of the proverbial “*mom and pop shop*.” Although bank runs were numerous, bank depositors—because of the double-liability of bankers—were usually made whole. As a general rule banking crisis were quick, short in duration, and localized.

Shareholder potential double liability in the running of a banking business was conceptually similar to what today is called “*contingent capital*,” found in the many modern hybrid debt securities that can provide immediate liquidity for a capital-starved business. The fact that the bank manager/owner faced serious liability in the event of failure would become a powerful incentive to convey, consolidate, or transfer the assets of his distressed bank to a more profitable banking entity, while his bank was still solvent. This would make for a much smoother reorganization.

There also existed legislation that prevented share transfers from being made sixty days before failure, which prevented bank owners from arranging their affairs to limit their personal exposure similar to what we found in Cyprus. This 60-day rule made voluntary liquidations more common in the banking system of that day and it far exceeded the number placed into liquidation involuntarily by bank regulators.

Given the benefits of bank shareholder double liability why did it disappear from practice in the U.S. and other countries to be supplanted with deposit insurance?

A BRIEF HISTORY OF THE FDIC

In the U.S., banking expanded westward following the growth of railroads, land settlements, and the farm mortgage market. Along with that growth, bank shareholding grew as well, up to the stock market crash of 1929. With the market crash and the depression that followed, bank runs and bank failures increased taking down and exposing larger numbers of average Americans into the double liability consequences. The outcome was disastrous and politically damaging. It was the *New Deal* under President Roosevelt that first introduced the federal provision for deposit insurance to make depositors whole in newly failed banking institutions. With these developments double-liability in time became less politically attractive than deposit insurance and it soon faded from the U.S. rulebooks. It took more than a decade to be widely accepted in the United States and in other countries it took even longer. For example, federal deposit insurance in Canada was not created until 1967.

Is this to suggest that we should return to dual shareholder liability as a way to supplement current initiatives aimed at conduct regulation, capital adequacy and liquidity? The authors of the C.D. Howe Institute report realize this would not be possible in today's world with financial institutions being so widely held and with shareholders having so very little influence on a financial institution's board of directors. It does, however, strongly suggest that federal deposit insurance should not be expanded and should in fact be curtailed for the simple reason that it generates a lack of incentive on the part of the public to guard against bank mismanagement. In fact, the risk of moral hazard associated with deposit insurance was well understood at the time of its introduction, according to Howe. Its acceptance had more to do with maintaining public confidence in the banking system during unsettling economic times. Ironically, no single-liability state created a deposit insurance system, underscoring the fact that shareholders and managers were still expected to provide the real safety net.

CONCLUSION

We've drawn heavily from the C.D. Howe Institute's report for a fresh historical perspective in order to help explain many of the dangerous eventualities of our modern day banking systems that have placed many individuals in harm's way without their knowledge. Rereading my article, "Bank Deposits Are Risky—Now More Than Ever" in our May 2014 issue of the *LMR* can also be helpful in gaining a better understanding of what is in store for the public since the enactment of the Dodd-Frank Act if certain precautionary measures are not taken.

The crux of my previous article was to point out to our readers that *statutory bail-ins*, as defined in the Dodd-Frank Act, amount to forcing a failed institution's shareholders back into a *similar* double liability exposure situation should a financial institution fail—and by extension, the bank depositors as well. Can it be any more frightening than this? Is it really possible that our current laws could subject the public to this sort of unexpected dilemma? Unfortunately it is.

Perhaps we should remind ourselves that investors

in bank shares can be just as naïve as an ordinary customer of a bank—i.e., a bank depositor. There is no financial expertise required to be either. Most likely neither are aware of the new rules governing our banking systems today and how easily they could be drawn into a financial quagmire of which they are ill equipped to handle. For sure neither the average bank shareholder nor bank depositor has any intention of ever running or owning a commercial bank by simply making a bank deposit or buying bank shares anymore than we would. Yet this all could change in the blink of an eye if that bank is declared insolvent and those individuals are a party to the insolvency in either of those roles. Unfortunately, the way our laws are set up today many could find themselves in the identical situation as the Cypriots.

The fact is that most bank depositors lose the incentive to watch over their savings in commercial banks account because deposit insurance assures them the government will return their money in case of a bank failure, while at the same time it allows banks to take on more care-less risks with depositor monies. Studies made by economist Demirgüç-Kunt and Detragiache of the World Bank Development Research Group find that "*...deposit insurance tends to be detrimental to bank stability. The U.S. Savings & Loan crisis of the 1980s has been widely attributed to the moral hazard created by a combination of generous deposit insurance, financial liberalization, and regulatory failure...Thus, according to economic theory, while deposit insurance may increase bank stability by reducing self-fulfilling or information-driven depositor runs, it may decrease bank stability by encouraging risk-taking on the part of banks.*"⁸

The most important thing to keep in mind is that banks are inherently susceptible to systemic risk simply because without a lender of last resort they operate on an illiquid basis at all times. During the 2008 crisis, 1,200 banks required assistance from the FDIC and it ran completely out of money, requiring help from the Treasury. Now the one rule in the entire Dodd-Frank Act that limits banks from engaging in hedge fund ownership and risky derivatives—the *Volker rule*—is on target to be completely repealed by a lobbyist

group headed up by Citigroup, JP Morgan, and Wells Fargo. They have already succeeded in receiving an extension through 2017 for banks to continue their derivative business as usual.

Given the situation we hope you will agree that it's time to do something about this at once. We should all be setting up an alternate warehouse for our money and begin the process of weaning ourselves from the precarious nature of our current commercial banking system and its new regulations. This new money headquarters should be in a completely different sector of the economy, away from the commercial bank/Wall Street sector. Specifically, it should be the insurance sector. Keep very little money in the banks, only enough to pay for current expenses. All excess cash flow should be swept into your alternate money warehouse where you will benefit from the safety, privacy, and control of the money you put in it, plus numerous other benefits to shield you from the uncertainty of our times. In an economic environment such as what we have today there is really no reason to delay. Please contact an Authorized IBC Practitioner today (at www.infinitebanking.org/finder) to learn more about how to set up your own alternate money headquarters as soon as possible.

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Nelson's Favorite Quotes

Lawyers believe a man is innocent until proven broke. --Robin Hall

The first piece of luggage on the carousel never belongs to anyone. --George Roberts

After the game, the King and the Pawn go into the same box. --An Italian proverb

Knowledge does not equal understanding
-- Anonymous

Nelson's Newly Added Book Recommendations

<https://infinitebanking.org/reading-list/>

Looking Out for #1: How to Get from Where You Are Now to Where You Want to Be in Life
by Robert Ringer

Country Squire In The White House
by John T. Flynn. *This book was written in 1940. It will give you some valuable insight into "how the thinking in America" at that time got us into the financial catastrophe we currently experience.*

Secrets About Money That Put You At Risk
by Michal J. McKay

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

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

- *Gary Sund - Danvers, MA*
- *Barry Brooksby - Saint George, UT*
- *Elizabeth Miller - London, OH*
- *Harry Smallwood - Columbus, OH*
- *Thomas Young - Beaver, PA*
- *Pedro Palicio - Coral Gables, FL*
- *Patrick Donohoe - Salt Lake City, UT*

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.

The *IBC Practitioner* has signed the *IBC Practitioner's Agreement* with the IBI that specifies that he or she is a financial professional who wishes to advertise his status as an *IBC Practitioner*, and acknowledges possession of the proper licensing and other legal requirements to practice in his industry. The *IBC Practitioner* agrees for those clients who want an IBC policy, he will design it according to certain characteristics to ensure that these specific clients are getting a "*Nelson Nash*" policy, as described in his books and seminars. If an *IBC Practitioner* is dealing with a client who asks for an "*IBC*," "*Nelson Nash*," "*privatized banking*," or "*banking*" policy, or if the Practitioner recommends such a policy to the client, and/or if the client has come to the Practitioner by referral from his listing at the IBI website, then and only then the Practitioner must be sure to set this particular client up with a *dividend-paying, whole life policy*.