The Trouble with Debt

by Sean Corrigan
July 2, 2002

Last week, headlines around the world were screaming out the sad tale of WorldCom--or, as a host of copy writers have come to call it, WorldCON--and its $4 billion or so misstatement of earnings.

But should we really be surprised that another poster child of the boom--especially one whose growth has come through rapid-fire acquisitions led by a rock-star CEO--has been revealed to be a hotbed of malpractice?

No, we shouldn't be, because inflations--i.e., vast infusions of surplus, dishonest money--always lead, via fervent speculation, to rampant corruption. Always. If you doubt this, go check the historical record.

But there is a wider point here, which will be lost in the scandal and the immediate financial disillusionment this splash has already caused.

The whole Greenspan New Era productivity myth was based upon his false syllogism that if profits were up and costs were subdued, then heightened investment--in shiny new technology, naturally--was generating increased productivity and so monetary policy could remain accommodative.

Devotees of the Austrian School will have spotted a certain circularity here, for easy money was artificially stimulating investment (and eventually malinvestments), and the two together were boosting the prices of financial assets.

Those higher prices were themselves vital to much of the surge in accounting profits for a host of reasons mostly unrelated to the generation of real economic wealth.

The Fed's intrinsically meaningless price indices, meanwhile, were well behaved, not just because plunging sales stickers in tech were being progressively overweighted in the statistical calculations (like a sort of reverse NASDAQ effect), but because foreigners were happy to swap their cheap goods for a piece of the American action, instead of asking for goods (or selling their dollars) in return.

But there is another wrinkle: GDP growth had also seemed so extraordinary, primarily due to two main impetuses; that reverse NASDAQ effect of what are known as "hedonic" adjustments to the raw numbers of technology spending (to take account of supposed quality improvements), and the novel inclusion of elements such as software as an investment, not an expense.

This latter mattered because the GDP, or gross domestic product, numbers are in fact not really "gross" at all, but a mishmash of net expenditures with a partial gross addition in the critical, but largely arbitrary, category of investment. Reclassifying an activity as "investment" rather than mere business-to-business spending thus swells the aggregate--especially if "real" values are reckoned to be far outstripping actual dollars spent, thanks to those wondrous hedonics.

So it seems ironic that, just as the Bureau of Economic Analysis shifted software from expense to capital expenditure to boost the bottom line--to the disapprobation of such august bodies as the Bundesbank, who famously recalculated the European data on the basis of the BEA methodology and found Germany came out way ahead of the States!--WorldCom was practicing the same game.

But if WorldCom--and, no doubt a host of imitators yet to be identified--was artificially reporting capex, should we go back and revise all those GDP numbers lower, too?

The answer is clearly in the affirmative.

Thus, another tenet of the Greenspan Model proves to be invalid. Not only were profits often fraudulently overstated--as well as being falsely, if legally, enhanced by stock-options accounting--but "growth," too, was slower than reported in the boom years.

Do you know what was real, though? Incontrovertibly, unimpeachably, and rigorously recorded? Debt--even if the ultimate title to much of it has been obscured by Wall Street's skills in financial engineering. Debt. Liabilities. Owing money. Claims on yet-to-be-earned income. A lien on the future. A mortgage on Tomorrow. Debt. The real, four-letter legacy of Alan Greenspan and his former accomplice, Bob Rubin.

In a week when Adelphia--in the supposedly safe, "utility-like" cable TV business--filed for the fifth largest bankruptcy in U.S. history, and when, abroad, FIAT was cut to one notch above junk and left with the threat of being tipped into that inglorious category by Moody's, the status of much of that debt is again a vexed question.

Moody's itself was relatively sanguine in its latest overview. Noting the speculative grade default rate was stable at 10.3 percent in May, the agency merely remarked that there had been a "slower than expected decline" in that proportion, though spokesman David Hamilton did admit that "credit remains a concern."

FitchIBCA painted a somewhat bleaker picture, posting a 13.4-percent default rate on its high-yield universe, with any improvement in overall ratings a mere statistical artefact resulting from the fact that even as so many CCC and lower-grade bonds had defaulted--fully $34 billion out of $120 billion late last year--several "fallen angels" had been newly included, as they in turn dropped out of the investment grade rankings.

S&P was perhaps the most sombre, noting that "the second half of 2002 continues to be challenging." Standard & Poor's also pointed out that, while 60 percent of U.S. ratings outlooks were currently stable, negatives, at 35 percent, outpaced positives 7:1.

Moreover, the firm was at pains to point out that pressure was not restricted to tech, telecom, and energy, but that the malaise was much more widespread.

Autos were characterized thus: "financial performance deteriorated precipitously." In capital goods: "the extent of the weakness cannot be overstated." Banks? "The majority of the 25 percent subject to change have a negative outlook." Energy: "Dismal."

Chemicals, forestry & mining, auto supply, consumer goods, media & entertainment, airlines--all had more companies with negative outlooks than with positive. Only health had parity between the ups and the downs (thank you, socialized medicine!).

As for those banks, while earnings were a record $21.7 billion in the first quarter--largely due to the Fed's largesse and the corresponding aid to net interest income--the FDIC warns of two major risks; that high loan-to-value consumer loans are not performing as well as their grantors' models predicted (Capital Insight Rule I: The Model is NOT the Market) and that there are heavy exposures to commercial property in some of the districts worst affected by the bust.

For thrifts, there are other worries. For the first time in four years, loan-loss provisions do not fully cover noncurrent loans, and there has been a sharp jump in problem thrift assets to a $15 billion level not seen since 1994.

At the personal level, the ABI showed record filings for bankruptcy in the last four quarters, with more than 1.5 million, mostly individual, filings being logged for the first time ever. Also, despite secularly low interest rates, we know debt service as a proportion of disposable income is already at a record, even without adding in the personal sector's equivalent of a "special purpose vehicle"--a consumer lease agreement whose contingent cash-flows underpin financial market debt somewhere else in the system.

But, hey, why worry? Just buy a house, and all your problems will be solved. Or, at least, that's what the data continue to tell us is the preferred solution for many.

Existing home sales this year so far are up 18 percent in dollar terms from the first five months of 2001, with average prices rising 9 percent nationwide to top the $200,000 mark. A record average/median ratio also suggests the distribution is being sharply skewed to high-end purchases, to boot.

New home sales, too, topped the one million annual rate last month for the first time ever, and overall housing turnover is now a record 18 percent of disposable income--significantly above the 13-percent average since the last cycle peak in 1989, and twice the 9-percent low seen in the 1990 property bust.

Moreover, consider that, if we knew that in a nation the size of, say, France, there had been a median home price increase of 25.5 percent in a year and that this, far from deterring purchasers, had led to a 22.7-percent increase in sales, would you say this represented a Bubble--a good old debt-fueled Bubble--and that this might pose risks to financial stability, especially when so many people involved were dependent for work, whether directly or indirectly, on the most battered industries?

In which case, what are we to make of the extraordinary 57-percent dollar year-on-year increase in spending on the California Real Estate Rush?

Houses are nonproductive assets, financed with a great deal of leverage. What is more, though they release their services in small increments to the owners, they deliver a large dollop of uncompensated purchasing power up front to their builders or to those cashing out of the market, as well as to the Realtors, who netted around $1,200 for each loan originated in the record $2 trillion total last year.

Therefore, houses are, perhaps, the ultimate engines of created credit on the upswing, and are among the more dangerous deflators on the way down.

As this last, fully functioning monetary engine accelerates its revolutions--with the wholehearted endorsement of Dr. Debt, Alan Greenspan himself--bear in mind that real estate did not pop until nearly two years after the Nikkei's 1989 peak and that land values ran up nearly 20 percent in the interim, even as stock prices were falling by half.

Consider also that it was the fall of 1931--again, almost two years after the stock market crash--when real estate woes started to exact a heavy toll on banks' loan portfolios and on the mortgage bonds they had issued previously.

As Benjamin Anderson put it, by 1931-32, many were wondering whether they would not have done better in 1929 to have sold mortgages and invested the money in stocks, even at the height of the mania. Many of the latter were still paying substantial dividends, Anderson noted: many of the former--even those issued by prime mortgage guaranty companies--had long ceased to pay interest.

Dr. Debt may well find it will not just be equity investors and overseas dollar holders who come to curse him. Overburdened homeowners and even those who count these debts and their derivatives among their own savings may well come to do likewise before the crisis passes.

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If you believe in what you are doing, then let nothing hold you up in your work. Much of the best work of the world has been done against seeming impossibilities. The thing is to get the work done. –Dale Carnegie

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Regulatory Rot

by Gregory Bresiger

July 23, 2002

Harvey Pitt should just give up.

Once again, our government is pursuing a futile quest. The idea of regulation has never and will never work effectively. Still, the regulators always say we need more of them, despite a record of failure as enviable and consistent as that of the Chicago Cubs or the pathetic New York City Board of Education.

It is time to think the unthinkable: Forget about the system of regulation; consign it to the garbage bin of history.

Yes, it's time to think about closing down the SEC, along with a myriad of other regulatory bodies. It is time to ask the same question of the regulators that we, the citizens who pay for all this, should be asking of every level of government: Just what, exactly, are these tens of thousands of people accomplishing? I mean, besides providing themselves with nice salaries, prestigious offices, and the power to destroy businesses.

The trading industry supposedly was riddled with price-fixing, according to a controversial study that the government used to justify its order-handling rules. These rules were a reform designed by regulators to fix the problem, real or imagined. The rules gave an impetus to electronic communications networks (ECNs), which became the darlings of the regulators. ECNs were the entities that would compensate for the supposed wrongs of market makers. In the late 1990s, ECNs started to take much business away from market makers. The regulators had succeeded.

Well, not exactly.

Now a new trading platform is in the process of starting up, with the blessing of the regulators. The SuperMontage will provide liquidity and transparency to the market. It will become the ultimate ECN. It will also be run by a former regulator--one that is about to become a for-profit exchange--called Nasdaq. This is a development fraught with potential problems, as Nasdaq will have advantages that it has not earned in the marketplace.

Already, the same ECNs that benefited from the favors of regulators in the 1990s are complaining that this new regulatory system will be rigged against them. Many market participants, in effect, could be forced to use SuperMontage, especially if the Brand X alternative to SuperMontage, the Alternative Display Facility (ADF), is not ready in time. The latter is the responsibility of another regulator, the NASD, which used to be the parent of Nasdaq but, as it goes private, has retained a small stake in Nasdaq. (Listen, this stuff is so convoluted that I couldn't make it up if I had the collective talents of a Sinclair Lewis, Joseph Conrad, F.A. Hayek, and Liam O'Flaherty.) How much does one want to bet that, if and when SuperMontage and ADF start operating, the regulators will require another regulatory scheme to correct the problems of these latest regulatory wonders?

Regulation, whether it involves railroads, trading, or software, is so incredibly involved that, inevitably, it must end up requiring new rounds of regulations to fix the first round of regulations. Regulation--like civil rights laws--has no timetable. It is designed to go without end. There is never a regulatory scheme that is designed to fix a problem once and for all, just as affirmative action will go on forever and then close up shop.

That is because the nature of public bureaucracy is self-perpetuating. In William Safire's book "Before the Fall," which was a chronicle of his years in the Nixon administration, Safire tells the story of useless tea regulatory board that some six U.S. presidents--Democrat and Republican--had unsuccessfully tried to jettison. Every time the tea board was marked for death, some congressman would put it back in the budget; it would survive because, after all, who would hold back an entire federal budget for a dinky little board? Even the powerful Nixon, at the height of his power before Watergate, couldn't get rid of it. To a much greater extent, the SEC has been as ineffective and as useless as that board. It should go.

The SEC, along with every other regulatory body, is based on a specious premise. It is based on the principles of the Sherman Act, which was passed in the late 19th century and was designed for an economy that was dominated by railroads. That economy no longer exists, yet our economy is hampered by the antiquated notions of that law.

Here we see the futility of regulation. It can't keep up with a dynamic economy, an economy that is changing much faster than the regulators, even if the regulators were men and women worked 24 hours a day and were imbued with the wisdom of Kant. Then again, the brilliant philosopher Immanuel Kant was a man of modesty.

The idea of regulation is not based on modesty and limitation. It is based on the idea that regulatory bodies are all-knowing; that they are run by men and women of limitless wisdom, who know, for example, when to favor ECNs at the expense of market makers and vice versa. All of them labor under the delusion of the Sherman Act, which states in Section I, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among several States, or with foreign nations, is hereby declared illegal…"

So, individuals or businesses working in their own self-interest to obtain a better price or higher profits may be deemed by regulators to restrain trade. But how does one objectively apply this law, free of political prejudice? This is tantamount to asking how can one eat a pint of Haagen-Dazs once a day for a month and not gain weight?

One can't.

These regulatory laws allow a lot of leeway for interpretations that mean the difference between leaving a company alone or filing a lawsuit that can cost hundreds of millions of dollars to defend. And how exactly does one know that "self-interest" has become "restraint of trade"? Maybe the best thing for a market sometimes is for one giant, efficient firm to provide the best price and quality of service, provided, of course, that anyone is free to start a competing service. And, more important, how does one know that the people administering our regulatory system do it in an objective, fair-minded, apolitical way?

History tells us that they don't. So the Clinton Justice Department believed Bill Gates and his Microsoft Empire are the moral equivalent of Lucifer. By contrast, the Bush Justice Department, administering the same laws, believes that the company has committed no crime. Someone must be wrong. Was the Sherman Law changed?

No, the politically interpreted nature of this law changed with the change of administrations. So the Lyndon Johnson Justice Department claimed that IBM was violating the law, but the Nixon Justice Department--all sworn to administer these same laws--said the lawsuit was no big deal and settled it on easy terms.

The quixotic, insane quest of regulators will continue just as long as these laws are on the books and as long as these regulators feel compelled to impose a dictatorship of virtue. Most of the people in Cervantes's delightful novel "Don Quixote" could see that this poor man was crazy. Are Americans ready to understand that our regulatory masters are charging into windmills? That their golden helmets are nothing but shaving basins? That their schemes are about a century behind the times?

I would rather take my chances with the IBMs, the Microsofts, or even the Nasdaqs of this world. After all, no one forces me to buy Gates's software or IBM's product or to use Nasdaq's trading platform. Unfortunately, the government can and does force me--through the coercive power of taxation--to pay for its wretched bureaucracies, whose only products are inefficiency, politics, and endless confusion.

Let Harvey Pitt and his minions go into a useful line of work. If they're afraid of the private sector, then let them contact me right here. I'll be happy to help them find work.

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Regulations give people permission not to think!

The Silence of the Privatizers

by Llewellyn H. Rockwell, Jr.

A question for all ye who favor what is misleadingly called Social Security "privatization." What do you have to say for yourselves now that the stock market is actually paying a smaller return than the government promises to pay, and has for 18 months? As bad as Social Security is, apart from inflation losses, the system doesn't actually cause people to lose 20 to 50 percent of their initial "investment."

Normally this point would be irrelevant. The point of the stock market is that the people who invest choose to do so rather than spend their money in others ways. Whether they win or lose, it’s their risk. And even if Social Security were a willing deal for people, there is no justification for forced savings.

But you privatizers have been plotting for years to institute a new layer of forced savings that would collect money to be channeled into stocks. Imagine how much you fellows would be sweating right now if you had actually succeeded in your policy goals. What if you had persuaded people to put their coercively stolen money into stocks instead of government bonds? Just imagine how great the public outcry would be for a complete bailout of Wall Street.

The much-ballyhooed "Social Security calculators" on your websites are the way you chose to demonstrate the higher returns on privatization. But the scroll-down menu for stock-market returns provides options only for positive returns of 10 to 1 percent. There is no option for a loss of 5, 10, or 50 percent. That means in the current climate, these online calculators are completely useless, even fraudulent. Why do you leave them up?

And don't say that you don't really favor stocks but rather "choice" in where people put their money. The whole sales pitch you have been giving, for years and years, is that your program would cause people to earn more money if they had the "freedom" to invest in stocks with money that has been taxed away. That's the supposed value added of privatization, according to your own writings. That's why Wall Street has been funding these lobbying programs for so many years.

This has always been a highly misleading, even radically unprincipled, approach. One can never know in advance what the returns on stocks versus bonds or any other private investment will be. And by talking about relative returns, you are playing right into the central-planners' hands by pretending that Social Security is an "insurance" program as opposed to a straight tax-and-spend redistribution operation.

The first intellectual duty of any critic of Social Security is to expose the main lie, and reveal that this program is not savings or insurance. But you have obscured that point in order to pitch what you believed to be a sure-fire sales campaign: appeal to people's pocketbooks. But that hasn't turned out very well, has it?

And what you haven't really explained to people is that your privatization plan, which would retain all the coercive aspects of the current system, would require transition costs that run into the many trillions, and accelerate the rate at which the program will appear to be in need of a bailout (diverting money tends to do that).

That aside, notice that the public is already ready to drag CEOs to the guillotine, and this over money that people voluntarily used to purchase stocks. Imagine if the money had been coercively taken from their paychecks and invested in stocks on the promise that at least if they can't spend their money, it can be invested at a high return? Investors would be out for blood, even more than they are now. And who are people going to blame but the "libertarians" who agitated for this program in the first place?

And don't talk to me now about the inherent risk of every investment. It's fair to say that people should offer up the losses of investments that they choose. But so long as you retain the coercive aspects of the program – forcing people to fork over money to the government instead of spending it on themselves and their families – you bear some moral culpability for what happens to the money after it is stolen.

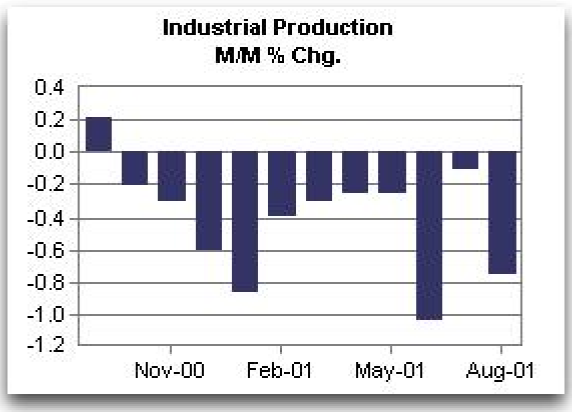
And don't tell me that while privatization isn't perfect, it is a good step in the right direction so should be pursued. In fact, it is a step in the wrong direction that will further tar the idea of markets and privatization with potentially catastrophic consequences.

There are better approaches. Lower the Social Security tax. Lower any tax. Expand tax-free savings. Allow people to opt out altogether in exchange for giving up future benefits.

All these approaches are consistent with market theory and practice. Privatization as it emerged over the years within the policy set is not. In any case, all of you set yourself up for this fall. You have asked Americans to compare returns on stocks as versus Social Security. Incredibly, after all the millions you have pumped into propaganda, and all the political compromises you have made to keep your guys on Social Security commissions, the end result is to make the government look good by comparison.

That's hard to do. Great going, guys. Now it's time to either take down your calculators, or perhaps make them reflect reality and license them for use by the Social Security Administration.

July 22, 2002



Llewellyn H. Rockwell, Jr. is president of the [Ludwig von Mises Institute] in Auburn, Alabama, and editor of [LewRockwell.com]. On Social Security, he highly recommends The Roots of the Social Security Myth *by John Attarian and* The Revolution of 1935: The Secret History of Social Security *by Gregory Bresiger.*

Do yourself a favor by clicking on the above two articles and study them. RNN

The Curative Power of Economic Busts

By Christopher Mayer

October 22, 2001

The salutary nature of an economic bust is how it sifts out the misallocations of capital made during the preceding boom. It thereby leaves a stronger mix of businesses better fitted to meet the needs and wants of consumers.

The misallocations induced by a credit-inspired boom are built on the sandy foundations of expansive monetary policy and government intervention (in the form of regulations, tax incentives, and other manipulative tools). All serve to distort the pattern of production into something it otherwise would not be.

These distortions do not come without cost, as Austrian business cycle theory asserts. For there will come a day of reckoning, a time when projects begun under the illusory veil of easy money are no longer promising. At this point, the sifting process will begin.

In our own day, this sifting process has already begun with the liquidation and reorganization of businesses that can no longer survive in the current environment. These casualties include not only the profitless new-economy companies that were seemingly so full of promise, but also old-economy stalwarts, such as Xerox and Bethlehem Steel.

Bethlehem Steel

In the case of Bethlehem Steel, the venerable steel outfit has been unable, despite all the help from Uncle Sam over the years, to beat its cheaper foreign rivals. Bethlehem Steel recently filed for Chapter 11 bankruptcy. Since mid-1998, the company has bled over $500 million worth of operating losses, and revenues have declined $1.3 billion. The company is wallowing in $4.5 billion in debt-more than the book value of its assets.

Bethlehem will not go down without a fight-or, rather, it will not go down without at least trying to get something for nothing from much-abused American taxpayers in an effort to prop up its failing business a while longer.

In their campaign to snow fellow Americans, the steel interests will surely point out how important steel is to the U.S. economy and to U.S. interests, such as national defense. After all, Bethlehem was the largest shipbuilder during World War II, and it built the first aircraft carrier. The steel interest will also surely bring out the old bromide about how unfair it is that some Japanese or Korean or eastern European manufacturer *actually charges lower prices for the same steel*.

The great Frederic Bastiat, if he were here today, would surely point out that it is not so important whether or not a steel manufacturer is located in the U.S., but rather whether or not Americans can purchase the steel that they can pay for. Every argument has two sides, and while low steel prices push American steel manufacturers to the brink of extinction, these same low steel prices are a great boon for *American* purchasers of steel, such as General Motors or Caterpillar. Moreover, the capital freed from the steel industry could be put to more economical use in other industries.

As to fairness, perhaps the steel interests should consider how unfair it is for the rest of us *Americans* to have to pay more for our steel than we would otherwise.

The fight to alter the verdict of markets is costly and futile. Like irrepressible death itself, the market always gets its man. This time, the scythe swings for Bethlehem Steel.

Creative Destruction

Businesses are created, and they are destroyed. Like empires and men, their fortunes ebb and flow. Some thrive; some are crushed. Consumers are harsh masters. In free markets, you make what they want, or you perish.

And so the market turns, with old industries and businesses sometimes being replaced with newer ones that are in turn replaced yet again-in an endless cycle. At each turn, more efficient means replace less efficient ones.

In the twentieth century, America successfully made the transition from an economy dominated by agricultural production to one that became increasingly dominated by manufacturing. As recently as 1900, agricultural workers made up over 40 percent of the U.S. workforce, employing twice as many workers as the manufacturing sector. Compare that with the less than 3 percent of the population involved in production agriculture today.

The transition away from manufacturing has also elicited kicking and screaming from politicians and other dolts (manufacturing accounts for less than 20 percent of GDP today). So too, the shift away from an agricultural economy brought forth many paeans to the simpler life of farming and a call to help the American family farmer. Yet all the efforts to help the American farmer over the decades did not prevent the virtual extinction of the once-dominant family farm, as it yielded to more efficient and cheaper producers.

Farming is certainly not the only industry that has left the spotlight on the stage of the U.S. economy. Most people could readily identify others, like the railroad industry.

Such historical evidence of the powerful evolutionary nature of the market and its relentless capacity for overcoming obstacles-like the irresistible roots of a great oak that, over time, crack and rip through seemingly impenetrable concrete-does not prevent meddlers from attempting to stop it.

Meddling with the Process

Let us count the ways: stimulus packages ranging from $60 billion to $75 billion; $18 billion *at least* in new spending for defense; a $40-billion recovery package in the wake of September 11; a $15-billion bailout for the airlines; nine Federal Reserve rate cuts (bringing short-term rates to their lowest level in forty years); and more to come. We have possible support for U.S. steel manufactures, more foreign aid (a $15.6-billion foreign-aid bill!), nationalization of airport security, and we still have the same long-term problems as before that the government will surely find irresistible (i.e., more money for Social Security, education, health care, etc.).

Efforts to prop up failing businesses and the weakening economic picture should be seen for what they are, not what they try to be. They are attempts to arrest the curative powers of the bust. But, they will only delay and prolong the inevitable.

Japan is a case in point. Despite having access to all of the best in the meddlers' tool kits (short-term nominal interest rates are practically zero there), the Japanese economy remains mired in a decade-long slump, saddled with a huge public debt and a record postwar unemployment rate.

American politicians are still Keynesians at heart. They want to spend their way out of this recession.

In doing so, they prescribe the worst possible medicine for an already-hobbled horse. With the new packages and bailouts, new misallocations are created.

The Airlines Bailout

In the absence of an airline bailout, many of America's major airlines would have been pushed into bankruptcy. Many presume that this would have meant the end of commercial aviation in America. Not so. What would have happened? The airlines would have had to renegotiate their debts; equity holders may have been wiped out, their holding reduced to pennies; the unions would have had to make concessions; and the airlines would have had to come up with a plan, satisfactory to their creditors, that would have led them back to health. Some of the airlines may have been forced to sell to other carriers or other group of investors at rock-bottom prices. But in the end, the airlines industry would have emerged stronger for it. It would have forced a change in the way they do things.

But now, the airlines are getting a windfall that amounts, by some estimates, to more than three times what they actually lost. They are getting $5 billion in cash and $10 billion in loan guarantees. By the industry's own numbers, they lost $1.36 billion for the days they couldn't fly. That leaves $3.64 billion to compensate them for doing less business through September 30 than they would have otherwise. Keep in mind that after the bailout, the industry still laid off more than 70,000 workers and canceled hundreds of flights.

Having dodged a bullet, the airline industry can continue on its way (although UAL is now talking about its demise next year, *after* having taken the people's pottage. In fact, some experts are saying that some airlines will have to go bankrupt anyway, taking all that taxpayer money with them). But what about the travel industry? What about hotels? Their businesses, too, suffered from the attacks. Should we hand them some money for the business that they *might have done*?

What has the bailout cost America? Well, for one thing, $15-billion worth of resources that are being used in a manner that they might not otherwise have been used. What we don't see is what might have been. Somebody's pocket is leaner because the government took the money and put it in the sinkhole known as the American airline industry.

A Prescription for a Recovery

Any prescription for a recovery must begin with an acknowledgement of the healing process that is the hallmark of the bust. When you eat a huge meal and then experience indigestion, the remedy is not to eat more food. Rather, it's to step away from the table. In a similar way, it is time for the American economy to get off its easy-money binge.

As Murray Rothbard advised:

The first and clearest injunction is: *don't interfere with the market's adjustment process.* The more the government intervenes to delay the market's adjustment, the longer and more grueling the depression will be, and more difficult will be the road to recovery. Government hampering aggravates and perpetuates the depression.

Government is far from the economy's savior. Rather, it is a parasite, a cancer, that eats away at the wealth of its citizens with its fiat currency, its many billions of dollars of expropriated wealth, and its multitudinous directives. The incessant interference inhibits the market's drive to satisfy consumers. It also dulls the corrective process that weeds out poor investments, which then provides a foundation for future growth.

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"A professional politician is a professionally dishonorable man. In order to get anywhere near high office he has to make so many compromises and submit to so many humiliations that he becomes indistinguishable from a streetwalker."

~ H. L. Mencken

Niceness and the State

by Joe Sobran

Bulletin from the world of science: People are nice!
The NEW YORK TIMES reports: "We're Wired to Cooperate."

Researchers at Emory University in Atlanta have found, through experiments monitored by magnetic resonance imaging, that people get intense emotional satisfaction from cooperating with others. The brain lights up discernibly during acts of niceness, just as it lights up at yummy desserts, money, pretty faces, and other delights.

And you thought it was just you! Nope. It's pretty much the whole human race. There are presumably exceptions, of course.

Reading a story like that just makes you feel good all over. Isn't it nice that we're so nice?

I have no trouble believing it. The older I get, the more I notice how many little kindnesses people gratuitously perform for each other. Of course there are some selfish slobs too; but we notice them because they're exceptional.

The implications are anarchic. We don't need the state to force us to cooperate; we would do it spontaneously, without coercion. The force-system we call the state is worse than superfluous. It interferes with and frustrates the natural urge to cooperate; at worst, it embitters human relations. The paradigm of state-behavior -- massive organized force -- is war.

You might say that the state is parasitic on our innate need to cooperate. It makes us confuse obedience to force with social harmony. In fact, its greatest fiction is that it is itself the key to social harmony, as if we would all be shooting each other if the state weren't there to force us to behave.

During the last century, this idea was pressed all the way. Since the state can produce social order, many reasoned, the ideal state would be a socialist or communist one. The state would be a total concentration of power; formerly free cooperative acts would become "economic crimes." In communist countries people would actually be put to death for buying and selling things you and I can get at the store every day from a smiling clerk.

In reality, such states turned out to be disastrous, not only economically ruinous but socially destructive, fostering far more predatory behavior than freer societies did. The Soviet Union lasted as long as it did only because of its bribery and black markets, the vast "underground economy" -- or what might be called illicit cooperation.

Yet many intellectuals, including people as bright as Albert Einstein, were enamored of the giant new force-systems and thought they held the hope of the future. Sometimes I think an intellectual might almost be defined as one who insists on learning the hard way.

States do try to enlist our cooperative instincts, even for their most nefarious enterprises. Stalin is now credited with at least 20 million murders; he needed a lot of help to achieve that record -- not just a quota of thugs, but ordinary people doing the paperwork without feeling they were abetting evil. Franklin Roosevelt needed a lot of very brainy cooperation, in the Manhattan Project, to create an inconceivably murderous weapon, the atomic bomb. Some of the best scientists in the world flocked to serve his cause.

The "good German" who obeyed Hitler is now a by-word for immoral obedience, but the truth is that refusing to cooperate goes much against the grain for most people. Few of us can bear to disrupt society, and defying the state can seem unbearably disruptive, even when a bit of disruption is very much in order. The state always takes advantage of this fact of human nature.

Anarchism -- statelessness -- is recommended not only by our individuality, but by our sociability. We are individuals who enjoy cooperating with other individuals. We enjoy using our minds, but mostly in social enterprises. We enjoy making money, but chiefly so we can spend it on people we love. We love to possess in large part because we love to share. If you can't own anything, you can't share.

Maybe the nuttiest of all socialist ideas was the notion that abolishing private property would conduce to happy sharing. In reality, it meant only that everything was effectively owned by those who ruled the force-system, the state. Stalin owned everything in eleven time zones, yet his Western admirers never thought of him as rich. After all, he didn't dress like a rich man.

Once a barking dog awakened Stalin from his afternoon nap. Annoyed, he ordered the dog's owner shot. There's a lesson for nice people here.

Social Security Has Its Own Accounting Problems

By Paul Cleveland

The recent spate of accounting scandals has underscored the indispensable role played by moral rectitude in a healthy market system. When the desire to gain outruns the responsibilities of honesty and integrity, short-term gain may indeed be the result, but the personal and economic consequences cannot be delayed indefinitely.

While the scandals associated with the apparent cases of fraudulent accounting schemes at Enron and WorldCom are serious, they pale in comparison to the current fraudulent accounting schemes employed by the United States government in connection with the Social Security system. It is almost humorous to watch members of Congress scurry to investigate cases of private failure and deception, while refusing to honestly consider the morally dubious accounting schemes they have created to obscure the true state of the Social Security program. To use the word hypocrisy to describe this behavior on the part of legislators would seem to be too light a moniker. It seems that politicians refuse to remove the logs from their own eyes while trying to remove the splinters from the eyes of private business leaders.

To explain why this is the case, it might be useful to provide an illustration of the kind of accounting fraud that the government has practiced in connection with Social Security. Suppose for a moment that I just received a pay raise that nets me an additional $500 a month in disposable income. With that money I plan to save for the purchase of a new automobile. However, rather than actually saving the money by lending it at interest, I intend to spend it by borrowing against myself. My plan is to dutifully borrow the money by writing a “Cleveland Treasury Bond” each month for $500 and to make those bonds out to pay 8 percent interest. At the end of four years of acting in this way, would I have the financial wherewithal from these “securities” to purchase a new car? Of course not! Where would the money come from to pay the claim that my self-made securities represent? It is obvious that no such money would exist. I would have spent the money during that four-year period on other things. The “trust fund” that I created would be filled with worthless paper. It is clear in such a scheme that no real assets secure that paper. If I wanted to buy a new car, I would either have to realize a new income source, or cut my spending on other things, or hope beyond hope that the money would simply fall from the sky.

This illustration provides some helpful insight into the current state of affairs in the Social Security program. The so-called “trust fund” or “lock box” that was greatly debated in the 2000 presidential election has been filled with worthless IOUs that the government has issued against itself, even as it spent excess revenues entering the program from payroll taxes. This process of spending excess revenues generated by payroll taxes began in the 1980’s when Congress raised the payroll tax rates, generating more revenue than needed to pay the current beneficiaries of the program. Rather than setting the money aside and purchasing assets, government leaders embarked on a spending spree and put nonnegotiable U. S. Treasury bonds in the coffers of what they termed a “trust fund.” Of course, this action was nothing but an abuse of the public’s trust in its leaders to wisely steward taxpayer’s hard earned resources. What is lost on the average taxpayer is that the actual payment of these bonds will require some very hard choices—hard choices that will directly effect all taxpayers.

As it currently stands, payroll taxes will fail to cover the amount the Social Security Administration needs to pay benefits around the year 2016. Supposedly, the Social Security Administration will be able to redeem the bonds held in trust to pay these benefits for many years to come. However, a fundamental question looms—where will the money come from to pay those bonds? The government has already spent that money on other things. The only way the government will be able to make good on paying those benefits is to increase taxes, cut spending on other programs, or borrow the money from some other source. Either way, the costs of any of these options will be enormous, given the predictions of the amount of money that will be necessary to make good on the promised benefits. Of course, there is another option. The government could choose not to make good on the promised benefit payments. When the reality of the coming hardship begins to hit, Congress will likely find it easier to eliminate or radically reduce the benefits that some people receive in order to maintain the apparent solvency of the program.

The reality of this situation should not come as a surprise to anyone. Social Security has not been financially sound a single day of its existence. It has always been a pyramid scheme set up to redistribute money from later generations to earlier ones. In general, pyramid schemes represent fraud on the part of those who promote them because the number of participants and the amount of money needed to pay the benefits continually grows. In the early part of the twentieth century, Charles Ponzi, an Italian immigrant, made a splash in Boston by perpetrating such a fraud. He began by developing an elaborate story about how he could make exorbitant returns in international markets and offered investors in his company an unbelievable opportunity to participate in these returns if they would risk their money. There were not many takers initially, but he was able to induce a few people to invest their money with him. He simply deposited the money in local bank accounts and sought out additional investors. By the time the first notes came due, he had enough money to pay them off and did so in order to establish the reputation that he could actually make good on his promised return. Afterwards, money began to pour into Ponzi's company. He used it to buy whatever he wanted and bankrolled the rest. However, all along the way the growth of his assets lagged well behind the growth of his liabilities. He was never financially solvent. When word finally got out about what he was doing, there was a mad rush on his company to redeem the notes that had been issued. The rush revealed the truth and Ponzi went to jail for fraud which earned him the title, the Boston swindler.

The only difference between what Ponzi did in New England and what our government is doing nationally with Social Security is that Ponzi's victims were duped into investing in his company while those of our government's program are forced to participate. The only financially viable option for Social Security at this point is to begin to privatize the system by allowing people to invest in their own accounts. In this case, real assets would accumulate. Such a system would be most helpful to those on the lower end of the economic spectrum, especially the working poor. However, for this to happen members of Congress would have to "come clean" and be honest with both themselves and their constituencies about the true state of affairs of the Social Security system. It is time that for truthfulness to become more highly valued in both politics and business. Only in this way will we approach the goal of a society efficiently and justly serving the good of the persons who comprise it.

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