January 2005 BANK NOTES –

R. Nelson Nash, Editor

HAPPY NEW YEAR to all ! May great things come your way this year.

In making your plans for the year, consider attending at least one Infinite Banking Concepts Seminar. It can make a big difference in your life. I am committing myself to conduct 36 of them. Click on the **SEMINARS** button on this website and you will see those that have been scheduled so far.

The Mystery of Central Banking

Robert P. Murphy

With the recent rate hike, the mainstream press obediently parrots the macroeconomic analysis offered by our friendly central planners at the Federal Reserve. The average citizen knows that he or she is not nearly smart enough to understand the complex interrelationships of various price indices, yield curves, consumer confidence, and so forth—that's Greenspan's job.

But the basic story, as told by our wise overseers, runs something like this: A high interest rate keeps prices down, but stifles business and prolongs unemployment. On the other hand, a low interest rate stimulates output and hiring but causes inflation. It is the job of the central bank to pick an interest rate j-u-u-u-st right, to achieve the optimal balance between these two extremes. (Indeed, I once read a financial analyst who actually used the term "Goldilocks" in describing Fed policy.) A good central banker knows when to cut rates to jump start the economy out of a recession, but he also has the courage to "apply the brakes" by hiking rates when the economy begins to "overheat."

Standard Macro Models are Nonsense

As you may have inferred from my tone, I reject this popular analysis as utterly crude and pernicious. In a market economy, the interest rate is not merely a lever to stimulate or depress economic growth, and the connection between interest rates and inflation is far more subtle than the standard story suggests. The price of borrowing money has a "correct" value just as the price of a pair of shoes; the government cannot tinker with this value willy-nilly without causing drastic distortions.

Even putting aside theoretical objections (which we will analyze more fully below), the standard macroeconomic story has no historical support. The most obvious example is the Great Depression itself, which occurred a good fifteen years *after* the Federal Reserve had been established to ostensibly dampen the vicissitudes of the wildcat free market.

In the 1970s, the US experienced "stagflation," i.e. simultaneous double-digit unemployment *and* inflation. This was impossible according to the prevailing Keynesian orthodoxy, the equivalent of an economy that was both stuck in a rut *and* overheating at the same time.

More recently, Japanese policymakers were stumped in the 1990s when they couldn't improve their lackluster growth, despite nominal interest rates that were very close to or even literally zero percent. At that point, they had hit a wall; you can't cut rates lower than zero, since lenders would do better to stick their funds under a mattress. (I saw a lecture by Paul Krugman in which he told us that his advice to the Japanese central bankers had been to credibly announce very high rates of future inflation, which would cause the *real* rate of interest in Japan to become negative.)

As these historical episodes illustrate, even the staunchest proponent of central banking would have to concede that it is more an art than a science. "Exogenous" parameters in macroeconomic models can always change, such that the "optimal" policy move turns out, in retrospect, to be dead wrong. But isn't this true in all fields? Shouldn't we just give the macroeconomists more time to accumulate statistics and generate even more sophisticated mathematical models?

No, we shouldn't give the policy wonks another decade to tinker, because in this case it is the arrogant and ignorant mismanagement of the central bankers itself that is the major source of macroeconomic instability. As with other areas of government meddling in the economy, political "remedies" only serve to exacerbate (or indeed, often *cause*) the very problems they supposedly solve.

An Analogy

To appreciate the damage wrought by central banking, it may help to change the context in order to break free of habitual modes of thought. To that end, imagine that there is no Federal Reserve System, but rather a Federal Housing System. This organization is entrusted with a printing press, with which it can literally run off perfectly legal, crisp $100 bills. Every month, the Fed prints new greenbacks and distributes them to a select group of housing developers, giving the new money in proportion to how many houses a particular builder constructs in a given period. This privileged group then uses the newly printed money (in addition to other funds) to buy lumber, bricks, etc. and to hire workers to construct new houses, which are then sold to homeowners in the normal fashion.

What would be some of the major effects of this hypothetical arrangement? Well, the newly injected $100 bills would allow the builders to bid up the prices of lumber and other materials, siphoning these resources away from other uses, and causing more homes to be built than would otherwise have occurred. Especially on the heels of a bigger than expected injection of cash, there would be an apparent boom in the housing industry, as builders increased their orders for materials and hired more laborers to complete their projects. Because of the government subsidy, the housing industry would be more profitable than before, and competition among builders would eventually lead to a fall in housing prices for consumers.

Of course, running off new $100 bills from the Fed's printing press would cause a rise in the price level, first in the prices of lumber, shingles, windows, etc., but eventually in the prices of *all* goods and services, as the extra cash worked its way throughout the entire economy. The people running the Federal Housing System would soon learn that if they injected too much cash too quickly, it would cause massive dislocations in other industries (which need lumber, laborers, etc. too) and would lead to unacceptably high rates of price inflation. Of course, it would be very painful and disruptive to stop the printing press altogether, since this would put many builders out of business and cause a spike in housing prices. After such policy reversals, entire neighborhoods of half-built houses would be abandoned, serving as stark reminders of wasted resources.

After the Federal Housing System had been in place for some time, the private sector would become better at anticipating its actions. Analysts would devote their entire careers to parsing the casual remarks by Fed leaders, and would run statistical tests on the data used by the Fed to determine how much cash to print in the upcoming months. (For example, perhaps the Fed would look at new homes per capita, or the rate of housing growth compared to inflation, in order to determine its "target price" for new homes.) As people came to expect the monthly injections of cash, the Federal Housing System would become less and less able to influence events. In order to boost employment, for example, the Fed would have to inject ever higher amounts of cash, in order to catch the ever savvier home builders by surprise and make their projects more profitable than they had originally reckoned.

Naturally, certain groups would have a vested interest in either high or low rates of money injection. Young couples, for example, would clamor for the Fed to print out more cash and push down the price of a new house. Older couples who held no mortgage, on the other hand, would write Letters to the Editor urging restraint on the part of the Fed, since they would want their older homes to retain their market value. In this environment, it would be up to the technocratic economists to advise the Fed on a fair and sensible amount of money injection to the housing industry, which would best balance the desires of everyone.

The Real World

I hope most readers will agree that the hypothetical Federal Housing System would be a horrible idea. In the long run, it would be far better for everyone involved—even new home buyers—to eliminate the extra source of uncertainty and political manipulation in the housing industry by abolishing the FHS. Freely established market prices would foster the best use of scarce resources to satisfy consumer desires, whether for housing, fancy dinners, or automobiles.

But if the reader has agreed with me thus far, then he or she must also endorse the abolition of the Federal Reserve System. Despite the mysticism of central banking, and the awe with which we mere mortals behold Alan Greenspan, there is no major difference between central banking in the US, and the hypothetical scenario I invented above.

After the Federal Reserve sets a "target interest rate," it achieves its goal by (among other things) literally creating money out of thin air. The process is obscured through intermediate steps (such as "open market purchases" of securities), but ultimately the Federal Reserve creates new deposits for major banks out of an accounting vacuum, and then allows its privileged clients to use these new deposits as the collateral with which the client banks issue new credit to borrowers. Because borrowers will seek a larger quantity of credit only at lower interest rates, the Fed can indirectly influence the various market rates of interest by controlling the amount of credit that its client banks can ultimately loan.

All of the effects described above (for the Federal Housing System) occur under the Federal Reserve System, except that in the latter case the damage is more widespread, since the credit markets affect virtually all industries. Rather than printing up new cash and handing it out to large home builders, in effect the Federal Reserve prints up new cash and hands it out to privileged lenders. The hypothetical Fed stimulated housing construction, but the real Fed stimulates *all* industries that engage in long-term projects.

As explained by the Austrian theory of the business cycle, the interest rate serves to coordinate the intertemporal structure of capital goods. To put it simply, a high interest rate is a signal to producers that consumers are "impatient" and place a premium on production processes that involve a relatively short gestation period. A low interest rate, on the other hand, is a green light to producers to invest in processes that tie up resources for a longer period. (Notice that a process in which resource costs are rolled over for, say, ten years will be more sensitive to the interest rate than a process in which resource costs are recouped by the final sale after, say, two years.)

Depending on factors such as technology, the supplies of various capital goods, and the willingness of consumers to postpone immediate consumption in order to enjoy higher consumption in the future, the Austrians believe that there is a "correct" market rate of interest at any given time (for loans with a specified level of risk). But a central bank interferes with the market’s natural tendency to achieve these correct rates. In order to keep voters happy, the central bank habitually pushes rates lower than they ought to be, which causes the familiar boom period in which stock prices soar and unemployment falls. But this artificial expansion is unsustainable, and inevitably leads to a bust period, in which many of the production processes must be curtailed or abandoned altogether, and workers in these lines must be laid off.

Conclusion

A short article such as this one cannot of course explain the subtle features of Austrian business cycle theory; the interested reader should consult Mises’s discussion in *Human Action*. However, I hope that my analogy of the Federal Housing System has alerted the reader to the problems of our current arrangement. We will never rid ourselves of the boom-bust cycle until we remove our monetary and banking institutions from political manipulation, and return them to private individuals operating in a voluntary market. In light of the more sophisticated Austrian analysis, the standard macro theories regarding Fed policy and interest rates are hopelessly naïve and destructive.

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Consumers keep spending... but GM makes less than nothing on its cars.

GM reported a profit of 78 cents a share for the third quarter. But not a dime came from making cars and trucks. Instead, the automaker lost on every screw, bolt and rivet. It made up the losses by financing cars and houses.

"What's good for business is good for America," said Calvin Coolidge. Then what's bad for business is probably bad for America too. Both America and General Motors have largely ceased making things at a profit. Instead, both live on "finance." The nice thing about "finance" is that you can do it in an air-conditioned office wearing a suit. No sweat. Mothers are proud to say their sons have gone into "finance." There's something almost honorable about it.

If, on the other hand, their boy had gone to work in a GM assembly plant, they'd be a little embarrassed to say so. There's no glory in manufacturing anymore. And no money, either.

But what do people in "finance" actually do? They sit in front of a computer screen all day... and occasionally talk to clients... or co-workers. Beyond that, we really don't know. We suppose the idea is to borrow money at one rate and lend it out at a higher rate. Like merchants who buy at wholesale for resale at retail, the person in "finance" must have the same problems as everyone else. He has overhead, inventory and customers. He must protect his margins... and make sure he doesn't make the financier's classic mistake: misjudging his risk.

Yet that is exactly what we expect... and what we revel in. It is almost why we get up in the morning and what we look forward to. It is also inevitable.

As more and more people make more and more money in "finance," naturally, the trade attracts more and more people. The financiers compete to attract borrowers. The subprime borrower, who was judged too bad a credit risk at the beginning of the cycle, suddenly becomes a worthy customer and is lent money at rates scarcely higher than those of best customers.

The longer the finance craze goes on, the more it seems eternal. Risk is forgotten. "Risk premiums" disappear. Marginal borrowers are sent more credit cards. They could barely get a lease on a slum apartment a few years ago; now they can buy almost any house in town, with no money down. A few years ago, they had to shop for a car from Cowboy Bob's Pre-Owned Cars and BBQ Pit and pay 15% interest on a 10-year-old bomb. Now they can go into any showroom in town and drive away in a brand new car - and pay no interest at all!

The huge credit bubble should implode. But it's not happening either. At least not yet.

Still, word came last week that Standard & Poor's downgraded GM debt to just above junk status.

THE ERA OF FICTITIOUS CAPITALISM
by Addison Wiggin

Perspective.

While doing radio interviews this fall regarding themes in our book, Financial Reckoning Day: Surviving The Soft Depression of the 21st Century, the question invariably arises: "France? Nice place to visit, but why the heck do you live there?"

The short answer is, of course, the wine is cheap and the women are... um, elegant. The long answer is, we gain perspective. It's the long answer, because it requires an explanation. One could gain perspective from just about anywhere, of course... but why not do it in a place where the wine is cheap and the women pleasing to look at?

An English reader, who also lives in France, recently passed on an interesting article written by a Chinese bureaucrat, published on a non-profit website hosted in Italy, sponsored by the government of Singapore. The aim of the site is to increase amicable relations between Asia and Europe in a U.S.-centric world. The purpose of the article: A strategic recommendation on how China ought to position itself while the United States and Europe - as the major players in the two-bloc international system the author predicts will eventually emerge - gear up for eventual war.

If we were writing our daily missives from our offices in Baltimore, would such a site, and such an article, be interesting? Probably. But we'd likely judge the origin of the site through Murdoch's lens at Fox

News, like so many TV-addled minds do, and dismiss it out of hand. Away from influence, living as foreigners, in a country where they don't pronounce words as they are spelled, we take to the extraordinary like gnats to a sugar bowl. We are addicted to the taste and go there often to get a buzz going. But we are under no illusions that it has nutritional value.

What could possibly interest us about a Chinese bureaucrat's white paper on impending global war? First of all, his conclusion: "In the last century," writes Wang Jian, "American people were pioneers of system and technology innovation. However, the interests of a few American financial monopolies now lead this country to war. This is such a tragedy for the American people.

"Clouds of war are gathering. Right now, the most important things to do for China are:

1.) Remain neutral between two military groups while insisting on an anti-war attitude. 2.) Stock up in strategic reserves 3.) Get ready for a short supply of oil 4.) Strengthen armament power 5.) Speed up economic integration with Japan, Hong Kong, Korea and Taiwan... "

It's a rather unsettling idea. China as the neutral power in a war between the United States and a united Europe. How did Wang get there? That's the subject of the second part of the article, which we find intriguing... and even more unnerving. Wang's view is disturbingly similar to our own understanding of the way the global economy works.

"War is the extension of politics and politics is the extension of economic interests," Wang asserts. "America's wars abroad have always had a clear goal, however, such goals were never made obvious to the public. We need to see through the surface and reach the essence of the matters. In other words, we need to figure out what the fundamental economic interests of America are. Missing this point, we would be misled by American government's shows and feints."

Wang's argument in a nutshell: By the mid 1970s, the United States, the United Kingdom, France, Germany, Italy, Japan and other major capitalist countries had completed the industrialization process now underway in China. In 1971, when Nixon closed the gold window, the Bretton Woods system collapsed, and the dollar - the last major currency to be tethered to gold - came unstuck. Economic growth as measured by GDP was no longer restricted by the growth of material goods production. Toss in a few financial innovations, like derivatives, and the "fictitious" economy assumed the central role in the global monetary system.

"Money transactions related to material goods production," writes Wang, "counted 80% of the total [global] transactions until 1970. However, only five years after the collapse of the Bretton Woods, the ratio turned upside down - only 20% of money transactions were related material goods production and circulation. The ratio dropped to .7% in 1997."

As we note in our book, since Greenspan assumed the central role at the most powerful central bank in the world, he has expanded the money supply more than all other Fed chairmen combined. From 1985-2000, production of material goods in the United States has increased only 50%, while the money supply has grown by a factor 3. Money has been growing more than six times as fast as the rate of goods production. The results? Wang's research reveals that in 1997, before the blow-off in the U.S. stock market, mind you, global "money" transactions totaled $600 trillion. Goods production was a mere 1% of that.

"People seem to take it for granted that financial values can be created endlessly out of nowhere and pile up to the moon," our friend Robert Prechter writes in his book, Conquer the Crash. "Turn the direction around and mention that financial values can disappear in into nowhere and they insist that it isn't possible. 'The money has to go somewhere... It just moves from stocks to bonds to money funds... it never goes away... For every buyer, there is a seller, so the money just changes hands.' That is true of money, just as it was all the way up, but it's not true of values, which changed all the way up."

In the fictitious economy, the values for paper assets are only derived from the perceptions of the buyer and seller. A man may believe he is worth a million dollars, because he holds stocks or bonds generally agreed in the market to hold that value. When he presents his net worth to a lender, a mortgage banker for example, and wishes to use the financial assets as collateral for a loan, his million dollars is now miraculously worth two. If the market drops, the lender, now nervous about his own assets, calls in the note... the borrower once thought to be worth two million discovers he is broke.

"The dynamics of value expansion and contraction explain why a bear market can bankrupt millions of people," Prechter explains. "When the market turns down, [value expansion] goes into reverse. Only a very few owners of a collapsing financial asset trade it for money at 90 percent of peak value. Some others may get out at 80 percent, 50 percent or 30 percent of peak value. In each case, sellers are simply transforming the remaining future value losses to someone else."

As we saw in the 2000-2002 bear market, in such situations, most investors act as if they were deer being approached by a speeding truck at night. They do nothing. And get stuck holding financial assets at lower - or worse, non-existent - values. Anyone suffering glances at their pension statements over the past few years knows their prior "value" was a figment of their imagination.

Back to Wang: "In the era of fictitious capitalism, a fictitious capital transaction itself can increase the 'book value' of monetary capital; therefore monetary capital no longer has to go through material goods production before it returns to more monetary capital. Capitalists no longer need to do the 'painful' thing - material goods production."

Real-life owners of stocks, bonds, foreign currency and real estate have increasingly taken advantage of historically low interest rates and applied for mortgages backed by the value of these financial assets. Especially since the rally began 8 months ago, they then turn around and trade the new capital on the markets. "During this process," writes Wang, "the demand of money no longer comes from the expansion of material goods production, and instead it comes from the inflation of capital price. The process repeats itself."

Derivative instruments, themselves a form of fictitious capital, help investors bet on the direction of capital prices. And central banks, unfettered by the tedious foundation set by the gold standard, can print as much money as is required by the demands of the fictitious economy. You can, of course, trade the marginal values of these fictitious instruments and do quite well for yourself.

But Wang sees a darker side to the equation. "Fictitious capital is no more than a piece of paper, or an electric signal in a computer disk. Theoretically, such capital cannot feed anyone no matter how much its value increases in the marketplace. So why is it so enthusiastically pursued by the major capitalist countries?"

The reason, at least until recently, is that the "major capitalist countries" have been using their fictitious capital to finance consumption of "other countries'" material goods. Thus far, the most major of the capitalist countries, the United States, has been able to profit from the system because since the establishment of the Bretton Woods system, and increasingly since its demise, the world has balanced its accounts in dollars.

"Until now," writes Wang, "U.S. dollars [have counted] for 60-70% in settlement transactions and currency reserves. However, before the 'fictitious capital' era, more exactly, before the fictitious economy began inflating insanely in the 1990s, America could not possibly capture surplus products from other countries on such a large scale simply by taking advantage of the dollar's special status in the world... Lured by the concept of the 'new economy', international capital flew into the American securities market and purchased American capital, thus resulting in the great performance of U.S. dollar and abnormal exuberance in the American security market."

And here we arrive at the crux of Wang's argument that a war is brewing. "While [fictitious capital] has been bringing to America economic prosperity and hegemonic power over money," he suggests, "it has its own inborn weakness. In order to sustain such prosperity and hegemonic power, America has to keep unilateral inflow of international capital to the American market... If America loses its hegemonic power over money, its domestic consumption level will plunge 30-40%. Such an outcome would be devastating for the US economy. It could be more harmful to the economy than the Great Depression of 1929 to 1933."

Japan's example suggests, as your editors have oft reminded you, that a collapse in asset values in a fictitious economy can adversely affect the real economy for a long time.

In the era of fictitious capital, Wang surmises, America must keep its hegemonic power over money in order to keep feeding the enormous yaw in its consumerist belly. Hegemonic power over money requires that international capital keep flowing into the market from all participating economies. Should the financial market collapse, the economy would sink into depression.

America's reigning financial monopolies, he believes, (whoever they may be), would not stand for it.

Addison Wiggin
The Daily Reckoning

Social Security: House of Cards

by Rep. Ron Paul, MD

President Bush should be commended for promising to address the looming Social Security crisis during his second term, a crisis that Congress and successive presidents have ignored for decades. Hopefully Americans will realize that the notion of Social Security as an insurance program is a lie, and that Congress has not put their Social Security contributions into any trust fund.

Most Americans already know that Social Security is in trouble. Demographic shifts and an aging population have undermined the unspoken foundation of the system, which is the practice of taxing younger generations to pay benefits for current retirees. Younger generations, however, simply aren't big enough to pay for the millions of baby boomers who will begin retiring in the next decade. When Social Security began in the 1930s, many Americans never reached age 65. Today, however, millions of retirees live well into their eighties and nineties. These realities mean the current system could collapse in as little as twenty to thirty years.

Seniors hope the system will hold together for the remainder of their lives, while younger working people hope government will somehow fix things before they retire. Not surprisingly, Congress has chosen to ignore the problem until it becomes acute. It's hard to sell voters on austerity today to avoid a relatively distant crisis. Politicians usually operate on the opposite principle, by promising great things now and leaving the bills for others to pay later.

The greatest threat to your Social Security retirement funds is Congress itself. Congress has never required that Social Security tax dollars be kept separate from general revenues. In fact, the Social Security "trust fund" is not a trust fund at all. The dollars taken out of your paycheck are not deposited into an account to be paid to you later. On the contrary, they are spent immediately to pay current benefits, *and to fund completely unrelated federal programs*. Your Social Security administration "account" is nothing more than an IOU, a hopeful promise that enough younger taxpayers will be around to pay your benefits later. Decades of spendthrift congresses have turned the Social Security system into a giant Ponzi scheme, always dependent on new generations. The size and longevity of the Baby Boom generation, however, will finally collapse the house of cards.

We've all heard proposals for "privatizing" the Social Security system. The best private solution, of course, is simply to allow the American people to keep more of their paychecks and invest for retirement as they see fit. But putting Social Security funds into government-approved investments could have dangerous

consequences. Private companies would become a partner of sorts with the government. Individuals still would not truly own their invested Social Security funds. Payroll taxes likely would be raised to cover payments to current beneficiaries, as the President alluded to when warning us that fixing Social Security would be "costly."

Furthermore, who would decide what stocks, bonds, mutual funds, or other investment vehicles deserve government approval? Which politicians would you trust to build an investment portfolio with billions of your Social Security dollars? The federal government has proven itself incapable of good money management, and permitting politicians and bureaucrats to make investment decisions would result in unscrupulous lobbying for venture capital. Large campaign contributors and private interests of every conceivable type would seek to have their favored investments approved by the government. In a free market, an underperforming or troubled company suffers a decrease in its stock price, forcing it either to improve or lose value. Wary investors hesitate to buy its stock after the price falls. If a company successfully lobbied Congress, however, it would enjoy a large investment of your tax dollars. This investment would cause an artificial increase in its stock price, deceiving private investors and unfairly harming the company's honest competition. Government-managed investment of tax dollars in the private market is a recipe for corruption and fiscal irresponsibility.

The Social Security crisis is a spending crisis. The program could be saved tomorrow if Congress simply would stop spending so much money, apply even 10% of the bloated federal budget to a real trust fund, and begin saving your contributions to earn simple interest. That this simple approach seems impossible speaks volumes about the inability of Congress to cut spending no matter what the circumstances.

Dr. Ron Paul is a Republican member of Congress from Texas.

When You Won't Be Able to Find a Physician

by Gary North

That day is coming. The closer you are to age 65, the sooner it is coming.

You have to begin planning for this now. The care that you will receive is going to resemble the Post Office.

When you are over 65, a physician who accepts any Medicare patients is not allowed to accept payment from you if you are under Medicare. It's a felony if he does. The only exception is if you're covered by your employers' policy.

Because hospitals charge high prices to uninsured people, but accept Medicare payments or insurance company payments for 20 cents on the dollar, if you aren't under Medicaid, you can get ruined. Why does the government allow this dual pricing practice? Simple: the bureaucrats know that this forces everyone under Medicare/Medicaid at age 65.

Insuring yourself against a catastrophic illness with a high-deductible ($5,000) coverage would be affordable, but it's not possible. Private insurance companies do not cover people older than age 64.

THE SQUEEZE ON PHYSICIANS

There was a time when "my son, the doctor" meant a lot. It meant money, social prominence, and steady work. Today, it means filling out Medicare forms, high liability insurance, massive debts at graduation, and years of forfeited income early in life, when the compound growth process should get started.

There are two physicians in my congregation. Both of them have quit practicing. One is an official with Blue Cross/Blue Shield. The other runs a business selling an amazing cream, available only by prescription, that removes aging spots and scarring.

Back before World War I, the government first gave physicians protection from competition. Then, beginning in the 1960s, the government has tightened the regulatory screws. "The government giveth, and the government taketh away."

There is a joke about a physician who calls a plumber. The plumber works for three hours and charges the man $150 for labor. "Why, I don't make that much per hour, and I'm a physician." The plumber replies, "Neither did I, when I was a physician."

Recently, I received a letter from a family physician. What he says about his profession is not understood by the general public.

If he is correct, there is going to be a shortage of physicians, especially highly motivated ones. (Note: "shortage" always means "at some price.")

A PHYSICIAN'S WARNING

Anonymous

I am a family physician and teach medical students. One of the things I try to help them deal with is the little-understood (even by those in med. school) fact that by age 65, most family physicians will have earned less than most factory workers who are willing to work equivalent hours, yet the average 'proceduralist' physician will make within the first four or five years of practice, more money than the family physician will during his/her lifetime.

As a top-10%'er in my class, I had all the options, and had the 'backup' of an undergraduate degree/license as a pharmacist; that's now good for about $60/hr minimum. I had, unfortunately for my family (income equates to potential time spent with family), a 'calling' to be a family physician, in terms of abilities, interest, and what I felt 'right' doing.

I will make the same amount of money by age 65 (if the government doesn't screw up health care further by regulation) slightly less than I would have if I got out of high-school and signed on at $7.50/hr, working the same hours I now do, with never any career 'advancement' besides a wage keeping pace with inflation.

My patients of course are clueless; they see the Mercedes driven by a former classmate (I tutored) who is now a urologist, and the big house of the family physician down the street who signed on to work for the local hospital as a 'funnel' physician (so they can get HMO contracts by having lots of primary care providers); she works four days a week in the office, 9 to 4:30, and takes telephone-only call 3 days a month (no hospital practice required) and makes $115,000 a year. I'll make less than that, and work a 60-hour week, with some months being 'negative' – I've gone as long as 9 months without a paycheck, if there are practice transitions going on (new partner, relocation, etc.).

So far, it just represents my willingness to take some cash-flow risks, and my willingness to view medicine as a 'calling' rather than as a privileged license to take advantage of.

SOCIALIZED MEDICINE

The problem is that, unlike most areas of business, medicine is socialized, and there is no competition. The worst aspect of this is that the patients pay several-fold more for health care than they should have to, and get far less quality than they ought to. (Ironically most of this is due to government-imposed 'quality-assurance' and 'cost-containment' solutions which are actually insurance-lobbyist dreams-come-true but the public is persuaded are to 'help control costs and assure quality.') The reality is that a patient who presents with several inter-related problems has three kinds of care they will encounter:

1. Revolving-door. They see a physician who schedules 20–25 patients per day, and 'works in' another 10; they are in actual face-to-face contact with the physician for less than five minutes, problems are minimized and treated in a 'meets code specifications' type manner, and that physician makes maybe $150,000 to $300,000 per year for a 40-hour work week, usually with great benefits since they usually work for an HMO or hospital.
2. Biopsy the Wallet. They see a physician who has determined what that particular patient's insurance's weaknesses are, and spends the slightly-less-rushed encounter time to ask enough leading questions to determine a 'need' for whatever well-reimbursed tests or procedures the physician can 'capture.' That physician may make a little more income, and work the same basic hours.
3. Try to do the right thing. They see a physician who maybe sees 2–3 patients per hour, and tries to do a thorough history and examination and order whatever tests are appropriate or do whatever procedures are actually necessary. This physician will have a shabby office, and you will spend an hour or more in their waiting room, but will receive a caring and thorough evaluation. That physician will make between $50,000 and $120,000 for a 60-hour work week, and have puny 'benefits' because they are likely self-employed. They don't get the glitzy advertisements or marketing from the local hospital or HMO because they 'buck' the system and don't just skew their evaluation and treatment to maximize the HMO profits so they can get their 'cut.'

This is all due to the socialization of health care, and the fact that when patients are seen, procedures (most of which are very easy to do, and anyone with half a brain could do well, but are 'restricted' due to government and medical-association licensure issues) are way overpaid, and 'cognitive services' (which is what the physician's 12–15 years of post-high-school education are supposed to train us for) are typically unreimbursed or paid minimally for. Example: If I treat a diabetic hypertensive Medicare patient with lipid problems, depression, and arthritis, and multiple medication interactions, I may spend 40 minutes with them ($120 dollars cost to me in overhead) and Medicare won't even pay me enough to break even (I'd be better off sending the patient next door to see a specialist who will do some $900 procedure on them and make them a happy patient, and handing a $20 dollar bill to them to get them out of my office, than to see them and spend those 40 minutes with them). On the other hand, if I dream up some reason to do a procedure on them (ear wax removal? Skin lesion biopsy? etc.), sick the nurse on them, and move on to the next patient after 5 minutes with them, I may have a profit of $50 for 5–10 minutes' work.

Yes, careers can be a 'calling,' but when my kids say things like, 'Dad, why can't we ever go on vacation like the Smith's [union factory worker], or have a swimming pool like the Jones' [self-employed plumber], or just have supper together as a family like the Johnson's [both school teachers],' I have no good answers. The Smith's even have friends in the media, who caution social planners to be sure to keep blue-collar workers from having problems 'accessing' health care. The Jones family earns public sympathy as small business owners that the private practice family physician never gets. The Johnson's are in the martyr class of Teachers, Policemen, and Firemen who are reputationally under-paid, yet all attain a lifetime average of more per hour than the family physician who refuses to 'play the game' by practicing for the system instead of for the patient.

In a fair world (a capitalistic, free-enterprise one), I could charge say $5 more per visit, and patients who valued the extra time and better care would pay me $5 more than the doctor down the street. Since the average profit per doctor visit is in the $10-15 range, I'd get a substantial raise, encouraging and rewarding me for 'doing the right thing' – instead, they all pay the same $10 co-pay, whether they go to the revolving-door doc, the find-a-procedure-to-do doc, or myself. My income suffering isn't the big deal, but my kids don't get family time, and they will be lucky if we can send them to college, while the kids of those who surf socialism's great 'safety net' will treasure the many family vacations spent jet-skiing before they trod off to their ivy-league colleges.

'Callings' are at least affordable in a capitalistic environment, but as our society becomes more socialistic, they are not going to be the way most people make life decisions.

WHO IS RESPONSIBLE FOR PAYMENT?

I rarely visit a doctor's office: maybe once a year. Two more visits, and I'll be on Medicare. My goal is to pay cash, despite my Medicare coverage. I figure I'm a more valuable patient this way.

I use two physicians: a successful one and a conventional one. The conventional one treats everyone, accepts Medicare, accepts insurance company payments, and will have to work until he's 70. The other is an "alternative medicine" physician. He accepts no Medicare patients, accepts no third-party payments from insurers, and requires payment after every visit. I can pay him whatever he charges after I reach 65. He is not under the Medicare regulations.

He is booked solid for three months out. It's working for him.

In 1978, I spent two weeks lecturing to physicians in a dozen cities. I was accompanied by physicians from Canada and Australia. Two other teams like the one I was on also included physicians from England. We warned physicians about the coming of socialized medicine and government regulation. Attendance was sparse.

The Australian physician had adopted the practice of not accepting third-party payments. That way, he got paid on time. He also attracted patients who were after top-flight service. That, he provided. He recommended that every American physician adopt such a procedure. Few did.

The idea is now spreading. The Association of American Physicians and Surgeons have adopted The Physicians' Declaration of Independence (July 4, 2004). Its opening paragraph is a shot across the bow of socialized medicine.

> When in the Course of human events, it becomes necessary for one Profession to dissolve the Financial Arrangements which have connected them with Medicare, Medicaid, assorted Health Maintenance Organizations, and diverse Third Party Payers and to assume among the other Professions of the Earth, the separate and equal station to which the Laws of Nature and of Nature's God entitle them, a decent respect to the opinions of Mankind requires that they should declare the causes which impel them to the separation.

The rest of it is equally good. Paragraph 2 is basic.

> We hold these truths to be self-evident: that the Physician's primary responsibility is toward the Patient; that to assure the sanctity of this relationship, payment for service should be decided between Physician and Patient, and that, as in all transactions in a free society, this payment be mutually agreeable. Only such a Financial Arrangement will guarantee the highest level of Commitment and Service of the Physician to the Patient, restrain Outside Influence on Decision-Making, and assure that all information be kept strictly confidential. When a Third Party dictates payment for the Physician's service, it exercises effective control over the Decision-Making of the Physician, which may not always be in the best interest of the Patient. The Third Party then intrudes heavily into the sacred Patient-Physician relationship and demands to inspect the Medical Record in a self-serving attempt to satisfy itself that its money is being spent in accordance with its own pre-ordained accounting principles.

The declaration ends with this forthright assertion:

> We, therefore, the undersigned Physicians of the United States of America, appealing to the Supreme Judge of the world for the rectitude of our intentions, do, in the Name of our Patients solemnly publish and declare, that we will withdraw our participation in all above-described Third Party Payment Systems. Henceforth and Forever, we shall agree to provide our services directly to our Patients, and be compensated directly by them, in accordance with the ancient customs of our Profession. As has always been true of our Profession, our charges will be adjusted to reflect the Patients' ability to render payment. Nothing prevents any patient from purchasing and using Insurance. The Patients' medical interactions with us will remain completely confidential. We pledge the highest level of Service and Dedication to their Well-Being.
>
> And for the support of this Declaration, with a firm reliance on the protection of divine Providence, we mutually pledge to each other our Lives, our Fortunes and our sacred Honor.

To put all this into a form that most of us recognize, he who pays the piper calls the tune.

I want to call the tune. I can call it by paying. If my physician has structured his payments system to treat people like I am, he will be responsive to my demands.

But what of my local physician who is booked up for three months? He isn't charging enough. He is rationing access by making us wait for months. He should offer an "emergency appointment" option for an extra $100 per visit. That would be allocation by price.

As more physicians get the message, he will have competitors.

IF YOU GET SICK

By relying on third party payments, Americans have passed the buck to third parties. They have chosen low-deductible policies, paid for by employers. This has led to the usual scenario: the insured try to maximize their "free" care, and the companies try to reduce payment. Costs soar. Employers are trying to get out of the insurance-provision business. The health insurance industry looks more and more like Congress.

The physicians are caught in the middle. They are expected by everyone to charge less per visit.

So, my advice is this: don't get sick. Take responsibility for your health. Do the things you know you should, and avoid the things you know are bad for you.

The fact is, the largest single medical expense of your life will be your last six months of life. About two-thirds of everything you will spend on hospital and physicians' care will be spent in those final six months.

(This, according to the Blue Cross/Blue Shield man in our congregation.) So, Medicare will bust the fiscal system as more old people start dying. The expenses have only just begun.

This means that having an HSA policy is a good idea. These are tax-deductible medical policies. You deposit money on a tax-deductible basis. If you get sick, you can spend this money tax-free. The system will be abused, then reformed, then abused, and so on. But for now, HSA's represent a major savings.

Establish a good relationship with a physician today, so that he will continue to see you. Pay cash. Don't make his secretary fill out forms unless the expense is really high.

A social relationship is important. Give him a book that he might like when you visit his office. You just happened to pick it up. Talk about things he is interested in. Send him a nice Christmas present. Yes, even if he's Jewish. If you know he's interested in sports or other events, buy two tickets and just happen to have an out-of-town event pop up, and does he want them? Do this before you hit age 65. Establish a pattern early.

Living in a small town is better if you're over age 65. In a popular retirement area, you will sit in a large office that looks like Grand Central Station. You will get 10 minutes of time with the doctor. It's all Medicare, all the time. If you're in a small town, maybe there won't be a large office area. You'll get in.

CONCLUSION

We are about to hit the brick wall in health care delivery. If you can find a physician who doesn't accept Medicare, go there. Pay up front. Be sure he wants you as a patient.

The younger he/she is, the better. Get in on the ground floor, when there is no patient base. A hungry physician is happy to see you. Over time, it will be harder to get on the list.

Basically, the government is substituting rationing for price competition in health care delivery. Under such conditions, you must seek out legal ways to get to the front of the line.

Save or Else

by Llewellyn H. Rockwell, Jr.

The movement to privatize Social Security (fully or partially) may be the most ideologically duplicitous and fiscally irresponsible I've seen in my lifetime. It was proposed by Clinton and now by Bush. Whether it dies in the next few months or generates some monstrosity of a bill to be voted on, don't believe that there is anything in the works that is going to bring you more freedom.

Those of us who have followed this movement for years, from its initial treatments in the pages of the *American Economic Review*, to the op-ed bromides characteristic of every election year, can only marvel at what is unfolding before our eyes. It is as inevitable and predictable as a volcano, but it still hurts to see the city below wiped out.

Social Security is as economically and morally objectionable as any other form of forced redistribution, from public housing to corporate subsidies to warfare, but made worse by the subterfuge that it is an insurance program of some sort. Once we get that clear in our minds, how to deal with it becomes clearer as well. It needs to be zeroed out and replaced by *laissez-faire*, precisely as saving for later years has always occurred in the whole of human history.

There are more resources available than ever before to make this work, from the simplest to the most complex financial tools, and more personal wealth available for most everyone to live out their old age in comfort. In fact, Social Security hardly figures into the retirement plans of most young people today, as well it shouldn't.

More people than ever have a good reason to support the idea of letting it die or killing it. There are many ways to do this, with either big or small steps. Let people opt out completely. Cut payroll taxes. Raise the retirement age. Means test benefits. Establish a cut off for paying liabilities and end the program. Make the program part of federal budgeting so the charade will stop. Above all, tell the truth (as Hans Sennholz says). All of this would be fine. But this is not what is being discussed, despite all the talk of freedom and choice.

In the abstract, the idea of private accounts replacing a government boondoggle sounds good, even great. Other countries have done it; why not here? Actually, other national conversions did not have anywhere near the liability problem the US has; Chile, for example, had its inflated away. Why not let the power of free enterprise work on behalf of all of us as we get old? Sounds great, but that is not what's being proposed.

Look a bit closer and you see a big problem, namely that the current program is *not* merely a government-run retirement scheme that can be converted to a private system. It is a transfer program from working people to retired people. All that nonsense about how much the government owes you, how much the system has accumulated for you to enjoy later on, is an accounting fiction.

When people stop paying in, people will stop receiving. It is as simple as that.

In other words, there is no *there* to privatize. What is actually being talked about is the creation of a new national program of forced savings, complete with a guaranteed minimum income. It is to be created out of whole cloth using the revenue that would usually be funneled to retirees. Not that anyone is going to be denied what they believe is theirs. The money will continue to flow to older Americans but not come from present revenue. It will come from new funds. And where are these funds going to come from? Among those who favor privatization, there are two camps: the left-wing suggests more taxes and the right-wing suggests more debt.

That's your choice. And we are not talking about petty amounts here. Even for a small diversion of funds, the numbers are in the trillions, at least 1 or 2 or perhaps 3. Those figures are so large as to be nearly meaningless to us, and that is precisely the way Washington looks at it: why not just run up the debt for ever and ever amen? Why not continue to spend insane amounts of money and tell people that it doesn't need to be paid?

The proponents say it is worth running up this level of debt because it will save money later. But you know what? In the entire history of government finance and government programs, I doubt that there is a single one that didn't claim to save money in the long run. We have to "invest" now in education in order to save money later on x, y, and z. We must nationalize the health care system now so that we can save money later that will otherwise be spent on ballooning costs. We must go to war now to prevent a worse war later.

This is the staple rhetoric of all government programs from time immemorial. There is no more reason to believe George Bush than there was to believe Hillary Clinton when she made the same claim about her health program. Nor does it make any sense to say that vast amounts of real debt now, saves money over hypothetical debt in the future. When a robber comes to your door and says he wants your television and stereo now so that he won't have to take your car and kid next week, you might comply, but you shouldn't believe he is doing you a favor.

There are many puzzles to this bizarre forced-saving program, not the least of which is why it is that so many people who claim to be for free markets are backing it. Perhaps this can be chalked up to the usual pandering of Washington think tanks. But I don't believe that this explains all of it. There seems to be a genuine intellectual error at the root here, stemming from a failure to believe that a genuine free market can actually provide for people in their old age.

Herein we see the cultural problem that government programs create. Once the system is in place, people have some internal sense that the world would fall apart without it. If the government made all our shoes and clocks, we might have a hard time imagining it could be any other way. Post-socialist governments of the old Soviet empire had a hard time understanding how society could work if people were allowed to move their residencies without government permissions.

The urgent task that genuine market thinkers need to take on is to help people imagine a pre-FDR world in which individuals prepare for their own futures, without government forcing them to or stealing from others in order to enact a central plan.

But, you say, that's not politically viable. Maybe not. But it makes a lot more sense than the creation of a new forced savings program to sit on top of the old forced intergenerational wealth transfer. This idea should be rejected out of hand, as it would be if people told the truth. For example, let's say a politician said the following:

The nation's public housing program is unstable and needs to be secured for the future. So let us force all taxpayers who are currently paying for public housing to put aside some of those taxes for an individual housing fund, to be administered and looked after by the government and to be used only on a timetable established by the Department of Housing and Urban Development, to be applied only to government-approved houses built by approved contractors. You can move in when the government says you can. In this way, everyone will have housing and our nation's public housing stock will be secure for the future. No one will be denied public housing during the transition; it will be funded by debt.

Now, I submit that most people would smell a rat. After all, if we are going to get rid of public housing, then get rid of it. Stop building it. Stop paying for it. Let the free market handle housing. That this is the answer would be clear to anyone. But the solution above ropes more of the housing demand and supply into the quasi-public sector and thereby *increases* the degree of government imposition. (By the way, if such a proposal to create housing accounts were really made, I guarantee that the housing contractors would be involved at some level, just as the large brokerage houses are hip-deep in this Social Security privatization business.)

One excuse given is that Social Security needs to be reformed and this is the only politically viable way to do it. But consider the following: if it is politically possible to fund current recipients out of something other than current receipts, why not just let people keep their own money? Why not just cut? Why not permit an expansion of tax-free savings accounts? Or best of all, why not let people use the money for whatever purpose they want? If we are willing to tolerate vast debt incurred in order to pay off current recipients, then why not just let people opt out of the system completely?

It is a disastrous decision to create an additional forced savings program that is wholly unnecessary, and will bring about vast distortions in the stock market and could very well lead to the biggest bailout in the history of the world. If the debt mongers were at least setting some current payers free from a tax burden, you could see a case for it. But to replace the current terrible system with a new system that financially destabilizes the current one plus adds a bad system on top, is a very grim prospect.

No, I'm not making the perfect the enemy of the good. If it is possible to cut the payroll tax, fine. Do it. Spending should be cut too. That is not what is going on here. Current workers will still be taxed to pay into the old system, plus they will be taxed to pay into a new system, plus they will be taxed in other ways to pay for the shortfall created during the "transition period" (estimates range from 10 to 75 years).

Meanwhile some GOP political figures have proposed actual taxes as a means of transition, thereby harkening back to the original faux-privatization idea. This very well may turn out to be the "fiscally responsible" solution that is adopted. David Brooks notes that the White House has hinted that it might support a transition premium. And Carolyn Weaver of the American Enterprise Institute has long supported a "temporary" payroll tax increase of 1.5 percent.

Whether young workers can be bamboozled into supporting a higher "premium" to get a "private account" depends entirely on how effective the White House propaganda machine is and how far its intellectual backers are willing to sell out before they finally admit that they have made a pact with the devil.

And let me say a few words about this much-vaunted transition period. A limited program is supposed to last 10 years, as if anyone in DC plans that long in advance. Ten years ago, Gingrich was riding high with his Contract with America. Who even remembers that today?

As for the long-term conversion, it is supposed to last a minimum of forty years. In the whole of recorded history, no government anywhere has planned forty years in advance. Forty is the difference between the election of Wilson and Eisenhower, between the Civil War and the end of the Gilded Age, between Nixon's impeachment and nine years from now! Can you think of a single government program that was born in 1964 that bears any resemblance to what it looked like in legislation? Further, can you name a single government program in history that claimed to be saving money that in fact did so after forty years?

So when the White House spokesman announces that he wants to borrow a few trillion to finance a new program that "will be a savings over the current system," look out. When it proves not to be, the people who put the system in place will be long gone.

A final prediction follows. Those of us who have followed this debate for 20 years have always known that once it came down to the reality of the financial costs of the transition—a subject the privatization people have struggled to avoid—this whole scheme would unravel. Young people won't pay the premiums. And not even the most reckless of lawmakers is prepared to blast a $2 trillion hole in the budget based on some far-flung 40-year plan.

Once this faux-privatization idea is out of the way, we can get back to doing what believers in a free society should be doing: working toward getting government not more involved in society, but toward creating the intellectual conditions that enable people to imagine a world where government leaves the choice over how to use resources to individuals.

If more choice is the goal, let people drop out of the system. Don't create another coercive system and tell people they are being liberated.

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