BankNotes - Nelson Nash's Monthly Newsletter | October 2008

The Infinite Banking Concept™

2957 Old Rocky Ridge Road, Birmingham, AL 35243
Nelson Nash, Founder

BankNotes archives are located on our website: http://www.infinitebanking.org/banknotes.htm

David Stearns, Editor
1233 Branchwater Lane, Birmingham, AL 35216

Nelson Nash's live seminars for the next two months (The seminar sponsor or contact person is listed with phone and e-mail address in case you want to attend)

Friday-Saturday, 3-4 October, Ft. Worth, TX, James Neathery 817-790-0405, jcneat@gmail.com

Friday-Saturday, 10-11 October, Salem, OR, Tom McFie 866-502-2777, Tomas@Life-Benefits.com

Friday-Saturday, 17-18 October, Hilton Head, SC, Rich Keal 206-718-0303, rich@genwealth.net

Wednesday-Thursday, 22-23 October, Indianapolis, IN, John Rafferty 317-571-2365, john_rafferty@glic.com

Friday-Saturday, 24-25 October, Flint, MI, Gina Wells 810-579-5808, 877-579-2224, gina@advanced-capitalgroup.com

Saturday, 8 November, Toledo, OH, Lupe Hinojosa 419-534-2000, lupehinojosa@sbcglobal.net

Tuesday-Wednesday, 11-12 November, Tallahassee, FL, Ed Kimmel, 850-562-1256, samsonshair@yahoo.com

Thursday-Friday, 13-14 November, Little Rock, AR, Becky Rice, 501-221-7400, becky@rebeccarice.net

Saturday, 15 November, Helena, AR, Joe Hart, 901-326-6500, becomeyourownbank@gmail.com

Friday-Saturday, 21-22 November, Beaver, PA, Tom Young, 866-316-5071, leahn@quixnet.net

Here is a listing of Nelson's newly added Book Recommendations

A NATION OF SHEEP by Judge Andrew P. Napolitano

THINK AND GROW RICH by Napoleon Hill

THE FAILURE OF THE "NEW ECONOMICS" by Henry Hazlitt

MONETARY POLICY IN THE UNITED STATES by Richard H. Timberlake

THE ULTIMATE GIFT by Jim Stovall

Nelson's Favorite Quotes of the Month

"What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin." - Mark Twain

When you find that you are on the side of the majority it is time to pause and reflect. - Mark Twain

"If an explanation is necessary, no explanation is possible."- Anonymous

The late Marion Rappe, then a young history professor, once announced at the beginning of a lecture: "If the taxpayers of California ever figured out the racket we've got going here, they would line the faculty up against the wall and shoot us." Wishful thinking, I say. The public knows; no one cares.

Government is essentially the negation of liberty. - Ludwig von Mises

"If you want your dreams to come true, you have to wake up. Otherwise they will never be more than dreams." – Unknown

It is the small owner who offers the only really profitable and reliable material for taxation... He is made for taxation... he is far more tied to his place and his calling than the big owner; he has less skill, and ingenuity as regards escape." - Auberon Herbert

The following articles are Nelson's favorite finds from the last month's reading

The Glories of Change

Daily Article by Jeffrey A. Tucker | Posted on 9/15/2008

The events on Wall Street, the collapse of Lehman and the selling off of Merrill, are magnificent and inspiring events. What we see here are examples of sweeping and fundamental change taking place, a huge upheaval that affects the whole of society, and toward the better, since what we have going on here is a massive reallocation of resources away from failing uses toward more productive uses.

Hundreds and hundreds of billions of dollars are on the move, sweeping all before them. And yet take note: it is not war accomplishing this. It is not violence. It is not the result of a planning committee. No election is necessary. No terrorist act took place. There was no government edict.

The agent of change here is that composite of all the world's exchanges that relentlessly shove resources this way and that way, so that they will find their most economically valued uses in society.

No one person is in charge. Layers upon layers of decisions by millions and billions of people are the essential mechanism that makes the process move forward. All these decisions and choices and guesses come to be aggregated in a single number called the price, and that price can then be used in that simple calculation that indicates success or failure. Every instant of time all around the world that calculation is made, and it results in shifts and movement and progress.

But as wonderful as the daily shifts and movements are, what really inspires are the massive acts of creative destruction such as when old-line firms like Lehman and Merrill melt before our eyes, their good assets transferred to more competent hands and their bad liabilities banished from the face of the earth.

This is the kind of shock and awe we should all celebrate. It is contrary to the wish of all the principal players and it accords with the will of society as a whole and the dictate of the market that waste not last and last. No matter how large, how entrenched, how exalted the institution, it is always vulnerable to being blown away by market forces — no more or less so than the lemonade stand down the street.

The need for dramatic shifts is essential for progress. But adapting to changing conditions and becoming an agent of that change, staying with the curve and jumping out in front of it — this is the real challenge. Enacting change — any kind of change but especially big and fundamental change — sometimes seems impossible in this world. We all desire it and know it is necessary. Seeking the reality of rebirth has an appeal. But finding the mechanism to make it happen is hugely difficult.

Try to change an institution from the inside and you will meet resistance around every corner. Bureaucracies are nearly impossible to change. Even firms in private enterprise are reluctant to adapt, and have to be pushed and nudged by the accounting ledger or no movement happens. Churches and other charitable organizations can whither and die without periodic and fundamental change and upheaval. Many institutions grow up around the principle of stability first. The organizational structure tends in the direction of the protective mode, with everyone burrowing in and resisting doing something different today and tomorrow from what he or she did yesterday and the day before. Inertia is the default.

How to break away from this problem is a great challenge. The theory of democracy was that we would have a voting mechanism to enact and force change, but the problem is that votes and personnel shifts bring a change in the look and feel of government but do not get below the surface. Wars and revolutions yield change but at too great a cost. The change wrought by markets goes to the very core of the issue. It makes and breaks whole institutions, sometimes overnight. And it does so in a beneficial way for the whole, without blood and without the risk of unanticipated calamity.

All the plans of big shots, all the desires of our governing masters, all the wishes and dreams of people who imagine themselves to be larger and more important than the rest of us, melt like snow on a sunny day.

In this sense, the market is the great leveler, the force in the universe that humbles all people and reminds them that they are no more important than anyone else and that their wishes must ultimately be shelved when faced with the overwhelming desire on the part of market traders that some other reality emerge.

For this reason, everyone has reason to celebrate the end of Lehman and Merrill. Overnight, while we slept, the seemingly mighty were humbled, the first made last and the last made first. The greatest became the least, all without a shot being fired.

A Career Working Behind Enemy Lines

Daily Article by John Semmens | Posted on 9/19/2008

My career at the Arizona Department of Transportation (AzDOT) wasn't planned from the start. I had some academic training in economics, but no background or training in transportation. As a libertarian, I had an instinctual aversion to government. However, after a lengthy dose of unemployment, I broke down and took what I felt would be a temporary position with AzDOT in 1976.

My suspicions about government were confirmed early on in my employment. One of my first assignments was to analyze the "need" for commuter airline service subsidies in Arizona. I went into this study with virtually no knowledge of the industry. I was stunned to discover that so little of the cost for the service was paid for by the passengers. The benefit/cost ratio and rate of return for every option under consideration were negative. Upon presenting these findings to AzDOT management, along with my recommendation that the state not get involved in such a venture, I was rebuked. My task, I was informed, was not to ascertain *whether* tax dollars would be committed to this program, but to advise on *how* they ought to be dispensed. "The door to the subsidy program is already open," said the division director. "Our job is to shovel the money out."

With more candor than most of his successors in my 32 years with the agency, this director acknowledged the inefficiency and inequity of the program. "The political reality is that the federal money is going to be spent," he said. "Better that it be spent in Arizona than in some other state. Besides, the intended recipient has political connections, so we have no choice."

My first thought was that I had to get out. How could I maintain my personal integrity within such a corrupt organization? Under further consideration, though, I thought, how could I abandon the field to the sole possession of those ideologically committed to bigger government? Wouldn't the battle for smaller government benefit from having someone working behind "enemy lines?" I decided that the answer to this question was "yes" and determined to give it a go.

As an eyewitness with over three decades of inside, close-up observation, I can assure readers that every libertarian criticism that has been leveled at government is true. But ideologues devoted to big government comprise only a small minority of those occupying public-sector positions. The rest are almost invariably unwilling to lift a finger on behalf of restraining the growth of government. Some rationalize their inaction on the grounds of self-interest. A bigger government most likely will mean a bigger paycheck. Others exhibit an inordinate fear of retribution (employees on the "merit" system are virtually impossible to fire) to justify not sticking their necks out. The vast majority are, like the vast majority of the population, oblivious to the issues, alternatives, and outcomes of the agency's actions. Finally, a significant minority are "dead wood" — personal energy conservers who do as little as possible, exploiting the awareness that getting rid of them is more work than management is willing to undertake.

This is not to say that I was entirely on my own in the battle from within. From time to time I received invaluable assistance from coconspirators whose only desired reward was that I keep their names out of it. Given the fairly steady stream of criticism, threats, and attempted (but ultimately, ineffective) retaliation I experienced over the years, I can appreciate their reluctance to take credit for their contributions. But taxpayers should know that there are some good people on the inside. I am maintaining my contacts with these covert confederates and will be using their assistance in my new role as a former insider.

Over 200 years ago, British statesman Edmund Burke said, "All that is necessary for the triumph of evil is for good men to do nothing." The evil of oppressive government depends upon the absence of action by those who would oppose it. My experience in AzDOT persuaded me of the wisdom of Burke's observation. The growth of government in transportation is intellectually indefensible. It promotes neither efficiency nor equity. It proceeds only because there is insufficient opposition. Proponents and beneficiaries of this growth of government rely heavily upon the ignorance of the general population and a sense of hopelessness among opponents to deter action against their schemes. My experience, though, indicates that ignorance and hopelessness are unwarranted.

To encourage a sense of hopelessness, the proponents of bigger government line up impressive coalitions of interest groups, lobbyists, and media to work with the bureaucracy on ways to extract more taxes and dispense more spending. At the same time, they attempt to marginalize critics as "lone voices" challenging an entrenched orthodoxy. To try to ensure ignorance, distorted claims alleging the dire need for more government, its wondrous benefits, and the absence of viable alternatives are disseminated to the general public. While this presents a formidable force for expanding government, it is not invulnerable.

One of my assignments in the 1980s was to prepare a report for a potential Tucson–Los Angeles passenger rail study. Inasmuch as Amtrak appeared to be demonstrating that rail passenger service was a dying industry, I asked why we should expect such a proposed service to be warranted. I was told that the governor's office had requested the study because it had received a "flood" of mail on the topic that was running two-to-one in favor. Wanting to fully document this aspect of the issue, I contacted the governor's office and requested copies of this mail for inclusion in the appendix of my report. They happily complied. Two days later, I received an envelope from the governor's office with these copies. There were three letters. Two urged the establishment of this service. One argued against it.

That a total of three letters could be described as a "flood" can only mean one of two things:

1. so few citizens actually make the effort to contact their government that getting any mail seems like a lot;
2. brazen lying is a tactic that usually works.

One could make the case for either interpretation. Regardless of which seems more plausible to you, a hint on how to thwart government expansion is revealed. The loud opposition of just a few individuals may seem like a juggernaut to a bureaucrat attempting to implement an ill-considered plan. Better still if you can expose the weak support for the plan, both in terms of the claimed number of people behind it and the poor value of the suggested operation. My report highlighted the real paucity of public support and the projected high cost and low passenger counts expected from the service. That train never left the station.

The ammunition we need to expose the poor performance of government is out there. Ironically, the lust for federal aid guarantees this. The competition to get one's snout in the federal trough is intense. Consequently, the federal government requires applicants for aid to prepare a raft of data outlining their cases for why they should be favored for the disbursement of funds. These data are voluminous and often complex. The reports containing them are difficult reading. Nevertheless, these documents contain nuggets of information that can help overcome the ignorance barrier.

Take for example Phoenix's bid for federal aid for its light-rail system. Phoenix was required to submit both an annual report and an environmental-impact statement. The annual report was required to show forecast ridership and expenses. Buried in this report was the fact that the incremental cost per passenger boarding was over $13. The average fare per boarding was under 60 cents. Thus, the touted "affordability" of this service was achieved by having nonriders pay 95% of the cost.

The findings from the environmental-impact statement were even more interesting. Despite being publicly advertised as a way of reducing traffic congestion and air pollution, the report prepared by the transit agency had to concede that the new light-rail system would actually increase both congestion and air pollution, although not by enough to trigger federal sanctions.

Obtaining and using this ammunition is, for the most part, getting easier. Many of the reports are posted on web sites. The Freedom of Information Act assures access to documents that aren't posted. Software tools like spreadsheets, databases, and word-processing applications enable us to extract more information from the data we can get our hands on. It is feasible for one person, like myself, to pierce the veil of ignorance and expose the lies and distortions emanating from big-government propaganda.

My methods can be replicated. I hope to encourage others to take up the challenge — including the next generation of persons willing to aid the cause of liberty by going behind enemy lines.

John Semmens worked for the Arizona Department of Transportation (AzDOT) for 32 years. He has authored over 300 articles on transportation issues and was a contributing author to the award-winning book *Street Smart: Competition, Entrepreneurship, and the Future of Roads* published by the Independent Institute. He is currently available for transportation consulting work. Send him mail. Comment on the blog.

The Idiocy of Wall Street: Applauding Its Own Demise

Daily Article by Don A. Rich | Posted on 9/24/2008

The vertigo factor in the last two weeks of the stock market has been high: down 400 points, down 400 points, up 400 points, down 400 points, up… Which is it, one wants to know, because to have the answer as to the state of the future would relieve anxiety in the short run, even though the things we do to relieve short-run anxiety often cause long-term calamity.

Things like nationalizing the finance industry of the United States, which is, effectively speaking, the consequence of Federal Reserve and Treasury actions of the last two days.

The humor factor in the rally of last week has been far higher than the vertigo factor, however, as Wall Street bizarrely applauds the nationalization of the finance industry. I like to be less anxious, but not at the expense of socialism — or more likely fascism, the latter of which (when you listen carefully to the drumbeat for war with target of the month, Pakistan) is the clear direction of US policy.

Maybe former Treasury Secretary Paul O'Neil was right about those guys in front of the green trading screens on Wall Street being trained monkeys, because the actions and announcements emanating from the federal government have been anything but good for the wealth-creation mechanisms of capitalism, or for the future of liberty for that matter.

We were told less than six weeks ago by the Congressional Budget Office that the taxpayers may have to spend up to $25 billion dollars bailing out Fannie Mae and Freddie Mac. Secretary Paulson and Federal Reserve Chairman Bernanke assured us that beyond that, all was well. Why is anyone still listening to Paulson and Bernanke?

The announced bailout plans six weeks later have costs that Paulson and Bernanke now admit will run at least into the hundreds of billions of dollars. But why is anyone still listening to Paulson and Bernanke?

Given the economics discussed below, and the government's lack of credibility to date, the real costs will now clearly run into the high trillions. The question is, who will get stuck with the losses and how will that loss-distribution process be handled? For Wall Street to applaud the prospect of the upcoming events is lunacy. *Why is anyone listening to Paulson and Bernanke?*

The world economy has just been subjected by its central bankers (including Bernanke as vice chair under Greenspan and encouraged by Paulson at Goldman Sachs) to the largest credit bubble in history.

Not only residential real estate, but also corporate, developing market, and nonsecured debt security and loans have been priced at absurd valuations because the central banks of the world kept interest rates at absurdly low levels during the early part of the decade.

The consequence of this "open the floodgates" monetary-policy-induced credit bubble was to induce the entire financial services industry to distort the process assessing risk and reward in the allocation of capital on a system-threatening scale — hence the events of earlier this week. Basically, the central banks of the world pushed interest rates so low as to lure the finance industry into the trap of chasing yields irrespective of risk.

For example, Brazilian government debt used to trade at 1,000 basis points above Treasuries, dropping in the bubble to a low of a 200 basis-point differential, which was clearly absurd, even with the happy procapitalist surprise of Lula, and a type of central-bank-induced yield-chasing drop in risk differentials that pervades the world capitalist system due to the actions of people like Greenspan, Bernanke, and Paulson. (Paulson should not be allowed to escape the fact that, as CEO of Goldman Sachs during this period, he had plenty of chances to speak up, and said nothing.)

The resulting central-bank-induced disequilibrium relationships between price and risk is bound to generate massive movements in the prices of debt instruments back to their equilibrium relationship, a process that in its infancy has already destroyed the capital of the world's private-banking systems.

Why is anyone listening to the central bankers and Bernanke and Paulson if they caused the problem in the first place?

The biggest obstacle to correct action going forward is that no one in the financial industry or press is asking the right questions.

The federal government — through the Department of the Treasury and the Federal Reserve — is now committed to assuming the entire credit risk of the financial-services industry of the United States, and quite possibly much of the industrialized world. The US government itself is already insolvent in an intertemporal sense, with a budget deficit over time of $30 trillion in present discounted-value terms. How the federal government's assumption of the American and world financial systems' risks is supposed to be credible on a long- or even medium- and short-term basis is totally unclear.

Moreover, Bernanke and Paulson still maintain in effect that we are experiencing some kind of hiccup now, which, if the feds temporarily take charge, can somehow be papered over without huge losses somewhere.

In a bubble, asset prices are by definition far above equilibrium values. The federal government is now committed to guaranteeing the difference between the real equilibrium values of all debt securities and their stated/nominal value, which was created during the greatest credit bubble in history.

That difference between nominal and equilibrium/real value must by definition be a massive number because of the extent of the credit bubble, on the order of $5 trillion dollars in the United States alone.

Unlike the short-attention-span monkeys of Wall Street, the reasonable analyst will conclude that all the federal government's options for making up the difference between nominal and real values have bad implications for Wall Street.

Before moving on to a more formal analysis, the federal government is now admitting that the entire credit-generation process in the United States has collapsed. Going forward, that is bad news for the real economy — for the claims on the profit-generating capacity of the economy upon which the stock market constitutes claims. This is all bad news, not good news, for Wall Street.

More formally, there is a gap between the nominal and real value of debt instruments that across the entire credit spectrum easily exceeds $5 trillion, the risk of which the federal government has assumed.

There are three possibilities that in combination cover all the bases for possible governmental actions.

First, the federal government raises taxes to pay off the difference. That clearly isn't good news for Wall Street or the wealth-creation process.

Second, the Federal Reserve System prints enough money to prop up debt-security prices at nominal values over time, thereby bringing about equilibrium by raising the prices of everything else. A borderline hyperinflation isn't good news for Wall Street.

Third, perhaps in some instances the federal government seizes the assets of the financial industry at fire-sale prices, and therefore inflicts the loss on shareholders and private creditors in a bizarre form of monetary-policy-induced, catastrophe-driven socialism or fascism.

Well, that isn't good news for Wall Street and the wealth-generation process and, as the above scenarios cover all the possibilities, none of this is a good sign. It is a sign, rather, that we have allowed our monetary, fiscal, and regulatory authorities to lure us like lambs to the slaughter to the unwarranted socialization of the most important sector of the capitalist system.

Don A. Rich is an instructor of economics, finance, and political science at Montgomery County Community College in Blue Bell, PA. He also teaches economics, government, and history at Delaware County Community College in Exton, PA.

The Thuggery of Al Gore

by William L. Anderson

In Mario Puzo's book, *The Godfather*, Vito Corleone is able to rise to power by intimidation and sometimes murder. As Puzo describes it, Corleone made sure that his competitors in distributing olive oil (yes, Vito *did* do olive oil, among a few other things) had a few problems, like having their delivery trucks robbed, oil dumped in the streets, and whatever else it took to convince his rivals that they should not compete with him.

The Godfather, of course, is a novel (later made into a movie). It is eminently readable, but a novel all the same. What happened this past week, however, was *not* from a novel, but rather from the mouth of the former U.S. vice president and the latest Nobel Peace Prize winner:

LONDON, England (CNN) – Former vice president and environmental campaigner Al Gore has urged young people to protest against new coal-fired power plants that don't use carbon capture and storage technology.

Speaking at the opening plenary session of the Clinton Global Initiative Annual Meeting in New York, Gore said: "If you're a young person looking at the future of this planet and looking at what is being done right now, and not done, I believe we have reached the stage where it is time for civil disobedience to prevent the construction of new coal plants that do not have carbon capture and sequestration."

There is a problem, of course, and that is that there is no developed technology of "carbon capture" for power plants that can be applied on a large scale, and the early reports are that such a technology would add another 50 percent to the capital costs of the project, making the plant so expensive that it is not worth building in the first place. Thus, my first reaction to this article was to dismiss it as Al Gore being Al Gore: like the idiot uncle in the closet who escapes once in a while.

However, when one combines this latest outburst with his recent call to eliminate *all* coal-and-oil fired power plants from the United States and replace them with "renewable" energy sources such as windmills and solar panels, a whole different picture emerges. Gore claims that these "new technologies" will "stimulate the economy," but this is nothing more than the Broken Window Fallacy in different terms.

Beyond all his claims of "new technologies" and the like, there was another statement that Gore made which exposes what he is doing – and it is *not* "saving the planet":

"I believe for a carbon company to spend money convincing the stock-buying public that the risk from the global climate crisis is not that great represents a form of stock fraud because they are misrepresenting a material fact," he said. "I hope these state attorney generals around the country will take some action on that."

Gore clearly is calling for executives of electric power companies that build power plants to be charged with felonies (securities fraud is a felony under state and federal laws), which means that he wants these people to go to prison simply for building electric power plants. Again, it is easy to dismiss this as more Gore rhetoric, except that his actions are much more nefarious than just a nutty guy running his mouth.

Al Gore, you see, is a *competitor* of the electric power companies. He is not just an advocate; he is a major partner in a fund called Generation Investment Management Ltd., which just capped out at $5 billion. (I doubt seriously that Gore brought any money into the fund; he is the political front man, but stands to become an extremely wealthy person through it.)

Now, if Gore simply were a guy making money on the free market who had radical opinions, I would not be writing this article. However, that is not what is happening. Al Gore is a powerful political figure who is calling for his shock troops to use violence – and don't kid yourself, that is what he wants – against companies with huge cost advantages against his own technologies of choice.

For all of the ballyhoo for solar and wind power, the ability of these mechanisms to create the energy that comes from coal, oil, or natural gas is miniscule. Robert Bryce in his recent book, *Gusher of Lies: The Dangerous Delusions of Energy Independence*, lays bare just how inferior the Gore-financed technologies really are. In fact, if it were not for the special subsidies, tax breaks, and government purchases of these various energy devices, Gore's fund would be topping out at zero. *To put it another way, Gore's "new technologies" are not commercially viable on a large scale, and certainly cannot begin to replace the current electric production grid in this country and most likely never would be able to do so.*

Thus, if these technologies are going to be used on the scale that Gore demands, the only way to do it is through naked brute force. In a word, Gore is appealing to thuggery; he cannot beat his competitors in the marketplace, so he calls for gangs of thugs to shut down construction of these plants, and if that does not work, he wants the government to arrest and imprison the owners.

Vito Corleone, while he could manipulate the law, never *was* the law. Individual congressmen could send up bills for Vito, judges might look the other way, but his overall influence was marginal. Gore, on the other hand, is becoming a political force at a time when Congress is about to nationalize the entire U.S. financial system, which means that investment in the future is going to flow toward those projects that are politically-connected.

In a free market, investment dollars flow to those projects that promise the most profit; in a political market, the profits come not from correct entrepreneurial choices, but rather from manipulation of the tax code, subsidies, and outright force.

Gore's latest outbursts, however, bring a new element into the whole energy markets. He is calling for criminalization of burning oil and coal, and if that won't work, he wants gangs of thugs to shut down the building of new plants, all in the name of the scam of global warming.

It is his crusade for the state to control the weather, of course, that gives Gore the cover to call for thuggish acts by others which will result in Gore becoming even wealthier than he already is. The economist Bruce Yandle once pointed out in his "Baptists and Bootleggers" example that calls for regulation will come from people who represent the "Baptists" in order to front for the "bootleggers." (Baptists and bootleggers both want the liquor stores closed, but for very different reasons.)

Al Gore, however, is taking Professor Yandle's analogy up another notch. That is because Gore is playing the role of both Baptist *and* bootlegger. I should add that he also seems to be auditioning for the role of the Godfather himself.

September 29, 2008

William L. Anderson, Ph.D. [send him mail], teaches economics at Frostburg State University in Maryland, and is an adjunct scholar of the Ludwig von Mises Institute. He also is a consultant with American Economic Services.

The Great Bank Robbery of 2008

Daily Article by Robert P. Murphy | Posted on 9/30/2008

The Paulson bailout failed in the House. If it isn't a death blow to the plan, it should be. This is not an economic plan: it is a heist.

It will go down as The Great Bank Robbery of 2008.

The economics behind it are nonsense, but we are naïve if we spend much time even considering the "arguments" for it. This is a money and power grab, pure and simple.

Just as magazine covers today feature scantily clad women that would have been scandalous a generation ago, in the same manner Paulson's proposal — made in broad daylight and on national TV! — is almost naked in its audacity.

Austrian economists tend to be libertarians in their political views, and they are often chided for not keeping these systems hermetically sealed and separated in their minds. Fortunately, this alleged vice is a virtue in our present situation. Because of all the mumbo jumbo thrown around to show why the plan is necessary, some very sharp academic economists are in a tizzy trying to treat this as an extra-credit question, rather than a crime scene. That is a waste of time.

In this article, we will of course cover why the Keynesian justifications — coming from a "free-market" administration — are nonsense. But in the grand scheme, that's not entirely relevant. People didn't seriously consider the testimony of the tobacco company CEOs about the nonexistent dangers of smoking, because everyone knew those executives stood to lose billions from the settlement. So by the same token, no one should pay much attention to the official statements made by Henry Paulson, since he stands to *personally* be put in charge of doling out hundreds of billions of dollars to some of the most powerful people on the planet.

The Keynesian Fallacy: The Paulson Plan Won't Create Wealth

In very simple terms, the Paulson Plan is a straight-up transfer of $700 billion — and counting! — from the taxpayers to a few big financial institutions. (Some smaller banks are complaining that they don't own the exotic mortgage-backed derivatives, but rather simple mortgages. They do not believe they will see a dime of the Paulson money.) It's easy to get all twisted around, but just remind yourself of this: the Paulson Plan has the federal government borrow $700 billion (through issuing Treasury debt) in order to buy assets from Wall Street banks. (We are neglecting the time delay in the program; the entire $700 billion wouldn't be spent all at once.)

Some analysts think that the price paid for these "toxic" assets is important. No it isn't. The government officials running this operation will dole out the favors on both ends, when the mortgage-backed securities are coming and when they are going. Neglecting this insight, some people want to say that if the government pays $700 billion for a portfolio of assets that is really only worth $400 billion, then the taxpayers really only lost $300 billion, not the full $700 billion.

Yet this thinking is naïve. The taxpayers are not going to be treated as equivalent to shareholders of a firm that just acquired $400 billion in assets. The taxpayers are not going to get a cut of the monthly mortgage payments (less the servicing costs on the $700 billion in new debt) tied to the government's massive portfolio. Instead, the government will simply bump up its annual spending by a few billion dollars. Maybe it will have to spend the money on homeownership programs, or homebuilder job retraining, but the net income from those government-owned assets certainly won't translate into a dollar-for-dollar tax cut.

"Some very sharp academic economists are in a tizzy trying to treat this as an extra-credit question, rather than a crime scene."

And then at some point — during a future Republican administration, no doubt — there will be a push to "privatize" the secondary mortgage market, and the government's portfolio at that time will be auctioned off at very generous prices to politically connected institutions. For example, maybe the $400 billion portfolio is auctioned off for $250 billion. (Perhaps the big banks have to set up subsidiaries owned by minorities and women who get preferential treatment in the bidding process. But whatever the ruse, they will find a way to justify the low prices.) When all is said and done, the government will have played hot potato with the MBS, and the national debt — borne by taxpayers — would be $450 (=$700-$250) billion higher. The favored financial institutions would be "up" roughly the same amount, collectively. (Throughout, we are ignoring the timings of the payoffs and the effect on present discounted value.)

It is the crudest Keynesianism to view the Paulson Plan as an injection of capital or "liquidity." That money has to come from somewhere. If it is taxed or borrowed, then it is just a shell game; the liquidity is drained from elsewhere, to be injected into Wall Street.

Besides taxing or borrowing, the government has a trump card: it can have the Federal Reserve simply create the new money out of thin air, by engaging in some "Open Market Operations." Yet even in this case, real wealth still hasn't increased. Certain nominal figures, like "aggregate asset values" might go up. But that's not very relevant, because the economy isn't *really* richer. After all, there aren't more tractors or office buildings just because Bernanke allows the monetary base to grow more rapidly. So what happens in this case is that prices rise; people find it harder to buy milk, bread, and gasoline. But the Wall Street fat cats are fine with the general price hikes, because they got their hands on the newly injected funny money early in the game.

But Won't the Credit Markets Collapse?

Some observers would admit the legitimacy of my analysis above. "However," they might say, "the Paulson Plan, or something like it, is necessary to avert a total meltdown of the financial system. We're not trying to boost aggregate investment, so much as clearing out a clogged pipe."

This talk of a breakdown in the financial system is a bogeyman. Steve Landsburg does such a great job of exploding this myth that I will simply quote him:

So what's special about banks [that they deserve a bailout]? According to what I keep reading, it's that without banks, nobody can borrow, and the economy grinds to a halt.

Well, let's think about that. Banks don't lend their own money; they lend other people's (their depositors' and their stockholders'). Just because the banks disappear doesn't mean the lenders will. Borrowers will still want to borrow and lenders will still want to lend. The only question is whether they'll be able to find each other.

… [A]s any user of match.com can tell you, the technology for finding partners has improved since [the 1930s]. When a firm wants to raise capital, why can't it just sell bonds over the web? Or issue new stock? Or approach one of the hedge funds that seem to be swimming in cash? Or borrow abroad?

… I'm not sure these big Wall Street banks are really necessary, and I'm not sure we'd miss them much if they were gone. Maybe there's something I'm missing, but if so, I think it should be incumbent on Messrs. Bernanke, Paulson and above all Bush to explain what it is.

Conclusion

The Paulson Plan is a heist. It is a grand scheme in which the public will end up owing hundreds of billions of dollars to holders of new debt claims issued by the US Treasury. The plan won't "prop up" asset values and it won't provide any real stimulus to the economy.

Despite the dire warnings — coming from the same folks who brought you the Iraq invasion to remove WMD — there is no threat of a financial meltdown. If Goldman Sachs failed, the sun would still rise the next morning.

Far from providing stability and confidence, the Fed, Treasury, and SEC's recent moves have ensured that US capital markets will now function with the same efficiency as public education in this country. The Paulson Plan is one more step in the socialization of America, but it is also a great bank robbery.

Robert Murphy runs the blog Free Advice and is the author of *The Politically Incorrect Guide to Capitalism*. Comment on the blog.